

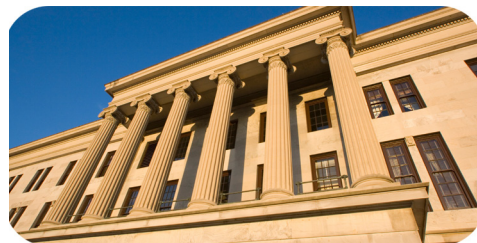
# LAYING THE GROUNDWORK FOR FUTURE GROWTH



# ANNUAL REPORT 2010

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## PROFILE

Northcore Technologies Inc. provides a Working Capital Engine™ that helps organizations source, manage, appraise and sell their capital equipment. Our integrated software solutions and support services are designed for organizations in the financial services, manufacturing, oil and gas, and government sectors to:

- Streamline the sourcing and procurement of critical assets, while reducing purchasing costs;
- Track the location of assets to support improved asset utilization and redeployment of idle equipment;
- Manage the appraisal of used equipment more effectively, resulting in a better understanding of fair market values; and
- Accelerate the sale of surplus assets while generating higher yields.

Northcore owns 50 percent of GE Asset Manager, LLC (also referred to as “GE Asset Manager”), a joint business venture with GE Capital Corporation, through its business division GE Commercial Finance, Capital Solutions (“GE Commercial Finance”). Together, the companies work with leading organizations around the world to help them liberate more capital value from their assets.

Northcore’s shares trade on both the Toronto Stock Exchange (TSX: NTI) and the OTC Bulletin Board (OTCBB: NTLNF).

Additional information about Northcore can be obtained at [www.northcore.com](http://www.northcore.com).



## LETTER TO SHAREHOLDERS

The year 2010 saw Northcore continue to lay the groundwork for future growth, yet our financial statements have yet to show the benefits. Because of this, we expended much time this year securing funding to stay in the game, and our efforts were rewarded. This is more important than ever now as I believe that, finally, we will be rewarded for our hard work and your patience in 2011 and beyond. Some of our past strategies, such as Southcore Technologies, did not pan out as we hoped, yet still yielded ancillary benefits, such as Discount This. Others are still gestating. Yet our historical thrust, GE Asset Manager, is more promising than ever.

## MAJOR DEVELOPMENTS

We completed a number of customer and operational activities throughout the course of 2010. These were designed to accelerate revenue opportunities, solidify our financial position, and strengthen our ability to work with our customers and partners.

### FINANCING ACTIVITIES

- Closed an equity transaction with GEM Global Yield Fund Limited, securing net cash proceeds of \$300,000. As a result of the transaction, Northcore issued 2,191,000 common shares for the first tranche draw and 6,000,000 warrants to finalize the availability of the committed \$6,000,000 equity line of credit with GEM;
- Closed the first tranche of an equity private placement on December 22, 2010, securing net proceeds of \$625,000 through the issuance of common shares and warrants. The second tranche closed for net proceeds of \$729,000 on February 14, 2011 as a subsequent event to the year-end; and
- Continued to strengthen our balance sheet through the conversion of \$145,000 secured subordinated notes into equity combined with \$143,000 of new equity through the exercise of the associated warrants.

### CUSTOMER ACTIVITIES

During 2010, Northcore focused on expanding the breadth of existing customer relationships and extending the product line in order to open up new opportunities. Results of this strategy include:

- Completed the development cycle and large scale roll out of a holistic remarketing platform to the Yale and Hyster dealer community, combining mobile computing with Asset Tracker and Asset Seller;
- Delivered and deployed a customized Asset Seller platform to Xstrata Corporation to effect the disposition of surplus mining assets;
- Initiated initial user interface design for the Group Purchasing platform subsequently named Discount This;
- Increased the volume of third party auction events in the light-duty construction equipment and utility vehicle categories, with successful value realization and improved sales cycle efficiency;
- Evidenced continued effectiveness in the remarketing of corporate aircraft and established Asset Seller as a leading platform for sales of high value asset categories by displaying showcased items in unprecedented rich detail;
- Awarded two supply arrangements with the Canadian Federal Government, qualifying Northcore for the provision of business technology services, one directly and one in partnership with Ottawa based Donna Cona Inc.; and
- Entered into a collaborative sales and marketing agreement with Revere Corporation where both parties can now serve their customers with a broader product offering.

## LETTER TO SHAREHOLDERS (CONTINUED)

### JOINT VENTURE WITH GE COMMERCIAL FINANCE

Throughout 2010, Northcore maintained a strong focus on GE Asset Manager, our joint venture with GE Commercial Finance. The year saw significant enhancements made to the entire portfolio of Joint Venture products, with substantial new releases of Asset Seller and Asset Tracker delivered to clients. In addition Northcore worked closely with GE internal teams to execute tasks required to achieve Bank Certification for internal and customer facing applications.

Established remarketing portals such as GEasset.com and ToroUsed.com experienced solid results in terms of viewership and sell-through. Specifically, the joint venture has shown its efficacy in helping partners accelerate their remarketing and redeployment of assets. Our successes in 2010 have heightened the commitment to see the JV achieve its full potential with a broader reach into GE's customer base.

### OUTLOOK

I can succinctly summarize our 2010 results: We're not there yet! We submitted more proposals for new business in 2010 than in any year in our history and today I am more optimistic than at any time since the go-go days of Bid.com. This time I'm confident it's not an illusion. We have started 2011 with two new service agreements that position Northcore to receive transaction based revenues, with the objective of participating more directly in the commercial success of our customers. We also added a new product within our Working Capital Engine and are expanding the connectivity of mobile applications, for broader functionality and reach into our Joint Venture customer targets. To support and advance these innovations we will be expanding our sales force. Finally, our development activity for Discount This is progressing according to plan and we are optimistic about the potential value of our patent protected intellectual property, as it relates to the emerging online group coupon discount marketplace. During the conference call we held on November 11, 2010 to discuss our third quarter, I alluded to potential developments in the first half of 2011 that were very exciting. All I can say at this time is that we believe that we are seeing that potential realized.

On behalf of our directors, senior management and all Northcore employees, I want to thank all of our shareholders for their ongoing support.

Yours truly,



Duncan Copeland, CEO  
Northcore Technologies Inc.

March 29, 2011

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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### OVERVIEW

Northcore Technologies Inc. ("Northcore" or the "Company") provides a Working Capital Engine™ that helps organizations source, manage, appraise and sell their capital equipment. Our integrated software solutions and support services are designed for organizations in the financial services, manufacturing, oil and gas, mining and government sectors to:

- Streamline the sourcing and procurement of critical assets, while reducing purchasing costs;
- Track the location of assets to support improved asset utilization and redeployment of idle equipment;
- Manage the appraisal of used equipment more effectively, resulting in a better understanding of fair market values; and
- Accelerate the sale of surplus assets while generating higher yields.

Northcore owns 50 percent of GE Asset Manager, LLC (also referred to as "GE Asset Manager"), a joint business venture with GE Capital Corporation, through its business division GE Commercial Finance, Capital Solutions ("GE Commercial Finance"). Together, the companies work with leading organizations around the world to help them liberate more capital value from their assets.

Northcore's shares trade on both the Toronto Stock Exchange (TSX: NTI) and the OTC Bulletin Board (OTCBB: NTLNF).

Our consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are presented in Canadian dollars. Unless otherwise indicated, all disclosures in this management discussion and analysis are presented in accordance with such principles and currency.

### DEVELOPMENTS IN 2010

Northcore completed a number of customer and operational activities throughout the course of 2010. These activities were designed to accelerate revenue opportunities, solidify our financial position, and strengthen our abilities to work with our customers and partners.

#### Financing Activities

- Closed an equity transaction with GEM Global Yield Fund Limited, securing net cash proceeds of \$300,000. As a result of the transaction, Northcore issued 2,191,000 common shares for the first tranche draw and 6,000,000 warrants to finalize the availability of the committed \$6,000,000 equity line of credit with GEM;
- Closed the first tranche of an equity private placement on December 22, 2010, securing net proceeds of \$625,000 through the issuance of common shares and warrants. The second tranche closed for net proceeds of \$729,000 on February 14, 2011 as a subsequent event to the year-end; and
- Continued to strengthen our balance sheet through the conversion of \$145,000 secured subordinated notes into equity combined with \$143,000 of new equity through the exercise of the associated warrants.

#### Customer Activities

During 2010, Northcore focused on expanding the breadth of existing customer relationships and extending the product line in order to open up new opportunities. Results of this strategy include:

- Completed the development cycle and large scale roll out of a holistic remarketing platform to the Yale and Hyster dealer community, combining mobile computing with Asset Tracker and Asset Seller;
- Delivered and deployed a customized Asset Seller platform to Xstrata Corporation to effect the disposition of surplus mining assets;
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- Increased the volume of third party auction events in the light-duty construction equipment and utility vehicle categories, with successful value realization and improved sales cycle efficiency;

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- Evidenced continued effectiveness in the remarketing of corporate aircraft and established Asset Seller as a leading platform for sales of high value asset categories by displaying showcased items in unprecedented rich detail;
- Awarded two supply arrangements with the Canadian Federal Government, qualifying Northcore for the provision of business technology services, one directly and one in partnership with Ottawa based Donna Cona Inc.;
- Completed the development of additional security modules required for Northcore's core products to achieve US bank certification;
- Entered into a collaborative sales and marketing agreement with Revere Corporation where both parties can now serve their customers with a broader product offering; and
- Delivered a number of enhancements to a customized Asset Tracker application used by a Global Electronics Leasing corporation.

### Joint Venture with GE Commercial Finance

Throughout 2010, Northcore maintained a strong focus on GE Asset Manager, our joint venture with GE Commercial Finance. The year saw significant enhancements made to the entire portfolio of Joint Venture products, with substantial new releases of Asset Seller and Asset Tracker delivered to clients. In addition Northcore worked closely with GE internal teams to execute tasks required to achieve Bank Certification for internal and customer facing applications.

Remarketing portals such as GEasset.com and ToroUsed.com have also experience solid results in terms of viewership and sell-through.

Specifically, the joint venture has shown its efficacy in helping partners accelerate remarketing and redeployment of fixed assets in spite of a sub-optimal economic climate. Both stakeholders remain committed to helping the venture achieve its full potential and a broader reach to GE customers.

### INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this report may include comments that do not refer strictly to historical results or actions and may be deemed to be forward-looking within the meaning of the Safe Harbor provisions of the U.S. federal securities laws. These risks include, among others, statements about expectations of future revenues, cash flows, and cash requirements. Forward-looking statements are subject to risks and uncertainties that may cause our results to differ materially from expectations.

These risks include:

- The timing of our future capital needs and our ability to raise additional capital when needed;
- Our ability to repay our debt to lenders;
- Increasingly longer sales cycles;
- Potential fluctuations in our financial results and our difficulties in forecasting;
- Volatility of the stock markets and fluctuations in the market price of our stock;
- The ability to buy and sell our shares on the Over the Counter Bulletin Board;
- Our ability to compete with other companies in our industry;
- Our dependence upon a limited number of customers;
- Our ability to retain and attract key personnel;
- Risk of significant delays in product development;
- Failure to timely develop or license new technologies;
- Risks relating to any requirement to correct or delay the release of products due to software bugs or errors;
- Risk of system failure or interruption;
- Risks associated with any further dramatic expansions and retractions in the future;
- Risks associated with international operations;

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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- Problems which may arise in connection with the acquisition or integration of new businesses, products, services, technologies or other strategic relationships;
- Risks associated with protecting our intellectual property, and potentially infringing the intellectual property rights of others;
- Fluctuations in currency exchanges;
- Risks to holders of our common shares following any issuance of our preferred shares; and
- The ability to enforce legal claims against us or our officers or directors.

Other such risks as we may identify and discuss from time to time, including those risks disclosed in the Company's Form 20-F filed with the Securities and Exchange Commission, and Management Information Circular, may also cause our results to differ materially from expectations.

We encourage you to carefully review these risks, as outlined above, to evaluate your existing or potential investment in our securities.

### **GENERAL INDUSTRY, ECONOMIC AND MARKET CONDITIONS**

Northcore's future revenues and operating results are largely dependent on a number of industry, economic and market conditions. If any of these conditions were subject to adverse developments, our operational performance would be affected. For example, if consolidation occurs within the target industries we operate in, adverse economic conditions impact our existing base of customers, or if the demand for asset management solutions decreases, our ability to increase our customer base, improve our revenues and generate a profit may be impacted.

### **ASSET MANAGEMENT FOCUS**

Since 2001, we have focused our efforts on delivering asset management software solutions to customers in the financial services, manufacturing, oil and gas, and government sectors.

Our future success, including revenue performance and ability to generate a profit may be impacted if:

- The significance of asset management requirements, including sourcing, procurement, product tracking, materials management and asset disposition activities, diminishes within our target markets and existing customer base;
- We are unable to expand our suite of asset management technology to meet new market requirements;
- We are unable to leverage new technology advancements into our core suite of offerings; or
- Our existing partners shift focus away from current asset management activities to other areas.

We believe however, that there is cause for optimism. The current financial climate and in particular the constraints on the availability of new capital, have lead many firms to focus on preservation of existing capital bases. Our tool-set is coincident in purpose with this goal, as we offer corporations the ability to redeploy existing assets rather than add new expenditures. In addition, our platform provides the capability to liquidate underperforming assets to supplement the capital base.

### **COMPETITIVE LANDSCAPE**

Northcore operates in a very competitive marketplace against organizations that, in some cases, are larger, have more resources, or broader technology offerings. These competitive organizations include Oracle, SAP, and Ariba, among others.

Our future success is dependent on our ability to gain market share from these competitors while ensuring that our existing customer base is free of any competitive encroachment.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### **CUSTOMER CONCENTRATION**

In 2010, one customer accounted for 69 percent (2009 - two customers accounted for 62 percent and 19 percent, respectively) of total revenues. If our relationships with any of these customers is severed or meaningfully altered, we would experience a significant decline in our performance, particularly through reduced revenues.

### **INTERNATIONAL MARKETS**

Since the sale of our Norway business unit in 2006, Northcore has concentrated its sales and marketing efforts primarily in North America. Given the recent increase in International opportunities in 2010, Northcore has engaged sales and marketing support in the Ireland and UK area to focus on this strata of potential clientele. This resource augmentation occurred at the end of the 2010 calendar year and is expected to pay dividends in fiscal 2011.

Operating as an organization with an international presence and an international base of customers exposes Northcore to a number of risks and uncertainties that may impact our operational performance. These risks and uncertainties include:

- Fluctuations in currency exchanges;
- Unexpected changes to foreign laws and regulations, and foreign tax laws;
- Local residency requirements for our sales and professional service personnel; and
- Fluctuations to local demand for asset management technology and services.

### **FOREIGN EXCHANGE RISK**

The Company's revenue from software licensing and related services and e-commerce enabling agreements is transacted in Canadian and U.S. dollar currencies. As the majority of our revenues are realized in U.S. dollar and our expenses are transacted in Canadian dollar, the appreciation of the U.S. dollar against the Canadian dollar may have a favorable impact on our results. The Company does not use derivative instruments to manage exposure to foreign exchange fluctuations.

### **INTEREST RATE RISK**

The Company has limited exposure to fluctuations in interest rates. The Company does not use derivative instruments to manage its exposure to interest rate risk.

### **CREDIT RISK**

Credit risk arises from the potential that a customer will fail to meet its contractual obligations under a software licensing and related services agreement or an e-commerce enabling agreement.

The Company invests its cash and cash equivalents in investments that are of high credit quality. Given these high credit ratings, the Company does not expect any investees to fail to meet their obligations.

At December 31, 2010, two customers accounted for 32 percent and 30 percent, respectively, (2009 - four customers accounted for 33 percent, 22 percent, 21 percent and 16 percent, respectively) of total accounts receivable. The allowance for doubtful accounts recorded as at December 31, 2010 was \$nil (2009 - \$nil).

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### **GOING CONCERN**

The Company has incurred negative annual cash flows from operations since inception and expects to continue to expend substantial funds to continue to develop technology, build an infrastructure to support business development efforts and expand other areas of business including the acquisition of, or strategic investments in, complementary products, businesses or technologies. The Company's ability to continue as a going concern will be dependent on management's ability to successfully execute its business plan including a substantial increase in revenue as well as maintaining operating expenses at or near the same level as 2010. The Company cannot provide assurance that it will be able to execute on its business plan or assure that efforts to raise additional financings will be successful.

The consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern. If the going concern assumption was not appropriate, adjustments would be necessary in the carrying value of assets and liabilities, and the reported losses and the balance sheet classification used.

The continued existence beyond 2010 is dependent on the Company's ability to increase revenue from existing products and services, and to expand the scope of its product offering which entails a combination of internally developed software and business ventures with third parties, and to raise additional financing.

### **CRITICAL ACCOUNTING ESTIMATES**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting years. Estimates are used when determining items such as the allowance for doubtful accounts, the fair value assigned to the debt and equity components of the secured subordinated notes and the expected requirements for non-operational funding. Actual results could differ from those estimates.

### **CRITICAL ACCOUNTING POLICIES**

We periodically review our financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and transparent information relative to the current economic and business environment. As part of this process, we have reviewed our selection, application and communication of critical accounting policies and financial disclosures. We have determined that the critical accounting policies related to our core ongoing business activities are primarily those that relate to revenue recognition. Other significant accounting policies are described in Note 3 to our audited annual consolidated financial statements for the year ended December 31, 2010.

### **REVENUE RECOGNITION**

The Company's revenues are derived from services (application development activities, software implementation and license fees, training and consulting, product maintenance and customer support), application hosting and royalty fees. Fees for services are billed separately from licenses of the Company's products. The Company recognizes revenue in accordance with Canadian GAAP, which in the Company's circumstances, are not materially different from the amounts that would be determined under provisions of FASB Accounting Standards Codification (ASC) Subtopic 985-605 (previously the American Institute of Certified Public Accountants Statements of Position (SOP) No. 97-2, "Software Revenue Recognition", and as amended by Statement of Position 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions"). The Company also considers the provisions of the Canadian Institute of Chartered Accountants (CICA) Emerging Issues Committee (EIC) 141 and CICA EIC 142, which is analogous to ASC 605, in determining the appropriate revenue recognition methodology.

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### Multiple Deliverable Revenue Arrangements

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract was amended to (1) exclude from the application of the updated guidance those arrangements that would be accounted for in accordance with ASC 985; (2) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (3) require in situations where a vendor does not have vendor-specific objective evidence (VSOE) or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (4) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (5) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The Company adopted EIC 175 prospectively effective January 1, 2010.

The Company is required to determine the appropriate accounting under EIC 175, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes. In the past, for arrangements involving multiple elements, the Company allocated revenue to each component based on VSOE of the fair value of each element. Effective January 1, 2010, the Company has allocated revenue using the relative selling price method of the separate units of accounting. The multiple elements in an arrangement typically might include one or more of the following: software, application development, maintenance, hosting, and/or other professional service offerings as described in Note 3 of the Company's Annual Financial Statements for 2010. The Company allocates the arrangement fee, in a multiple element transaction, to the separate elements based on their relative selling prices, as indicated by VSOE or third-party evidence of selling price, and if both are not available, estimated selling prices are used. The allocated portion of the arrangement which is undelivered is then deferred.

The Company's revenue arrangements may contain multiple elements; however, the adoption of EIC 175 did not have a material impact on the Company's financial statements.

### Hosting Fees

The Company earns revenue from the hosting of customer websites and applications. Under our existing hosting contracts, the Company charges customers a recurring periodic flat fee. The fees are recognized as the hosting services are provided.

### Application Development Fees

Typically, development of applications for the Company's customers are provided based on a predetermined fixed hourly rate basis. Revenue is recognized as time is incurred throughout the development process.

### Software License Revenue

The Company recognizes software license revenue in accordance with the terms of the license agreement and when the following criteria as set out in ASC Subtopic 985-605 are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- Fee is fixed or determinable; and
- Collectibility is probable.

Software license revenue consists of fixed license fee agreements involving perpetual licenses.

Software license agreements may be part of multiple element arrangements that include consulting and implementation services. When these services are considered essential to the functionality of the license, the associated revenue is recognized on the basis of the percentage of completion method as specified by contract accounting principles. When these services are not considered essential to the functionality of the license, the entire arrangement fee is allocated to each element in the arrangement based on the respective vendor specific objective evidence (VSOE) of the fair value of each element. The amount allocated to license revenues is based on the price charged by the Company when the same element is sold in similar quantities to a customer of a similar size and nature. If this amount is not determinable, the residual software license revenue is the amount of the total arrangement fee less the fair value of any undelivered elements. VSOE used in determining fair value for

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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installation, implementation and training is based on the standard daily rates for the type of service being provided multiplied by the estimated time to complete each task. VSOE used in determining the fair value of maintenance and support is based on the annual renewal rates. The revenue allocable to the software license is recognized when the revenue recognition criteria are met. The revenue allocable to the consulting services is recognized as the services are performed.

### **Implementation, Training and Consulting Service Fees**

The Company receives revenue from implementation of its product offerings, consulting services and training services. Customers are charged a fee based on time and expenses. Revenue from implementation, consulting services and training fees is recognized as the services are performed or deferred until contractually defined milestones are achieved or until customer acceptance has occurred, as the case may be, for such contracts.

### **Product Maintenance and Customer Support Fees**

The Company receives revenue from maintaining its products and the provision of on-going support services to customers. The maintenance and support fees are typically equal to a specified percentage of the customers' license fee. If associated with the fixed fee license model, the maintenance revenues received are recorded as deferred revenue and recognized on a straight-line basis over the contract period.

Services revenue from maintenance and support is recognized when the services are performed. Maintenance and support revenues paid in advance are non-refundable and are recognized on a straight-line basis over the term of the agreement, which typically is 12 months.

## **UNADOPTED NEW ACCOUNTING PRONOUNCEMENTS**

### **Business Combinations**

In October of 2008, the CICA issued Handbook Section 1582, Business Combinations, concurrently with Handbook Section 1601, Consolidated Financial Statements, and Handbook Section 1602, Non-controlling Interests. Section 1582, which replaces CICA Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. Section 1601, which replaces CICA Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. Section 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company will consider the impact of the new standards on its consolidated financial statements if the Company has a business combination.

### **International Financial Reporting Standards (IFRS)**

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period.

In February 2008, the AcSB confirmed that IFRS will be mandatory in Canada for profit-oriented publicly accountable entities for fiscal periods beginning on or after January 1, 2011. The Company's first IFRS financial statements will be for the year ending December 31, 2011 and will include the comparative period for 2010. Starting in the first quarter of 2011, the Company will provide unaudited consolidated financial information in accordance with IFRS including comparative figures for 2010.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. It has established a project team that is led by finance management and will include representatives from various areas of the Company as necessary to plan for and achieve a smooth transition to IFRS. Regular progress reporting to the Audit Committee of the Board of Directors on the status of the IFRS implementation project has been instituted.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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The implementation of IFRS consists of three primary phases, which in certain cases will be in process concurrently as IFRSs are applied to specific areas from start to finish:

- **Initial Assessment and Scoping Phase**  
This phase involves performing a high-level impact assessment to identify key areas that may be impacted by the transition to IFRS. As a result of these procedures, the potential affected areas are ranked as high, medium or low priority.
- **Impact Analysis, Evaluation and Design Phase**  
This phase involves specification of changes required to existing accounting policies, information systems and business processes, together with an analysis of policy alternatives allowed under IFRS and development of draft IFRS financial statement content.
- **Implementation and Review Phase**  
This phase includes execution of changes to information systems and business processes, completing formal authorization processes to approve recommended accounting policy changes and training programs across the Company's finance group and other staff, as necessary.

The Company completed the impact analysis, evaluation and design phase in December 2010 and, is now in the implementation and review phase.

Most adjustments required on transition to IFRS will be made, retrospectively, against opening deficit on the first comparative balance sheet based on standards applicable at that time. Transitional adjustments relating to those standards where comparative figures are not required to be restated and are applied prospectively will only be made as of the first day of the year of adoption.

### First-Time Adoption of IFRS

The Company's adoption of IFRS will require the application of IFRS 1, "First-Time Adoption of International Financial Reporting Standards", which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively. However, IFRS 1 does require certain mandatory exceptions and limited optional exemptions in specified areas of certain standards from this general requirement. The Company has elected to apply the below optional exemption available under IFRS 1.

- **Share-Based Payments**  
On adoption of IFRS, an entity is not required under IFRS 2, Share-Based Payments to recognize share-based payments settled before the entity's IFRS transition date. IFRS 1 encourages, but does not require, application of its provisions to equity instruments granted on or before November 7, 2002. The Company expects to recognize under IFRS 2 all share-based awards that were recognized under Canadian GAAP.

### Expected Areas of Significance

The key areas where the Company expects accounting policies may differ and where accounting decisions are necessary that may impact the Company's consolidated financial statements are set out below. The list and comments below should not be regarded as a complete list of changes that will result from the transition to IFRS. It is intended to highlight those areas the Company believes to be most significant, however, analysis of changes is still in process and not all decisions have been made where choices of accounting policies are available. The differences described below are those existing based on Canadian GAAP and IFRS today. At this stage, the Company has not quantified the impacts expected on its consolidated financial statements for these differences.

- **Joint Venture**  
The Company has a 50 percent interest in GE Asset Manager, LLC, a joint business venture with GE Commercial Finance. Under Canadian GAAP, the Company proportionately consolidates its 50 percent interest in the joint venture in the consolidated financial statements. Under current IFRS, IAS 31, Interests in Joint Ventures, a choice can be made between the proportionate consolidation and equity methods. Proposed changes to IFRS as outlined in Exposure Draft 9, Joint Arrangements, require the equity method.

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- **Share-Based Payments**

The Company issues stock-based awards in the form of stock options that vest over each specified time period. The options expire five years from the date of the grant. Under Canadian GAAP, the Company recognizes the fair value of the award, determined at the time of the grant, on a straight-line basis over the respective vesting period. Under IFRS 2, Share-Based Payments, the fair value of each tranche of the award is considered to be a separate grant based on the vesting period with the fair value of each tranche determined separately and recognized as compensation expense over the term of its respective vesting period. Accordingly, this will result in each grant being recognized in income at a faster rate than under Canadian GAAP.

- **Financial instruments**

Under Canadian GAAP, the Company allocates the proceeds received from the issuance of compound financial instruments based on the relative fair values of each of the components. IAS 32, Financial Instruments: Presentation, requires that the equity component of a compound financial instrument be assigned the residual amount after deducting from the fair value of the compound financial instrument as a whole the amount separately determined for the liability component. However, under IFRS 1, if the liability component of the instrument has either been settled or converted prior to the date of transition, an entity can elect not to split the amount recognized into the debt and equity components.

- **Impairments**

Under Canadian GAAP for assets other than financial assets, a write-down to estimated fair value is recognized if the estimated undiscounted future cash flows from an asset or group of assets is less than their carried value. Under IFRS, IAS 36, Impairment of Assets, requires a write-down to be recognized if the recoverable amount, determined as the higher of the estimated fair value less costs to sell or value in use, is less than carried value. Consistent with Canadian GAAP, impairments are measured at the amount by which carried value exceeds fair value less costs to sell.

Management has not yet finalized its determination of the impact of these differences on the consolidated financial statements. However, as part of Company's IFRS implementation plan, the Company will continue to review the impact on its business activities, its disclosure and internal controls over financial reporting and its financial reporting systems.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Management's Discussion and Analysis is dated March 29, 2011.**

**SELECTED ANNUAL INFORMATION**

<b>Year ended December 31,</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
	(in thousands of Canadian dollars, except loss per share)		
Revenues	\$ 636	\$ 759	\$ 741
Operating expenses:			
General and administrative	1,451	1,269	1,485
Customer service and technology	734	738	689
Sales and marketing	188	181	117
Stock-based compensation	358	183	43
Depreciation	22	29	33
Total operating expenses	2,753	2,400	2,367
Loss from operations before the under-noted	(2,117)	(1,641)	(1,626)
Interest expense:			
Cash interest expense	154	260	335
Accretion of secured subordinated notes	160	508	394
Total interest expense	314	768	729
Other expenses (income):			
Gain on settlement of debt	(57)	-	-
Provision for impaired investment	544	-	-
Total other expenses	487	-	-
<b>LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>\$ (2,918)</b>	<b>\$ (2,409)</b>	<b>\$ (2,355)</b>
<b>LOSS PER SHARE, BASIC AND DILUTED</b>	<b>\$ (0.018)</b>	<b>\$ (0.017)</b>	<b>\$ (0.022)</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING, BASIC AND DILUTED (000's)</b>	<b>162,899</b>	<b>140,434</b>	<b>108,861</b>

**RECONCILIATION OF LOSS TO OPERATIONAL EBITDA<sup>(1)</sup>**

<b>Year ended December 31,</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
	(in thousands of Canadian dollars)		
Loss for the year, as per above	\$ (2,918)	\$ (2,409)	\$ (2,355)
Reconciling items:			
Stock-based compensation	358	183	43
Depreciation	22	29	33
Interest Expense:			
Cash interest expense	154	260	335
Accretion of secured subordinated notes	160	508	394
Non-recurring Items:			
Gain on settlement of trade payables	-	(240)	-
Gain on settlement of debt	(57)	-	-
Provision for impaired investment	544	-	-
<b>OPERATIONAL EBITDA</b>	<b>\$ (1,737)</b>	<b>\$ (1,669)</b>	<b>\$ (1,550)</b>

(1) Operational EBITDA is defined as the loss before interest, taxes, depreciation, stock-based compensation and other non-recurring expenses. The Company considers Operational EBITDA to be a meaningful performance measure as it provides an approximation of operating cash flows. Operational EBITDA should not be considered as a substitute or alternative for operating loss or loss for the year, in each case determined in accordance with GAAP.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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### RESULTS OF OPERATIONS

#### Comparison of Years Ended December 31, 2010 and December 31, 2009

**Loss:** Our loss for the year ended December 31, 2010 was \$2,918,000, an increase of \$509,000 or 21 percent from the loss of \$2,409,000 reported for the year ended December 31, 2009. The increase in loss was attributable to the provision for impaired investment, increase in operating expenses and decrease in revenues, partially offset the decrease in interest expense and a gain on settlement of debt. Excluding these non-recurring non-cash expenses, the loss increased by \$22,000 or one percent from 2009.

The Operational EBITDA loss was \$1,737,000 for 2010 as compared to \$1,669,000 for 2009, an increase in the EBITDA loss of \$68,000 or four percent. The increase in Operational EBITDA loss was due to a decrease in revenues, largely offset by a reduction in operating costs.

**Revenues:** Revenues are comprised of services (application development activities, software implementation and license fees, training and consulting, product maintenance and customer support), application hosting and royalty fees.

Revenues decreased to \$636,000 for the year ended December 31, 2010 from \$759,000 for the year ended December 31, 2009, representing a decrease of \$123,000 or 16 percent. The decrease in services revenue was the main reason for the decline in revenues.

**General and Administrative:** General and administrative expenses include, primarily: all salaries and related expenses (including benefits and payroll taxes) other than technology staff compensation (which is included in customer service and technology expenses), and sales and marketing staff compensation (which is included in sales and marketing expenses), occupancy costs, foreign exchange gains or losses, professional fees, insurance, investor relations, regulatory filing fees, and travel and related costs.

General and administrative expenses increased by \$182,000 or 14 percent, to \$1,451,000 for the year ended December 31, 2010, as compared to \$1,269,000 for the year ended December 31, 2009. The increase in expenses over the same period of last year was mainly due to an increase in financing fees, partially offset by savings in professional fees and bad debt expense. In addition, prior year's expenses included a significant reduction in licensing fees as a result of settlement of past debts for \$240,000 less than the amounts recorded.

**Customer Service and Technology:** Customer service and technology expenses consist of costs associated with acquired and internally developed software, and research and development expenses, including fees to independent contractors and salaries and related expenses of personnel engaged in these activities.

Customer service and technology expenses the year ended December 31, 2010 amounted to \$734,000, relatively consistent with \$738,000 for the year ended December 31, 2009.

**Sales and Marketing:** Sales and marketing costs include all salaries and related expenses of sales and marketing personnel as well as business development expenses such as advertising, sales support materials, and trade show costs.

Sales and marketing costs the year ended December 31, 2010 amounted to \$188,000, relatively consistent with \$181,000 for the year ended December 31, 2009.

**Employee Stock Options:** For the year ended December 31, 2010, employee stock option expense amounted to \$358,000, as compared to \$183,000 for the year ended December 31, 2009, an increase \$175,000. The increase was due to 7,515,000 stock options granted and related vesting expense in the current year as compared to 1,870,000 stock options granted and related vesting expense in 2009.

**Depreciation:** Depreciation expense for the year ended December 31, 2010 was \$22,000, a slight decrease from the \$29,000 recorded for the year ended December 31, 2009.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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**Interest Expense:** Interest expense reflects interest incurred from debt instruments and loans. Interest expense for the year ended December 31, 2010 was \$314,000 compared to \$768,000 for December 31, 2009, representing a decrease of \$454,000 or 59 percent. During 2010, cash interest expense of \$154,000 and non-cash interest expense of \$160,000 was incurred related to the secured subordinated notes and notes payable. Comparatively, cash interest expense of \$260,000 and non-cash interest expense of \$508,000 was recorded in 2009. The reduction in interest expense was due to the full conversions of Series I, J, K and M subordinated notes during 2009.

### Comparison of Years Ended December 31, 2009 and December 31, 2008

**Loss:** Our loss for the year ended December 31, 2009 was \$2,409,000, an increase of \$54,000 or two percent from the loss of \$2,355,000 reported for the year ended December 31, 2008. The increase in loss was attributable to the increase in operating and interest expenses, partially offset the increase in revenues.

The Operational EBITDA loss was \$1,669,000 for 2009 as compared to \$1,550,000 for 2008, an increase in the Operational EBITDA loss of \$119,000 or eight percent. The increase in Operational EBITDA loss was a combination of an increase in sales and marketing expense, partially offset by an increase in revenues.

**Revenues:** Revenues are comprised of services (application development activities, software implementation and license fees, training and consulting, product maintenance and customer support), application hosting and royalty fees.

Revenues increased to \$759,000 for the year ended December 31, 2009 from \$741,000 for the year ended December 31, 2008, representing an increase of \$18,000 or two percent. The increase in revenues was attributed to the increase in application hosting as a result of additional applications being hosted during 2009, partially offset by a decrease in services and royalty fees.

**General and Administrative:** General and administrative expenses include, primarily: all salaries and related expenses (including benefits and payroll taxes) other than technology staff compensation (which is included in customer service and technology expenses), and sales and marketing staff compensation (which is included in sales and marketing expenses), occupancy costs, foreign exchange gains or losses, professional fees, insurance, investor relations, regulatory filing fees, and travel and related costs.

General and administrative expenses decreased by \$216,000 or 15 percent, to \$1,269,000 for the year ended December 31, 2009, as compared to \$1,485,000 for the year ended December 31, 2008. Savings over the same period of last year was mainly due to a significant reduction in licensing fees as a result of settlement of past debts for \$240,000 less than the amounts previously recorded and lower financing fees, partially offset by an increase in investor relations and bad debt expense.

**Customer Service and Technology:** Customer service and technology expenses consist of costs associated with acquired and internally developed software, and research and development expenses, including fees to independent contractors and salaries and related expenses of personnel engaged in these activities.

Customer service and technology expenses increased by \$49,000 or seven percent, to \$738,000 for the year ended December 31, 2009, as compared to \$689,000 for the year ended December 31, 2008. The increase in expenses was due primarily to the increase in staffing levels compared to last year.

**Sales and Marketing:** Sales and marketing costs include all salaries and related expenses of sales and marketing personnel as well as business development expenses such as advertising, sales support materials, and trade show costs.

Sales and marketing costs for the year ended December 31, 2009 amounted to \$181,000, as compared to \$117,000 for 2008, representing an increase of \$64,000 or 55 percent. The addition of a new sales leader and the related marketing and business development expenses attributed to the increase in sales and marketing costs compared to last year.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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**Employee Stock Options:** For the year ended December 31, 2009, employee stock option expense amounted to \$183,000, as compared to \$43,000 for the year ended December 31, 2008, an increase \$140,000. The increase was due to 1,870,000 stock options granted and related vesting expense in the current year as compared to 480,000 stock options granted and related vesting expense in 2008.

**Depreciation:** Depreciation expense for the year ended December 31, 2009 was \$29,000, relatively consistent with \$33,000 recorded for the year ended December 31, 2008.

**Interest Expense:** Interest expense reflects interest incurred from debt instruments and loans. Interest expense for the year ended December 31, 2009 was \$768,000 compared to \$729,000 for December 31, 2008, representing an increase of \$39,000 or five percent. During 2009, cash interest expense of \$260,000 and non-cash interest expense of \$508,000 was incurred related to the secured subordinated notes and notes payable. Comparatively, cash interest expense of \$335,000 and non-cash interest expense of \$394,000 was recorded in 2008. The increase in interest expense was due to the accretion of Series L, M and N subordinated notes issued during 2008 and the refinanced Series K-Extension notes during 2009.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

### SUMMARY OF QUARTERLY RESULTS

The following table sets forth certain unaudited consolidated statements of operations data for each of the eight most recent quarters that, in management's opinion, have been prepared on a basis consistent with audited consolidated financial statements contained elsewhere in this annual report and include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the information presented. These operating results are not necessarily indicative of results for any future period. You should not rely on them to predict future performance.

Quarter ended	Dec 31, 2010	Sep 30, 2010	Jun 30, 2010	Mar 31, 2010	Dec 31, 2009	Sep 30, 2009	Jun 30, 2009	Mar 31, 2009
(in thousands of Canadian dollars, except per share amounts)								
Revenues	\$ 192	\$ 140	\$ 132	\$ 172	\$ 179	\$ 213	\$ 208	\$ 159
Operating expenses:								
General and administrative	396	315	352	388	342	328	159	440
Customer service and technology	184	174	184	192	193	191	180	174
Sales and marketing	55	41	41	51	56	55	53	17
Stock-based compensation	118	81	74	85	91	5	39	48
Depreciation	6	5	5	6	6	7	8	8
Total operating expenses	759	616	656	722	688	586	439	687
Loss before the under- noted	(567)	(476)	(524)	(550)	(509)	(373)	(231)	(528)
Interest expense:								
Interest on notes payable and secured subordinated notes	54	39	32	29	38	64	63	95
Accretion of secured subordinated notes	48	42	37	33	60	173	139	136
Total interest expense	102	81	69	62	98	237	202	231
Other expenses (income):								
Gain on settlement of debt	-	(57)	-	-	-	-	-	-
Provision for impaired investment	-	544	-	-	-	-	-	-
Total other expenses	-	487	-	-	-	-	-	-
Loss and comprehensive loss for the period	\$ (669)	\$ (1,044)	\$ (593)	\$ (612)	\$ (607)	\$ (610)	\$ (433)	\$ (759)
Loss per share - basic and diluted	\$(0.004)	\$(0.006)	\$(0.004)	\$(0.004)	\$(0.004)	\$(0.004)	\$(0.003)	\$(0.006)

### FOURTH QUARTER

Northcore reported revenues of \$192,000 for the quarter, an increase of \$52,000 or 37 percent from the \$140,000 reported in the third quarter of 2010. This increase was attributable to the increase in services revenue. In the same period of 2009, Northcore generated revenues of \$179,000.

Northcore reported a loss for the fourth quarter of \$669,000, a decrease of \$375,000 or 36 percent compared to \$1,044,000 reported in the third quarter of 2010. The third quarter loss included a provision for impaired investment of \$544,000 and a gain on settlement of debt of \$57,000. In the same period of 2009, Northcore reported a loss of \$607,000.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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### SUBSEQUENT EVENT

Subsequent to the year ended December 31, 2010, the Company completed a transaction resulting in the issuance of 10,478,000 equity units, priced at \$0.08 per unit, for gross proceeds of \$838,000 and net proceeds of \$729,000 after deducting financing fees of \$84,000 and legal fees of \$25,000. Each unit consists of one common share and one share-purchase warrant. Each warrant may be converted into a common share at the exercise price of \$0.12 at any time prior to February 14, 2013. In addition, the Company issued to the financing agent, an option to purchase 2,250,000 units at a price of \$0.08 per unit at any time prior to February 14, 2013.

### LIQUIDITY AND CAPITAL RESOURCES

The Company has been funded to date primarily through a series of private placements of equity and convertible debentures, option and warrant exercises, sales of equity to strategic partners and gains from investments. Since inception, the Company has received aggregate net proceeds of \$96.6 million from debt and equity financing and has realized net proceeds of \$25.8 million from disposal of investments. The Company has not earned profits to date and, at December 31, 2010, has an accumulated deficit of \$118.9 million. The Company expects to incur losses into 2011 and there can be no assurance that it will ever achieve profitability. Operating results have varied on a quarterly basis in the past and may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of the Company's control.

The Company has incurred negative annual cash flows from operations since inception and expects to continue to expend substantial funds to continue to develop technology, build an infrastructure to support business development efforts and expand other areas of business including the acquisition of, or strategic investments in, complementary products, businesses or technologies. The Company has historically relied on non-operational sources of financing to fund its operations. The Company's ability to continue as a going concern is dependent on management's ability to successfully execute its business plan and to successfully repay or refinance obligations as they come due. Management believes that it has the ability to raise additional financing. The Company cannot provide assurance that it will be able to execute on its business plan or assure that efforts to raise additional financings would be successful.

Cash decreased by \$136,000 to \$90,000 as at December 31, 2010 from \$226,000 as at December 31, 2009.

Current assets of \$283,000 were exceeded by current liabilities (excluding deferred revenue) of \$1,565,000 in the current fiscal year by \$1,282,000. Current assets of \$514,000 were exceeded by current liabilities (excluding deferred revenue) of \$648,000 by \$134,000 in the prior year. Deferred revenue has been excluded from current liabilities as it is expected to be settled by resources other than cash.

#### a) Operating

Cash outflows from operating activities declined to \$1,577,000 in the current fiscal year compared to cash outflows from operating activities of \$1,913,000 in the prior year. The decline was due to with a decrease in non-cash working capital as per below.

Non-cash working capital resulted in inflows of \$314,000 in fiscal 2010 as compared to outflows of \$224,000 in fiscal 2009, an improvement of \$538,000, as summarized in the following table:

	2010	2009	Change
	(in thousands on Canadian dollars)		
Accounts receivable	\$ 96	\$ 52	\$ 44
Deposits and prepaid expenses	(1)	(7)	6
Accounts payable	73	(239)	312
Accrued liabilities	144	(27)	171
Deferred revenue	2	(3)	5
	\$ 314	\$ (224)	\$ 538

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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### b) Investing

Investing activities resulted in cash outflows of \$6,000 during fiscal 2010, compared to \$57,000 in 2009. Cash outflows from investing activities were the result of the acquisition of new capital assets during year.

### c) Financing

Financing activities generated net inflows of \$1,447,000 in fiscal 2010, as compared to \$1,736,000 in fiscal 2009. Cash inflows during the year were generated from the issuance of equity units for \$1,008,000, notes payable for 859,000 and the exercise of warrants and options generated proceeds of \$170,000 and \$4,000, respectively, partially offset by the repayment of notes payable of \$465,000 and share issuance costs of \$129,000. Cash inflows during 2009 were generated from the issuance of equity units for \$495,000 and the exercise of warrants and options for proceeds of \$1,320,000 and \$154,000, respectively, partially offset by the repayment of notes payable of \$233,000.

### d) Contractual Obligations

As at December 31, 2010, the Company's contractual obligations, including payments due by periods over the next five years, are as follows:

	Total	2011	2012	2013	2014	2015
		(in thousands of Canadian dollars)				
Operating leases	\$ 598	\$ 156	\$ 156	\$ 156	\$ 130	\$ -
License agreements	209	44	55	55	55	-
Notes payable	530	530	-	-	-	-
Secured subordinated notes -principal repayment <sup>(i)</sup>	960	600	-	360	-	-
Secured subordinated notes - interest payment <sup>(i)</sup>	136	91	36	9	-	-
	\$ 2,433	\$ 1,421	\$ 247	\$ 580	\$ 185	\$ -

(i) Assumes secured subordinated notes are held to maturity.

## FUNDING

### Overview

The Company has been funded to date primarily through a series of private placements of equity and convertible debentures, option and warrant exercises, sales of equity to strategic partners and gains from investments.

### Funding – 2010

On December 22, 2010, the Company completed a transaction resulting in the issuance of 7,816,000 equity units, priced at \$0.08 per unit, for net proceeds of \$625,000. Each unit consists of one common share and one share-purchase warrant. Each warrant may be converted into a common share at the exercise price of \$0.12 at any time prior to December 22, 2012.

On August 9, 2010, the Company closed an equity transaction with GEM, securing gross proceeds of \$383,000 and net cash proceeds of \$300,000 after deducting legal fees and one half of the commitment fee of \$90,000. In connection with the transaction, the Company issued 2,191,000 common shares and 6,000,000 share-purchase warrants with an exercise price of \$0.27 and an expiry date of August 9, 2013.

On June 16, 2010, the Company entered into an agreement with GEM Global Yield Fund Limited (“GEM”) for a \$6,000,000 equity line of credit. The Company will control the timing and maximum amount of any draw downs under this facility, and has the right, not the obligation, to draw down on available funds by requiring GEM to subscribe for the Company's common shares at a 10 percent discount to the average closing price of the Company's common shares over a 15 day trading period following the draw down notice date, provided that the Company's share price during the notice period is greater than the floor price of \$0.17 per share as defined in the

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is dated March 29, 2011.

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agreement. GEM will hold freely trading shares of the Company through a share lending facility provided by a current shareholder. As part of the equity credit line transaction, the Company has agreed to issue 6,000,000 warrants to GEM. The warrants are exercisable for a period of three years from the closing notice date at an exercise price of \$0.27 per share. The warrants are not issuable until the first draw down of funds have occurred.

During the year ended December 31, 2010, Series I and L warrant holders exercised 1,083,000 warrants for total proceeds of \$170,000.

### Funding – 2009

On November 18, 2009, PowerOne exercised the compensation options and purchased 747,000 equity units, consisting of 747,000 common shares valued at \$121,000 and 747,000 warrants valued at \$72,000. The Company recorded total proceeds of \$112,000, which were attributed to share capital.

On September 30, 2009, the Company completed a transaction resulting in the issuance of 2,604,000 equity units, priced at \$0.19 per unit, for net proceeds of \$495,000. Each unit consists of one common share and one-half common share purchase warrant. Each full warrant may be converted into a common share at the exercise price of \$0.25 at any time prior to September 30, 2011.

During the quarter ended March 31, 2009, Series M note holders converted \$660,000 out of a total of \$678,000 debentures and exercised a total of 13,200,000 common share-purchase warrants out of a possible 13,560,000 warrants, for total proceeds of \$1,320,000. As per the terms of the debenture, the remaining warrant options have expired.

As a result of this transaction, the Company issued 26,400,000 common shares, comprised of 13,200,000 common shares from the conversion of the Series M notes and 13,200,000 common shares from the exercising of the associated warrants.

During the year ended December 31, 2009, total proceeds of \$42,000 were realized from the exercise of 280,000 stock options at an average exercise price of \$0.15.

### Funding – 2008

On December 12, 2008, the Company issued of Series N secured subordinated notes with a face value of \$600,000. The Series N notes mature on December 12, 2011, have an annual interest rate of 10 percent and are convertible into equity units at a price of \$0.10 per unit. Interest is payable in cash upon the earlier of quarter end, conversion, or maturity of the notes. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.15 per warrant. The warrants expire on December 12, 2011. Dundee Securities Corporation received a brokerage commission of four percent on a portion of the private placement. The afore-mentioned conversion provisions are subject to a four month and one day hold period. The Series N notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

On July 11, 2008, the Company issued of Series M secured subordinated notes with a face value of \$678,000. The Series M notes mature on July 11, 2013, have an annual interest rate of 10 percent and are convertible into equity units at a price of \$0.05 per unit. Interest is payable in cash upon the earlier of maturity or conversion. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.10 per warrant. The warrants expire on the earlier of (i) July 11, 2013 and (ii) the date which is twenty days following the issuance of a notice by the Company to holders confirming that the closing price of the Company's common shares on the Toronto Stock Exchange, was greater than or equal to \$0.20 for the preceding 10 consecutive trading days. Dundee Securities Corporation received a brokerage commission of four percent on a portion of the private placement. The afore-mentioned conversion provisions were subject to a four month and one day hold period. The Series M notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

On March 31, 2008, the Company issued Series L secured subordinated notes with a face value of \$525,000. The Series L notes mature March 31, 2013, have an annual interest rate of 10 percent and are convertible into equity units at a price of \$0.10 per unit. Interest for the first two years is payable in shares upon the earlier of conversion

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Management's Discussion and Analysis is dated March 29, 2011.**

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or each anniversary date of the closing date. Interest payable for the remaining term of the notes is payable in cash upon the earlier of conversion, each anniversary date of the closing date, or maturity. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.15 per warrant. The warrants expire on the earlier of (i) March 31, 2013 and (ii) the date which is sixty days following the issuance of a notice by the Company to holders confirming that the closing price of the Company's common shares, on the Toronto Stock Exchange, was greater than or equal to \$0.36 for any 10 consecutive trading days. The aforementioned conversion provisions were subject to a four month and one day holding period. The Series L notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

### **TRANSACTIONS WITH RELATED PARTIES**

During the year ended December 31, 2010, interest payments relating to the secured subordinated notes totaling \$1,000 (2009 - \$45,000) were made to related parties.

On July 9, 2010, Chris Bulger, Chairman of the Board exercised 133,000 Series I warrants at an exercise price of \$0.20 per warrant, for total proceeds of \$27,000.

On May 31, 2009, Duncan Copeland, Chief Executive Officer and a director of the Company converted \$60,000 of Series I notes into 400,000 equity units at a price of \$0.15 per unit. Each unit is comprised of one common share and one share-purchase warrant with an exercise price of \$0.20 and an expiry date of September 12, 2010.

Also on May 31, 2009, Jim Moskos, Chief Operating Officer and a director of the Company converted the following: \$10,000 of Series K notes into 83,000 common shares at a conversion price of \$0.12 per share, \$13,000 of Series J notes into 83,000 common shares at a conversion price of \$0.15 per share, and \$10,000 of Series I notes into 67,000 equity units at a price of \$0.15 per unit. Each unit is comprised of one common share and one share-purchase warrant with an exercise price of \$0.20 and an expiry date of September 12, 2010.

Also on May 31, 2009, Chris Bulger, Chairman of the Board converted the following: \$56,000 of Series J notes into 375,000 common shares at a conversion price of \$0.15 per share and \$20,000 of Series I notes into 133,000 equity units at a price of \$0.15 per unit. Each unit is comprised of one common share and one share-purchase warrant with an exercise price of \$0.20 and an expiry date of September 12, 2010.

### **DISCLOSURE CONTROLS AND PROCEDURES**

The Company's management has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2010. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Operating Officer, concluded that, as of that date, the Company's disclosure controls and procedures were effective to give reasonable assurance that the information required to be disclosed by the Company in our corporate filings is recorded, processed, summarized and reported within the required time periods.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### **MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting.

The term "internal control over financial reporting" is defined as a process designed by, or under the supervision of, the Chief Executive Officer and Chief Operating Officer, or persons performing similar functions, and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the design and operating effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, management used the criteria set forth in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of December 31, 2010, the Company's internal control over financial reporting was effective.

Management is aware that there is a lack of segregation of duties due to the small number of employees dealing with general, administrative and financial matters. However, management has decided that considering the employees involved and the compensating control procedures in place, including substantive periodic review of financial statements by the Audit Committee to ensure that internal controls over financial reporting and disclosure controls and procedures are effective, the risks associated with segregation are insignificant and the potential benefits of adding employees to more clearly segregate duties do not justify the expenses associated with such increase.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

### **CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There has been no changes in the Company's internal controls over financial reporting during the year ended December 31, 2010, that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

### **ADDITIONAL INFORMATION**

Additional information about the Company, including the Company's Annual Information Form may be obtained on SEDAR at [www.SEDAR.com](http://www.SEDAR.com).

## MANAGEMENT'S REPORT

March 29, 2011

Preparation of the consolidated financial statements accompanying this annual report and the presentation of all other information in this report is the responsibility of management. The consolidated financial statements have been prepared in accordance with appropriate and generally accepted accounting principles and reflect management's best estimates and judgments. All other financial information in the report is consistent with that contained in the consolidated financial statements. The Company maintains appropriate systems of internal control, policies and procedures which provide management with reasonable assurance that assets are safeguarded and that financial records are reliable and form a proper basis for preparation of financial statements.

The Board of Directors ensures that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee which is composed of non-executive directors. The Audit Committee reviewed the consolidated financial statements with management and external auditors and recommended their approval by the Board of Directors. The consolidated financial statements have been audited by Collins Barrow, Chartered Accountants. Their report stating the scope of their audit and their opinion on the consolidated financial statements is presented below.



Duncan Copeland  
CEO



Jim Moskos  
COO

## AUDITORS' REPORT

To the Shareholders of Northcore Technologies Inc.

We have audited the accompanying consolidated financial statements of Northcore Technologies Inc., which comprise the consolidated balance sheet as at December 31, 2010 and the consolidated statements of operations and deficit and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis of our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Northcore Technologies Inc. as at December 31, 2010, and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

### Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 to the financial statements which describes the material uncertainties that cast significant doubts about the ability of Northcore Technologies Inc. to continue as a going concern.

### Other Matter

The financial statements of Northcore Technologies Inc. for the years ended December 31, 2009 and 2008, were audited by another auditor who expressed an unmodified opinion on those statements on March 30, 2010.

*Colling Barrow Toronto LLP*

Chartered Accountants, Licensed Public Accountants  
Toronto, Canada, March 29, 2011

## CONSOLIDATED BALANCE SHEETS

December 31, 2010 and 2009

(in thousands of Canadian dollars)

	2010	2009
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 90	\$ 226
Accounts receivable	157	253
Deposits and prepaid expenses	36	35
	283	514
INVESTMENT IN SOUTHCORE (Note 4)	-	544
CAPITAL ASSETS (Note 5)	31	47
	\$ 314	\$ 1,105
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable	\$ 404	\$ 331
Accrued liabilities	219	161
Deferred revenue	29	27
Notes payable (Note 7)	530	156
Current portion of secured subordinated notes (Note 8)	412	-
	1,594	675
SECURED SUBORDINATED NOTES (Note 8)	149	446
	1,743	1,121
<b>SHAREHOLDERS' DEFICIENCY</b>		
Share capital (Note 10)	110,762	110,238
Contributed surplus (Note 11)	3,462	3,071
Warrants (Note 12)	839	492
Stock options (Note 13)	1,780	1,425
Conversion feature on secured subordinated notes (Note 8)	667	779
Deficit	(118,939)	(116,021)
	(1,429)	(16)
	\$ 314	\$ 1,105

Going concern (Note 2)

Commitments and contingencies (Note 18)

Canadian and United States accounting policy differences (Note 21)

Subsequent event (Note 22)

On behalf of the Board:



Duncan Copeland  
Director



Christopher Bulger  
Director

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**Years ended December 31, 2010, 2009 and 2008**  
**(in thousands of Canadian dollars, except per share amounts)**

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Revenues (Note 15)	\$ 636	\$ 759	\$ 741
Operating expenses:			
General and administrative	1,451	1,269	1,485
Customer service and technology	734	738	689
Sales and marketing	188	181	117
Stock-based compensation (Note 13 (b))	358	183	43
Depreciation	22	29	33
Total operating expenses	2,753	2,400	2,367
Loss from operations before the under-noted	(2,117)	(1,641)	(1,626)
Interest expense:			
Cash interest expense	154	260	335
Accretion of secured subordinated notes	160	508	394
Total interest expense	314	768	729
Other expenses (income):			
Gain on settlement of debt (Note 7 (b))	(57)	-	-
Provision for impaired investment (Note 4)	544	-	-
Total other expenses	487	-	-
<b>LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>\$ (2,918)</b>	<b>\$ (2,409)</b>	<b>\$ (2,355)</b>
<b>LOSS PER SHARE, BASIC AND DILUTED (Note 10 (e))</b>	<b>\$ (0.018)</b>	<b>\$ (0.017)</b>	<b>\$ (0.022)</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING, BASIC AND DILUTED (000's)</b>	<b>162,899</b>	<b>140,434</b>	<b>108,861</b>

See accompanying notes to consolidated financial statements.

## **CONSOLIDATED STATEMENTS OF DEFICIT**

**Years ended December 31, 2010, 2009 and 2008**

**(in thousands of Canadian dollars)**

	<b>2010</b>	<b>2009</b>	<b>2008</b>
DEFICIT, BEGINNING OF YEAR	(116,021)	(113,612)	(111,257)
LOSS FOR THE YEAR	(2,918)	(2,409)	(2,355)
DEFICIT, END OF YEAR	\$ (118,939)	\$ (116,021)	\$ (113,612)

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2010, 2009 and 2008

(in thousands of Canadian dollars)

	2010	2009	2008
<b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b>			
<b>OPERATING</b>			
Loss for the year	\$ (2,918)	\$ (2,409)	\$ (2,355)
Items not affecting cash:			
Stock-based compensation	358	183	43
Depreciation	22	29	33
Accretion of secured subordinated notes	160	508	394
Gain on settlement of debt	(57)	-	-
Provision for impaired investment	544	-	-
	(1,891)	(1,689)	(1,885)
Changes in non-cash operating working capital (Note 19)	314	(224)	394
	(1,577)	(1,913)	(1,491)
<b>INVESTING</b>			
Capital assets	(6)	(57)	-
<b>FINANCING</b>			
Repayment of notes payable (Note 7)	(465)	(233)	(330)
Proceeds from issuance of notes payable (Note 7)	859	-	-
Warrants exercised (Note 12 (b))	170	1,320	-
Options exercised (Notes 13 (d) and 14)	4	154	-
Issuance of common shares and warrants (Notes 10 (d))	1,008	495	-
Share issuance costs (Note 7 (d))	(129)	-	-
Issuance of secured subordinated notes (Note 8)	-	-	1,803
Advances from related parties (Note 6)	-	-	59
Repayment to related parties (Note 6)	-	-	(59)
	1,447	1,736	1,473
NET CASH OUTFLOW DURING THE YEAR	(136)	(234)	(18)
CASH, BEGINNING OF YEAR	226	460	478
CASH, END OF YEAR	\$ 90	\$ 226	\$ 460
<b>SUPPLEMENTAL DISCLOSURE OF CASH PAYMENTS</b>			
Interest paid	\$ 80	\$ 213	\$ 250

SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES – See Note 19

See accompanying notes to consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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## 1. DESCRIPTION OF BUSINESS

Northcore Technologies Inc. (“Northcore” or the “Company”) provides a Working Capital Engine™ that helps organizations source, manage, appraise and sell their capital equipment.

Northcore owns 50 percent of GE Asset Manager, LLC (also referred to as “GE Asset Manager”), a joint business venture with GE Capital Corporation, through its business division GE Commercial Finance, Capital Solutions (“GE Commercial Finance”).

## 2. GOING CONCERN

While the accompanying consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, certain adverse conditions and events cast substantial doubt upon the validity of this assumption. Financial statements are required to be prepared on a going concern basis unless management either intends to liquidate the Company or cease trading or has no realistic alternative but to do so within the foreseeable future. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of operations. The Company has not yet realized profitable operations and has relied on non-operational sources of financing to fund operations. The Company’s ability to continue as a going concern will be dependent on management’s ability to successfully execute its business plan including a substantial increase in revenue as well as maintaining operating expenses at or near the same level as 2010. The Company cannot provide assurance that it will be able to execute on its business plan or assure that efforts to raise additional financings will be successful.

These consolidated financial statements do not include adjustments or disclosures that may result from the Company’s inability to continue as a going concern. If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying values of assets and liabilities, and the reported losses and the balance sheet classifications used.

The continued existence beyond 2010 is dependent on the Company’s ability to increase revenue from existing products and services, and to expand the scope of its product offering which entails a combination of internally developed software and business ventures with third parties, and to raise additional financing.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP), which are substantially the same as generally accepted accounting principles in the United States (U.S. GAAP), except as disclosed in Note 21. The accompanying consolidated financial statements are prepared using accounting principles applicable to a going concern, which assumes that the Company will continue in operation for a reasonable period of time and will be able to realize its assets and discharge its liabilities in the normal course of operations (See Note 2).

### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and subsidiaries over which it exercises control. All inter-company balances and transactions have been eliminated upon consolidation.

### Investments

Investments over which the Company is able to exercise significant influence are accounted for by the equity method. Investments over which the Company has joint control are accounted for by the proportionate consolidation method. Investments are written down when there is evidence that a decline in value that is other than temporary has occurred.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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On September 23, 2003, the Company established a joint venture with the GE Commercial Finance, with each entity holding a 50 percent interest in the joint venture. The joint venture operates under the name of GE Asset Manager, LLC. The consolidated financial statements of the Company reflect the Company's pro rata share of the joint venture's assets, liabilities, and results of operations in accordance with the proportionate consolidation method of accounting (See Note 20).

On June 24, 2009, the Company entered into a strategic partnership with Pan Pacific through a 40 percent ownership in Southcore. The consolidated financial statements of the Company reflect the Company's equity interest in Southcore. During 2010, the Company wrote off the investment in Southcore as the Company determined that there was an other than temporary decline in the value of the investment (See Note 4).

### Capital Assets and Depreciation

Capital assets are recorded at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis in amounts sufficient to amortize the cost of capital assets over their estimated useful lives as follows:

Computer hardware	3 years
Computer software	1 year or life of the license
Furniture and fixtures	5 years
Leasehold improvements	Shorter of useful life or life of the lease

### Software Development Costs

The cost of software internally developed for client applications through e-commerce enabling agreements and software licensing is expensed as incurred.

### Translation of Foreign Currencies

The accompanying consolidated financial statements are prepared in Canadian dollars. The Company's foreign subsidiaries in the United States are classified as fully integrated with the functional currency being the Canadian dollar. The Company uses the temporal method of foreign currency translation for these operations. Monetary assets and liabilities are translated at the exchange rates in effect on the balance sheet date. Non-monetary assets are translated at historic exchange rates. Revenue and expense amounts are translated using the average monthly exchange rates except depreciation of capital assets, which is translated at historic exchange rates. Gains and losses from foreign exchange translations are included in the statement of operations.

### Loss Per Share

The treasury stock and the "if converted" methods of calculating diluted loss per share are used. For all years presented, all stock options, convertible debentures and warrants are anti-dilutive, therefore diluted loss per share is equal to basic loss per share. The basic loss per share calculation is based on the weighted average number of shares outstanding during the year.

### Revenue Recognition

The Company's revenues are derived from services (application development activities, software implementation and license fees, training and consulting, product maintenance and customer support), application hosting and royalty fees. Fees for services are billed separately from licenses of the Company's products. The Company recognizes revenue in accordance with Canadian GAAP, which in the Company's circumstances, are not materially different from the amounts that would be determined under provisions of FASB Accounting Standards Codification (ASC) Subtopic 985-605 (previously the American Institute of Certified Public Accountants Statements of Position (SOP) No. 97-2, "Software Revenue Recognition", and as amended by Statement of Position 98-9, "Modification of SOP 97-2, Software revenue Recognition, With Respect to Certain Transactions"). The Company also considers the provisions of the Canadian Institute of Chartered Accountants (CICA) Emerging Issues Committee (EIC) 141 and CICA EIC 142, which is analogous to ASC 605, in determining the appropriate revenue recognition methodology.

### Multiple Deliverable Revenue Arrangements

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract was amended to (1) exclude from the application of the updated guidance those arrangements that would be accounted for in accordance with ASC

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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985; (2) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (3) require in situations where a vendor does not have vendor-specific objective evidence (VSOE) or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (4) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (5) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance.

The Company adopted EIC 175 prospectively effective January 1, 2010.

The Company is required to determine the appropriate accounting under EIC 175, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes. In the past, for arrangements involving multiple elements, the Company allocated revenue to each component based on VSOE of the fair value of each element. Effective January 1, 2010, the Company has allocated revenue using the relative selling price method of the separate units of accounting. The multiple elements in an arrangement typically might include one or more of the following: software, application development, maintenance, hosting, and/or other professional service offerings as described in Note 3 of the Company's Annual Financial Statements for 2009. The Company allocates the arrangement fee, in a multiple element transaction, to the separate elements based on their relative selling prices, as indicated by VSOE or third-party evidence of selling price, and if both are not available, estimated selling prices are used. The allocated portion of the arrangement which is undelivered is then deferred.

The Company's revenue arrangements may contain multiple elements; however, the adoption of EIC 175 did not have a material impact on the Company's financial statements.

### **Hosting Fees**

The Company earns revenue from the hosting of customer websites and applications. Under existing hosting contracts, the Company charges customers a recurring periodic flat fee. The fees are recognized as the hosting services are provided.

### **Application Development Fees**

Typically, development of applications for the Company's customers are provided based on a predetermined fixed hourly rate basis. Revenue is recognized as time is incurred throughout the development process.

### **Software License Revenue**

The Company recognizes software license revenue in accordance with the terms of the license agreement and when the following criteria as set out in ASC Subtopic 985-605 are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- Fee is fixed or determinable; and
- Collectibility is probable.

Software license revenue consists of fixed license fee agreements involving perpetual licenses.

Software license agreements may be part of multiple element arrangements that include consulting and implementation services. When these services are considered essential to the functionality of the license, the associated revenue is recognized on the basis of the percentage of completion method as specified by contract accounting principles. When these services are not considered essential to the functionality of the license, the entire arrangement fee is allocated to each element in the arrangement based on the respective VSOE of the fair value of each element. The amount allocated to license revenues is based on the price charged by the Company when the same element is sold in similar quantities to a customer of a similar size and nature. If this amount is not determinable, the residual software license revenue is the amount of the total arrangement fee less the fair value of any undelivered elements. VSOE used in determining fair value for installation, implementation and training is based on the standard daily rates for the type of service being provided multiplied by the estimated time to complete each task. VSOE used in determining the fair value of maintenance and support is based on the annual renewal rates. The revenue allocable to the software license

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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is recognized when the revenue recognition criteria are met. The revenue allocable to the consulting services is recognized as the services are performed.

### **Implementation, Training and Consulting Service Fees**

The Company receives revenue from implementation of its product offerings, consulting services and training services. Customers are charged a fee based on time and expenses. Revenue from implementation, consulting service and training fees is recognized as the services are performed or deferred until contractually defined milestones are achieved or until customer acceptance has occurred, as the case may be, for such contracts.

### **Product Maintenance and Customer Support Fees**

The Company receives revenue from maintaining its products and the provision of on-going support services to customers. The maintenance and support fees are typically equal to a specified percentage of the customers' license fee. If associated with the fixed fee license model, the maintenance revenues received are recorded as deferred revenue and recognized on a straight-line basis over the contract period.

Services revenue from maintenance and support is recognized when the services are performed. Maintenance and support revenues paid in advance are non-refundable and are recognized on a straight-line basis over the term of the agreement, which typically is 12 months.

### **Deferred Revenue**

Deferred revenue is comprised of the unrecognized portion of consulting and implementation fees received from maintenance and support of e-commerce enabling agreements, and the unrecognized portion of license, installation, and consulting revenue on the sale of software licenses and related services.

### **Secured Subordinated Notes**

Financial instruments that contain both a liability and an equity element are required to have the instrument's component parts classified separately under Canadian GAAP. The Company uses the Cox-Rubinstein binomial valuation model to determine the fair value of the conversion feature at the issue dates of convertible secured subordinated notes and discloses the liability and equity components separately on its balance sheet.

### **Financial Instruments**

Under Section 3855, Financial Instruments – Recognition and Measurement, financial instruments must be classified into one of these five categories: held-for-trading; held-to-maturity; loans and receivables; available-for-sale financial assets; or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost using the effective interest rate method. Transaction costs are expensed when incurred. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is de-recognized or impaired at which time the amounts would be recorded in net income.

The Company designated its accounts receivable as loans and receivables, which are measured at amortized cost. Accounts payable, accrued liabilities, notes payable and secured subordinated notes are classified as other financial liabilities, which are measured at amortized cost. The Company had neither available for sale, nor held to maturity instruments during the years ended December 31, 2010 and 2009.

The Company had no "other comprehensive income or loss" transactions during the years ended December 31, 2010, 2009, and 2008 and no opening or closing balances for accumulated other comprehensive income or loss.

### **Stock-Based Compensation**

The Company accounts for stock-based compensation using the fair value method of accounting, which is consistent with CICA 3870, "Stock-based Compensation and Other Stock-based Payments." The estimated fair value is amortized to expense over the vesting period. Performance based options are expensed upon achievement of specific criteria.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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Stock-based compensation to non-employees is recognized and recorded in the accounts of the Company at the fair market value of the equity instrument as determined by the Cox-Rubinstein binomial valuation model or the fair value of services provided, if more reliably measurable.

### **Goodwill and Intangible Assets**

Effective January 1, 2009, the Company adopted the recommendations of the CICA Handbook Section 3064, Goodwill and Intangible Assets. This Handbook Section replaces CICA Handbook Section 3062, Goodwill and Other Intangible Assets, and CICA Handbook Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The adoption of this new standard had no impact on the consolidated financial statements.

### **Income Taxes**

The Company accounts for income taxes in accordance with the asset and liability method. The determination of future tax assets and liabilities is based on differences between the financial statement and income tax bases of assets and liabilities, using substantively enacted tax rates in effect for the year in which the differences are expected to reverse. Future tax assets are recorded to recognize tax benefits only to the extent that, based on available evidence, it is more likely than not that they will be realized.

### **Use of Significant Accounting Estimates**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting years. Estimates are used when determining items such as the allowance for doubtful accounts, the fair value assigned to the debt and equity components of the secured subordinated notes and the expected requirements for non-operational funding. Actual results could differ from these estimates.

## **UNADOPTED NEW ACCOUNTING PRONOUNCEMENTS**

### **Business Combinations**

In October of 2008, the CICA issued Handbook Section 1582, Business Combinations, concurrently with Handbook Section 1601, Consolidated Financial Statements, and Handbook Section 1602, Non-controlling Interests. Section 1582, which replaces CICA Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. Section 1601, which replaces CICA Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. Section 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company will assess the impact of the new standards on its consolidated financial statements when it completes a business combination.

### **International Financial Reporting Standards (IFRS)**

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period.

In February 2008, the AcSB confirmed that IFRS will be mandatory in Canada for profit-oriented publicly accountable entities for fiscal periods beginning on or after January 1, 2011. The Company's first IFRS financial statements will be for the year ending December 31, 2011 and will include the comparative period for 2010. Starting in the first quarter of 2011, the Company will provide unaudited consolidated financial information in accordance with IFRS including comparative figures for 2010.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

The Company has assembled an IFRS transition team and is committed to the development of its IFRS changeover plan. The Company has completed the impact analysis, evaluation and design phase and is now in the implementation and review phase. As part of Company's IFRS implementation plan, the Company will continue to review the impact on its business activities, its disclosure and internal controls over financial reporting and its financial reporting systems.

### 4. INVESTMENT IN SOUTHCORE

During the quarter ended June 30, 2009, the Company entered into a strategic partnership with Pan Pacific through the shared ownership of Southcore. Northcore issued 7,500,000 common shares from treasury to Pan Pacific in exchange for a 40 percent interest in Southcore. The shares were to be delivered in two tranches of 3,750,000 shares each. The first tranche was delivered on the closing date of the transaction on June 24, 2009. The second tranche was to be delivered upon the achievement of certain performance criteria.

The investment was recorded using the equity method of accounting. The fair value of the first tranche in the amount of \$544,000 was calculated as 3,750,000 shares multiplied by the closing trading price of the Company's common shares on the Toronto Stock Exchange ("TSX") immediately preceding the closing date. The contingent 3,750,000 shares were to be issued to Pan Pacific and recorded as an addition to the investment upon the satisfaction of performance criteria as specified in the agreement. There were no significant operations in Southcore or gain or loss from equity investment recorded during the period from inception to December 31, 2010.

During the year ended December 31, 2010, the Company wrote off the investment in Southcore as the Company determined that there was an other than temporary decline in the value of the investment. The investment in Southcore was wound-up during the year ended December 31, 2010.

### 5. CAPITAL ASSETS

	2010			2009		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
	(in thousands)					
Computer hardware	\$ 139	\$ 114	\$ 25	\$ 133	\$ 100	\$ 33
Computer software	15	9	6	15	1	14
Leasehold improvements	27	27	-	27	27	-
	\$ 181	\$ 150	\$ 31	\$ 175	\$ 128	\$ 47

During the year ended December 31, 2010, the Company recorded capital asset depreciation in the amount of \$22,000 (2009 - \$29,000, 2008 - \$33,000).

### 6. TRANSACTIONS WITH RELATED PARTIES

During the year ended December 31, 2010, interest expense on advances from a director was \$nil (2009 - \$nil, 2008 - \$1,000).

During the year ended December 31, 2010, the Company received and repaid advances from a director and officer in the amount of \$nil (2009 - \$nil, 2008 - \$59,000).

During the year ended December 31, 2010, the Company paid \$1,000 (2009 - \$45,000, 2008 - \$9,000) in interest relating to the secured subordinated notes to related parties.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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### 7. NOTES PAYABLE AND DEMAND LOAN

- a) The Series H secured subordinated notes with a principal balance of \$170,000 matured on October 21, 2007. The Company entered into an agreement with the debt holders in December 2007 to repay the accrued interest of \$60,000 in cash in January 2008 and the principal of \$170,000 over a two year term at an interest rate of 11 percent, in blended quarterly interest and principal payments of \$24,000. As of the date of refinancing, the total amount to be repaid was \$230,000. The notes payable were issued to private investors including an amount totaling \$20,000 issued to a director/officer of the Company. The notes payable matured on December 31, 2009 and were secured as per the Series H security terms; however, the final installment has not been remitted and the Company is currently in negotiation with the note holders over the timing of the final settlement amount.

During the year ended December 31, 2010, the Company paid \$3,000 (2009 - \$80,000) and accrued additional interest in the amount of \$3,000 (2009 - \$6,000). The balance outstanding as at December 31, 2010 is \$30,000 (2009 - \$30,000).

- b) During the year ended December 31, 2008, the Company entered into an agreement with the remaining Series G debt holders to repay the accrued interest of \$113,000 and the principal of \$240,000 over a two year term at an interest rate of 12 percent in blended interest and principal quarterly payments of \$40,000. As of the date of refinancing, the total refinanced amount was \$353,000. The notes payable matured on December 31, 2009 and were secured as per the Series G security terms.

During the year ended December 31, 2009, the Company paid \$100,000 and accrued additional interest in the amount of \$11,000. The balance outstanding as at December 31, 2009 was \$126,000.

During the year ended December 31, 2010, the Company reached a settlement agreement with the Series G debt holders by paying \$86,000 in full settlement of the outstanding balance of \$143,000 recorded in the books of the Company. As a result of this transaction, the Company recorded a gain on debt settlement of notes payable of \$57,000

- c) During the year ended December 31, 2010, the Company received operating loans from private investors in the amount of \$359,000. The loans were unsecured, bore interest at 12 percent and were due on demand.

Also during the year ended December 31, 2010, the Company paid \$376,000 including accrued interest in the amount of \$17,000. These loans were repaid in full as at December 31, 2010.

On October 28, 2010, the Company received an operating loan from a private institution in the amount of \$500,000. The loan bears interest at 18.75 percent, matures in six months from the closing date and is secured by a general security agreement and common shares pledged by certain shareholders of the Company. The balance outstanding as at December 31, 2010 is \$500,000.

- d) During the year ended December 31, 2008, the Company entered into an agreement to assign \$50,000 face value of the Series K secured subordinated notes held by a shareholder of the Company to a Canadian financial institution. The Company agreed to repay the accrued interest and related costs of \$30,000 and the principal of \$50,000 over a two year term at an interest rate of 11 percent in blended interest and principal quarterly payments of \$11,000. The total refinanced amount was \$80,000. The note payable matured on December 31, 2009 and was secured as per the Series K security terms.

Upon the initial issuance of the Series K secured subordinated notes, the Company separated the liability and equity components. For the \$50,000 face value, the resulting pro rata fair values of the liability component of the notes and the conversion features of the shares were \$27,000 and \$23,000, respectively. The liability component was to be accreted to \$50,000 over the term of the Series K notes through the recording of non-cash interest expense until such date as which the underlying notes were converted into common shares.

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As of the date of the assignment, the liability component had been accreted to \$34,000. As a result of the refinancing and the terms of the note payable, the Company recorded the following amounts during the quarter ended March 31, 2008: (1) the equity component of the Series K notes of \$23,000 was transferred to contributed surplus; (2) the 29,000 common shares recorded in the amount of \$4,000, which were issued in settlement of previously recorded interest expense of \$4,000 on the \$50,000 of Series K notes up to the period ended March 31, 2008 were cancelled and the amount was reclassified to the notes payable balance; (3) the 110,000 common shares recorded in the amount of \$17,000, which were issued in settlement of the previously recorded interest expense of \$17,000 on the Series G notes that were rolled into the \$50,000 of Series K notes were cancelled and the amount was reclassified to the notes payable balance; and (4) a charge of \$25,000 was recorded in general and administrative expenses in order to record the face amount of the note payable as of the date of refinancing.

During the year ended December 31, 2009, the Company paid \$53,000 (2008 - \$33,000) and accrued interest in the amount of \$1,000 (2008 - \$5,000). The balance of the note was repaid in full as at March 31, 2009.

### 8. SECURED SUBORDINATED NOTES

- a) The following summarizes the face and carrying values of the secured subordinated notes.

Secured Subordinated Notes	2010		2009	
	Face Value	Carrying Value	Face Value	Carrying Value
	(in thousands)			
Series N (Note 8 (b))	\$ 600	\$ 412	\$ 600	\$ 289
Series L (Note 8 (d))	360	149	505	157
Closing balance	\$ 960	\$ 561	\$ 1,105	\$ 446
Current portion of notes	\$ 600	\$ 412	\$ -	\$ -
Long-term portion of notes	\$ 360	\$ 149	\$ 1,105	\$ 446

- b) During the year ended December 31, 2008, the Company issued Series N secured subordinated notes with a face value of \$600,000. The Series N notes mature on December 12, 2011, have an annual interest rate of 10 percent and are convertible into equity units at a price of \$0.10 per unit. Interest is payable in cash upon the earlier of each quarter end, conversion, or maturity of the notes. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.15 per warrant. The warrants expire on December 12, 2011. Dundee Securities Corporation received a brokerage commission of four percent on a portion of the private placement. The afore-mentioned conversion provisions were subject to a four month and one day hold period. The Series N notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series N secured subordinated notes. The Company determined the fair value of the liability component of the Series N notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series N notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the units, comprised of shares and attached warrants, was \$211,000, \$215,000 and \$174,000, respectively. The liability component will be accreted to \$600,000 over the term of the Series N notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares. Financing costs in the amount of \$8,000 were expensed in general and

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administrative expenses as incurred on the issuance of Series N notes.

- c) During the year ended December 31, 2008, the Company issued Series M secured subordinated notes with a face value of \$678,000. The Series M notes had a maturity date of July 11, 2013, an annual interest rate of 10 percent and were convertible into equity units at a price of \$0.05 per unit. Interest was payable in cash upon the earlier of conversion or maturity of the notes. Each equity unit consisted of one common share and one share-purchase warrant with an exercise price of \$0.10 per warrant. The warrants expire on the earlier of (i) July 11, 2013 and (ii) the date which is twenty days following the issuance of a notice by the Company to holders confirming that the closing price of the Company's common shares on the TSX was greater than or equal to \$0.20 for the preceding 10 consecutive trading days. Dundee Securities Corporation received a brokerage commission of four percent on a portion of the private placement. The afore-mentioned conversion provisions were subject to a four month and one day hold period. The Series M notes were secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series M secured subordinated notes. The Company determined the fair value of the liability component of the Series M notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series M notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the units, comprised of shares and attached warrants, was \$117,000, \$315,000 and \$246,000, respectively. The liability component was to be accreted to \$678,000 over the term of the Series M notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares. Financing costs in the amount of \$8,000 were expensed in general and administrative expenses as incurred on the issuance of Series M notes.

During the year ended December 31, 2009, \$678,000 (face value) of the Series M notes (book value of \$127,000) were converted, resulting in the issuance of 13,560,000 common shares valued at \$315,000 and 13,200,000 warrants valued at \$240,000. The remaining 360,000 warrant conversion features on the Series M notes, valued at \$7,000, have expired as per the terms of the notes.

- d) During the year ended December 31, 2008, the Company issued Series L secured subordinated notes with a face value of \$525,000. The Series L notes mature on March 31, 2013, have an annual interest rate of 10 percent and are convertible into equity units at a price of \$0.10 per unit. Interest for the first two years is payable in shares upon the earlier of conversion or each anniversary date of the closing date. Interest payable for the remaining term of the notes is payable in cash upon the earlier of conversion, each anniversary date of the closing date, or maturity. Each equity unit consisted of one common share and one share-purchase warrant with an exercise price of \$0.15 per warrant. The warrants expire on the earlier of (i) March 31, 2013 and (ii) the date which is sixty days following the issuance of a notice by the Company to holders confirming that the closing price of the Company's common shares, on the TSX was greater than or equal to \$0.36 for any 10 consecutive trading days. Dundee Securities Corporation received a brokerage commission of four percent on a portion of the private placement. The afore-mentioned conversion provisions are subject to a four month and one day holding period. The Series L notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series L secured subordinated notes. The Company determined the fair value of the liability component of the Series L notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series L notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the units, comprised of shares and attached warrants, was \$119,000, \$221,000 and \$185,000, respectively. The liability component will be accreted to \$525,000 over the term of the Series L notes through the recording of a non-cash interest expense until such date at which the underlying notes are

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converted into common shares. Financing costs in the amount of \$21,000 were expensed in general and administrative expenses as incurred on the issuance of Series L notes.

During the year ended December 31, 2009, \$20,000 (face value) of the Series L notes (book value of \$6,000) were converted into 200,000 equity units represented by 200,000 common shares valued at \$8,000 and 200,000 warrants valued at \$7,000.

During the year ended December 31, 2010, \$145,000 (face value) of the Series L notes (book value of \$46,000) were converted into 1,450,000 equity units represented by 1,450,000 common shares valued at \$61,000 and 1,450,000 warrants valued at \$51,000.

- e) During the year ended December 31, 2007, the Company issued Series K secured subordinated notes with a face value of \$1,360,000. The Series K notes were issued to private investors including an amount totaling \$60,000 issued to two directors and officers of the Company. The Series K notes matured on June 15, 2009, had an annual interest rate of 11 percent and were convertible into common shares of the Company at a price of \$0.12 per common share. Interest on the Series K notes is payable in common shares upon the earlier of each quarter end, maturity or conversion of the notes. At any time after the closing, the Series K notes, including any accrued interest thereon, will be automatically converted into common shares at the Conversion Price when the volume weighted average trading price of the common shares through its principal trading market for a 10 consecutive trading day period is \$0.30 or more. The Series K notes were secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series K secured subordinated notes. The Company determined the fair value of the liability component of the Series K notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series K notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the shares were \$744,000 and \$616,000, respectively. The liability component was to be accreted to \$1,360,000 over the term of the Series K notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares.

During the quarter ended March 31, 2008, the Company entered into an agreement to assign \$50,000 face value of the Series K secured subordinated notes held by a director and shareholder of the Company to a Canadian financial institution (See Note 7 (d)).

Prior to the maturity of the notes in 2009, \$290,000 (face value) of the original Series K notes (book value of \$271,000) were converted into 2,417,000 common shares valued at \$131,000. Upon maturity on June 15, 2009, the remaining \$1,020,000 (face value) balance of the original Series K notes (book value of \$1,020,000) was refinanced. Accordingly, 8,500,000 share conversion features on the original Series K notes, valued at \$462,000, were cancelled.

On June 16, 2009, the Company extended the maturity date of the Series K ("Series K-Extension") secured subordinated notes with a face value of \$1,020,000 to December 30, 2009. The Series K-Extension notes had an annual interest rate of 11 percent and were convertible into common shares of the Company at a price of \$0.12 per common share. Interest on the Series K-Extension notes was payable in common shares upon the earlier of each quarter end, maturity or conversion of the notes. At any time after the closing, the Series K-Extension notes, including any accrued interest thereon, were to be automatically converted into common shares at the Conversion Price when the volume weighted average trading price of the common shares through its principal trading market for a 10 consecutive trading day period is \$0.30 or more. The Series K-Extension notes were secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

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As required by Canadian GAAP, the Company separated the liability and equity components of the Series K-Extension secured subordinated notes. The Company determined the fair value of the liability component of the Series K-Extension notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series K-Extension notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the shares were \$625,000 and \$395,000, respectively. The liability component was to be accreted to \$1,020,000 over the term of the Series K-Extension notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares.

During the year ended December 31, 2009, \$1,020,000 (face value) of the Series K-Extension notes (book value of \$797,000) were converted into 8,500,000 common shares valued at \$395,000.

- f) During the year ended December 31, 2006, the Company issued Series J secured subordinated notes with a face value of \$755,000. The Series J notes were issued to private investors including an amount totaling \$105,000 issued to three directors and officers of the Company. The Series J notes had a maturity date of February 8, 2011, an annual interest rate of 11 percent and were convertible into equity units at a price of \$0.15 per unit. Interest for the first year was payable in shares of the Company with the provision that the total number of shares issued as interest payment cannot exceed 6,529,959 shares. Interest payable for the remaining term of the notes was payable in cash upon the earlier of maturity and conversion. Each equity unit consisted of one common share and one share-purchase warrant with an exercise price of \$0.20 per warrant. The warrants expire on the earlier of (i) February 8, 2009 and (ii) the date which is sixty days following the issuance of a notice by the Company to holders confirming that the closing price of the Company's common shares, on the TSX was greater than or equal to \$0.35 for any 10 consecutive trading days. The afore-mentioned conversion provisions were subject to a four month and one day holding period. The Series J notes were secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series J secured subordinated notes. The Company determined the fair value of the liability component of the Series J notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series J notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the units, comprised of shares and attached warrants, was \$202,000, \$353,000 and \$200,000, respectively. The liability component was to be accreted to \$755,000 over the term of the Series J notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares.

During the year ended December 31, 2006, \$470,000 (face value) of the Series J notes (book value of \$156,000) were converted into 3,133,000 equity units represented by 3,133,000 common shares valued at \$220,000 and 3,133,000 warrants valued at \$125,000.

During the year ended December 31, 2008, \$60,000 (face value) of the Series J notes (book value of \$27,000) were converted into 400,000 equity units represented by 400,000 common shares valued at \$28,000 and 400,000 warrants valued at \$16,000.

During the year ended December 31, 2009, the remaining \$225,000 (face value) of the Series J notes (book value of \$124,000) were converted into 1,500,000 common shares valued at \$105,000 (See table below). During 2009, 1,500,000 warrant conversion features on the Series J notes, valued at \$60,000, expired as per the terms of the notes.

- g) During the year ended December 31, 2005, the Company issued Series I secured subordinated notes with a face value of \$1,200,000. The Series I notes were issued to private investors including an amount totaling \$110,000 issued to four directors and officers of the Company. The Series I notes had a maturity date of

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September 12, 2010, an annual interest rate of 11 percent and were convertible into equity units at a price of \$0.15 per unit. Interest for the first year was payable in shares with the provision that the total number of shares issued as interest payment cannot exceed 974,000 shares. Any of the first year interest not paid through the issuance of shares shall be paid in cash. Interest payable for the remaining term of the notes was payable in cash upon the earlier of maturity and conversion. Each equity unit consisted of one common share and one share-purchase warrant with an exercise price of \$0.20. The warrants expired on September 12, 2010. The Series I notes are secured by a general security agreement on the assets of the Company, subordinated to the security claims provided to the holders of previously issued notes.

As required by Canadian GAAP, the Company separated the liability and equity components of the Series I secured subordinated notes. The Company determined the fair value of the liability component of the Series I notes by calculating the present value of the associated cash flows, using a discount rate that reflects the Company's underlying rate of borrowing. The Company determined the fair value of the conversion feature at the issue date of the Series I notes using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the liability component of the notes and the conversion features of the units, comprised of shares and attached warrants, was \$280,000, \$472,000 and \$448,000, respectively. The liability component was to be accreted to \$1,200,000 over the term of the Series I notes through the recording of a non-cash interest expense until such date at which the underlying notes are converted into common shares.

Financing costs in the amount of \$137,000 were incurred in the issuance of the Series I notes. A portion of these financing costs, in the amount of \$32,000 attributed to the liability component of the notes was allocated to deferred charges. The remaining financing costs of \$105,000 attributed to the equity portions of the notes were recorded as a reduction to the conversion feature on secured subordinated notes amount within shareholders' deficiency.

In addition to the financing costs described above, the Company issued to the financing agent, PowerOne Capital Markets Limited ("PowerOne"), an option to purchase up to 747,000 equity units at a purchase price of \$0.15 per unit. The option expires on September 12, 2010. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.20. The share-purchase warrants expire on September 12, 2010. Using the Cox-Rubinstein binomial valuation model, the Company has determined the fair value of these equity units to be \$193,000 and included this amount in other options. The portion of the fair value of this option, in the amount of \$45,000, attributable to the liability component of the notes was allocated to deferred charges. The remaining portion, in the amount of \$148,000, attributable to the equity components of the notes was recorded as a reduction to the conversion feature on secured subordinated notes amount within shareholders' deficiency. These options were exercised by PowerOne during the year ended December 31, 2009 (See Note 14).

During the year ended December 31, 2006, \$900,000 (face value) of the Series I notes (book value of \$291,000) were converted into 6,000,000 equity units represented by 6,000,000 common shares valued at \$257,000 and 6,000,000 warrants valued at \$243,000.

During the year ended December 31, 2009, the remaining \$300,000 (face value) of the Series I notes (book value of \$197,000) were converted into 2,000,000 equity units represented by 2,000,000 common shares valued at \$86,000 and 2,000,000 warrants valued at \$81,000.

- h) During the year ended December 31, 2010, the Company recorded cash interest expense aggregating \$154,000 (2009 - \$260,000, 2008 - \$335,000) and interest accretion of \$160,000 (2009 - \$508,000, 2008 - \$394,000).
- i) As at December 31, 2010, accrued liabilities include \$62,000 (2009 - \$53,000) of unpaid interest payable relating to the secured subordinated notes.

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- j) The following summarizes the change in the face and carrying values of the liability and equity components of the secured subordinated notes.

Secured Subordinated Notes (liability component)	2010		2009	
	Face Value	Carrying Value	Face Value	Carrying Value
	(in thousands)			
Opening balance	\$ 1,105	\$ 446	\$ 3,638	\$ 1,855
Accreted (non-cash) interest	-	161	-	508
Issuance of notes:				
Series K-Extension (Note 8 (e))	-	-	1,020	625
Conversion of notes:				
Series M (Note 8 (c))	-	-	(678)	(127)
Series L (Note 8 (d))	(145)	(46)	(20)	(6)
Series K-Extension (Note 8 (e))	-	-	(1,020)	(797)
Series K (Note 8 (e))	-	-	(290)	(271)
Series J (Note 8 (f))	-	-	(225)	(124)
Series I (Note 8 (g))	-	-	(300)	(197)
Maturity of notes:				
Series K (Note 8 (e))	-	-	(1,020)	(1,020)
Closing balance	\$ 960	\$ 561	\$ 1,105	\$ 446

Conversion Features on Secured Subordinated Including Conversion of Attached Warrants	2010		2009	
	Common Shares Issuable	Carrying Value	Common Shares Issuable	Carrying Value
	(in thousands of shares and dollars)			
Opening balance	22,100	\$ 779	67,537	\$ 2,280
Issuance of notes:				
Series K-Extension (Note 8 (e))	-	-	8,500	395
Conversion of notes:				
Series M (Note 8 (c))	-	-	(26,760)	(554)
Series L (Note 8 (d))	(2,900)	(112)	(400)	(15)
Series K-Extension (Note 8 (e))	-	-	(8,500)	(395)
Series K (Note 8 (e))	-	-	(2,417)	(131)
Series J (Note 8 (f))	-	-	(1,500)	(105)
Series I (Note 8 (g))	-	-	(4,000)	(167)
Expiry of conversion features:				
Series M (Note 8 (c))	-	-	(360)	(7)
Series K (Note 8 (e))	-	-	(8,500)	(462)
Series J (Note 8 (f))	-	-	(1,500)	(60)
Closing balance	19,200	\$ 667	22,100	\$ 779

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### 9. INCOME TAXES

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, a future tax asset is recorded based upon tax losses carried forward and differences in tax and accounting values in the Company's assets and liabilities. The tax asset is reduced by a valuation allowance to the extent that it is more likely than not that the asset would not be realized. The valuation allowance is reviewed and adjusted as appropriate for each reporting period. At December 31, 2010 and 2009, the Company established the valuation allowance at 100 percent of the future tax asset.

	2010	2009
	(in thousands)	
FUTURE TAX ASSET		
Tax losses carried forward	\$ 6,465	\$ 7,348
Difference in tax and accounting valuations for capital assets and investments	124	53
	6,589	7,401
Valuation allowance	(6,589)	(7,401)
Future tax asset	\$ -	\$ -

The provision for income taxes differs from the amount computed by applying the combined Canadian Federal and Provincial statutory income tax rate of 31 percent (2009 – 33 percent) to the loss from continuing operations before income taxes. The sources and tax effects of the differences are indicated below.

	2010	2009
	(in thousands)	
PROVISION FOR INCOME TAXES		
Income taxes at statutory rate	\$ (905)	\$ (795)
Change in enacted rates	123	1,258
Non-deductible interest on subordinated notes	50	167
Stock-based compensation not deductible for tax	111	60
Write-down of investment	169	-
Expiry of tax loss carry-forwards	1,297	-
Other	(33)	41
	812	731
Change to valuation allowance	(812)	(731)
Provision for income taxes	\$ -	\$ -

Tax loss carry-forwards at December 31, 2010 expire as follows:

<u>Year</u>	<u>Amount</u> (in thousands)
2014	\$ 3,047
2015	3,351
2026	2,588
2027	2,050
2028	1,969
2029	1,700
2030	1,897
Tax loss carry-forwards that do not expire	9,259
	<u>\$ 25,861</u>

The Company has net operating loss carry-forwards of \$16,602,000 that expire in years 2014 through 2030, and indefinite loss carry-forwards of \$9,259,000. The indefinite loss carry-forwards are comprised of net capital losses from continuing Canadian operations of \$4,151,000 and from discontinued operations of \$5,108,000, which are available to reduce future year's capital gains.

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### 10. SHARE CAPITAL

- a) **Authorized**  
 Unlimited number of common shares  
 Unlimited number of preference shares – issuable in series

b) **Outstanding Common Shares**

	2010		2009		2008	
	Number	Amount	Number	Amount	Number	Amount
	(in thousands of shares and dollars)					
Opening balance	159,353	\$110,238	109,527	\$104,676	108,287	\$104,495
Shares issued pursuant to:						
Conversion of debentures (Note 8)	1,450	107	28,177	2,561	400	55
Payment of interest (Note 10 (c))	232	48	1,068	184	979	147
Warrants exercised (Note 12 (b))	1,083	209	13,200	1,560	-	-
Stock options exercised (Note 13 (d))	45	7	280	73	-	-
Other options exercised (Note 14)	-	-	747	233	-	-
Issuance of treasury shares (Note 4)	-	-	3,750	544	-	-
Equity private placements (Note 10 (d))	10,007	153	2,604	407	-	-
Shares cancelled (Note 7 (d))	-	-	-	-	(139)	(21)
Closing balance	172,170	\$110,762	159,353	\$110,238	109,527	\$104,676

In addition to the above, the conversion of the remaining secured subordinated notes would result in the issuance of 3,600,000 (2009 – 5,050,000) common shares for Series L notes and 6,000,000 (2009 – 6,000,000) common shares for Series N notes.

c) **Payment of Interest**

During the year ended December 31, 2010, accrued interest in the amount of \$48,000 relating to Series L notes was settled through the issuance of 232,000 common shares based on an average fair value of \$0.21 per share.

During the year ended December 31, 2009, accrued interest in the amount of \$184,000 relating to Series K and L notes was settled through the issuance of 1,068,000 common shares based on an average fair value of \$0.17 per share.

During the year ended December 31, 2008, accrued interest in the amount of \$147,000 relating to Series K notes was settled through the issuance of 979,000 common shares based on an average fair value of \$0.15 per share.

d) **Equity Private Placements**

On December 22, 2010, the Company completed a transaction resulting in the issuance of 7,816,000 equity units, priced at \$0.08 per unit, for net proceeds of \$625,000. Each unit consists of one common share and one share-purchase warrant. Each warrant may be converted into a common share at the exercise price of \$0.12 at any time prior to December 22, 2012.

The Company determined the fair value of the common shares and warrants at the issue date using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the 7,816,000 common shares and 7,816,000 warrants, was \$461,000 and \$164,000, respectively.

On June 16, 2010, the Company entered into an agreement with GEM Global Yield Fund Limited (“GEM”) for a \$6,000,000 equity line of credit. The Company will control the timing and maximum amount of any draw downs under this facility, and has the right, not the obligation, to draw down on available funds by requiring GEM to subscribe for the Company’s common shares at a 10 percent discount to the average closing price of the Company’s common shares over a 15 day trading period

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following the draw down notice date, provided that the Company's share price during the notice period is greater than the floor price of \$0.17 per share as defined in the agreement. GEM will hold freely trading shares of the Company through a share lending facility provided by a current shareholder. As part of the equity credit line transaction, the Company has agreed to issue 6,000,000 warrants to GEM. The warrants are exercisable for a period of three years from the closing notice date at an exercise price of \$0.27 per share. The warrants are not issuable until the first draw down of funds have occurred.

In connection with the equity line of credit, Northcore incurred direct transaction costs totaling \$129,000, which consisted primarily of management fees owing to a party related to GEM and legal fees. Any other transaction costs, which do not directly relate to the issuance of shares, are expensed in general and administrative expenses as incurred.

On August 9, 2010, the Company closed an equity transaction with GEM, securing gross proceeds of \$383,000 and net cash proceeds of \$300,000 after deducting legal fees and one half of the commitment fee of \$90,000. In connection with the transaction, the Company issued 2,191,000 common shares and 6,000,000 share-purchase warrants with an exercise price of \$0.27 and an expiry date of August 9, 2013.

The Company determined the fair value of the warrants at the issued date using the Cox-Rubinstein binomial valuation model. As a result of the transaction, the Company recorded \$562,000 to Warrants, with an offsetting reduction to Share Capital. In addition, the deferred transaction costs in the amount of \$129,000 were recorded as a corporate transaction cost and a reduction to Share Capital.

On September 30, 2009, the Company completed a transaction resulting in the issuance of 2,604,000 equity units, priced at \$0.19 per unit, for net proceeds of \$495,000. Each unit consists of one common share and one-half common share purchase warrant. Each full warrant may be converted into a common share at the exercise price of \$0.25 at any time prior to September 30, 2011.

The Company determined the fair value of the common shares and warrants at the issue date using the Cox-Rubinstein binomial valuation model. The resulting pro rata fair values of the 2,604,000 common shares and 1,302,000 warrants, was \$407,000 and \$88,000, respectively.

e) **Loss Per Share**

The following table sets forth the computation of basic and diluted loss per share.

	2010	2009	2008
	(in thousands, except per share amounts)		
<b>Numerator:</b>			
Loss for the year	\$ (2,918)	\$ (2,409)	\$ (2,355)
<b>Denominator:</b>			
Weighted average number of shares outstanding, basic and diluted	162,899	140,434	108,861
Loss per share, basic and diluted	\$ (0.018)	\$ (0.017)	\$ (0.022)

For each fiscal year, the Company excluded the effect of all convertible debt, stock options and share-purchase warrants in the determination of diluted loss per share, as their impact would have been anti-dilutive.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### 11. CONTRIBUTED SURPLUS

- a) The following table summarizes the transactions within contributed surplus.

	2010	2009
	(in thousands)	
Opening balance	\$ 3,071	\$ 2,161
Allocation of recorded value of expired warrants (Note 11 (b))	391	266
Allocation of recorded value of expired conversion features on secured subordinated notes (Note 11 (c))	-	528
Allocation of recorded value of expired stock options (Note 13 (c))	-	116
Closing balance	\$ 3,462	\$ 3,071

- b) During the year ended December 31, 2010, \$391,000 (2009 - \$266,000) related to expired warrants was allocated from warrants to contributed surplus (See Note 12 (c)).
- c) During the year ended December 31, 2009, \$528,000 related to expired conversion features on secured subordinated notes was allocated to contributed surplus (See Note 8).

### 12. WARRANTS

- a) The following table summarizes the transactions within warrants.

	2010		2009	
	Number	Amount	Number	Amount
	(in thousands of warrants and dollars)			
Opening balance	10,249	\$ 492	10,783	\$ 510
Warrants issued pursuant to:				
Conversion of debentures (Note 8)	1,450	51	15,400	328
Equity private placement (Note 10 (d))	13,816	726	1,302	88
Exercise of other options (Note 14)	-	-	747	72
Warrants exercised (Note 12 (b))	(1,083)	(39)	(13,200)	(240)
Warrants expired (Note 12 (c))	(8,614)	(391)	(4,783)	(266)
Closing balance	15,818	\$ 839	10,249	\$ 492

In addition to the above, the conversion of the remaining secured subordinated notes would result in the issuance of 3,600,000 (2009 – 5,050,000) common shares-purchase warrants for Series L notes 6,000,000 (2009 – 6,000,000) common shares-purchase warrants for Series N notes.

b) **Warrants Exercised**

During the year ended December 31, 2010, Series I and L note holders exercised 1,083,000 common share-purchase warrants (book value of \$39,000) for total proceeds of \$170,000.

During the year ended December 31, 2009, the Company announced the conversion of the Series M secured subordinated notes and the exercising of the associated warrants. Series M note holders have converted \$660,000 out of a total of \$678,000 debentures and exercised a total of 13,200,000 common share-purchase warrants out of a possible 13,560,000 warrants, for total proceeds of \$1,320,000. As per the terms of the debenture, the remaining warrant options have expired (See Note 8 (c)).

As a result of this transaction, the Company issued 26,400,000 common shares, comprised of 13,200,000 common shares from the conversion of the Series M notes and 13,200,000 common shares from the exercising of the associated warrants for total proceeds \$1,320,000. Prior to the conversion, the warrants had a book value of \$240,000.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### c) Warrants Expired

During the year ended December 31, 2010, 8,614,000 Series I warrants (book value of \$391,000) expired unexercised and were accordingly cancelled.

During the year ended December 31, 2009, 3,533,000 Series I warrants (book value of \$140,000) expired unexercised and were accordingly cancelled.

During the year ended December 31, 2009, 1,250,000 warrants (book value of \$126,000) in connection with a private placement in 2005 expired unexercised and were accordingly cancelled.

## 13. STOCK OPTIONS

a) Stock options included in shareholders' deficiency are comprised of the following components:

	2010	2009
	(in thousands)	
Employees (Note 13 (b))	\$ 1,780	\$ 1,425

### b) Employee Stock Options

The Company has a stock option plan which provides for the issuance of stock options to employees, which may expire as much as 10 years from the date of grant, at prices not less than the fair market value of the common shares on the date of grant. A total of 16,550,000 options have been authorized by the Company's shareholders for issuance under the stock option plan.

The Management Resources and Compensation Committee of the Board of Directors reserves the right to determine the vesting periods to stock options granted. The options expire between 2011 and 2015.

A summary of changes in employee stock options for the two years ended December 31, 2010 and 2009 is as follows:

	2010	2009	2010	2009
	Number of Options (in thousands)		Weighted Average Exercise Price	
Opening balance	5,036	3,446	\$ 0.15	\$ 0.14
Granted	7,515	1,870	0.15	0.16
Exercised (Note 13 (d))	(45)	(280)	0.10	0.15
Cancelled	(1,560)	-	0.17	-
Closing balance	10,946	5,036	\$ 0.15	\$ 0.15
Exercisable, end of year	6,446	4,466	\$ 0.16	\$ 0.16

A summary of the status of the Company's outstanding options at December 31, 2010 is as follows:

Exercise Prices	Number of Options Outstanding (in thousands)	Remaining Contractual Life (in years)	Number of Options Exercisable (in thousands)
\$ 0.10	3,888	4.7	972
\$ 0.12	1,800	2.1	1,530
\$ 0.15	258	0.6	258
\$ 0.20	5,000	4.1	3,686
	10,946		6,446

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

The aggregate exercise price for employee options outstanding at December 31, 2010 was approximately \$1,623,000 (2009 - \$760,000, 2008 - \$496,000).

During the year ended December 31, 2010, the Company granted 7,515,000 stock options to employees, officers and directors of the Company. The options have a weighted average exercise price of \$0.15 and an expiry date of five years from the date of the grant. The weighted average grant date fair value of \$0.09 per option was valued using the Cox-Rubinstein binomial valuation model based on the below assumptions.

During the year ended December 31, 2009, the Company granted 1,500,000 stock options to employees, officers and directors of the Company. The options have a weighted average exercise price of \$0.18 and an expiry date of five years from the date of the grant. The weighted average grant date fair value of \$0.11 per option was valued using the Cox-Rubinstein binomial valuation model based on the below assumptions. Of these options, 1,300,000 options vested on the date of the grant and the remaining 200,000 options were cancelled during the year ended December 31, 2010.

During the year ended December 31, 2009, the Company granted 370,000 performance-based stock options to employees, officers and directors of the Company. The options have an exercise price of \$0.12 and an expiry date of April 30, 2014. The weighted average grant date fair value of \$0.08 per performance-based option was valued using the Cox-Rubinstein binomial valuation model based on the below assumptions. The performance-based options will vest upon the achievement of specific Company performance objectives. Of these options, 100,000 options have vested as at December 31, 2010.

During the year ended December 31, 2008, the Company granted 480,000 stock options to certain employees of the Company. The options have an exercise price of \$0.10 and expire on December 23, 2013. These options vest quarterly over a six-quarter period commencing with the quarter ended December 31, 2008.

The Company determined the weighted average fair value of employee stock option grants using the Cox-Rubinstein binomial valuation model with the following assumptions on a weighted average basis:

	2010	2009	2008
Fair value	\$0.09	\$0.11	\$0.07
Dividend yield	-	-	-
Risk free interest rate	2.63%	2.32%	1.82%
Volatility	89.10%	79.30%	73.27%
Expected term, in years	5	5	5

The Company records compensation expense for stock options granted to employees and directors based on the fair value method of accounting. For the year ended December 31, 2010, the employee stock option expense was \$358,000 (2009 - \$183,000, 2008 - \$43,000).

- c) During the year ended December 31, 2009, recorded value of \$116,000 related to expired non-employee stock options was allocated from stock options to contributed surplus.
- d) During the year ended December 31, 2010, total proceeds of \$4,000 were realized from the exercise of 45,000 stock options (book value of \$3,000) at an average exercise price of \$0.10.

During the year ended December 31, 2009, total proceeds of \$42,000 were realized from the exercise of 280,000 stock options (book value of \$31,000) at an average exercise price of \$0.15.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### 14. OTHER OPTIONS

During the year ended December 31, 2005, the Company issued to PowerOne 747,000 compensation options with a fair value of \$193,000 relating to the issuance of Series I secured subordinated notes (See Note 8 (g)). The options entitle the holder to purchase an equity unit at a purchase price of \$0.15 per unit. The options expire on September 12, 2010. Each equity unit consists of one common share and one share-purchase warrant with an exercise price of \$0.20. The share-purchase warrants expire on September 12, 2010.

On November 18, 2009, PowerOne exercised the compensation options and purchased 747,000 equity units, consisting of 747,000 common shares valued at \$121,000 and 747,000 warrants valued at \$72,000. The Company recorded total proceeds of \$112,000, which were attributed to share capital.

### 15. REVENUES

Revenues are comprised of the following:

	2010	2009	2008
		(in thousands)	
Services	\$ 332	\$ 444	\$ 454
Hosting fees	294	298	249
Royalty fees	10	17	38
	\$ 636	\$ 759	\$ 741

### 16. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

#### a) Financial Instruments

The Company has classified its financial instruments as follows:

	2010	2009
	(in thousands)	
<b>Financial Assets:</b>		
Held for trading, measured at fair value		
Cash	\$ 90	\$ 226
Loans and receivables, recorded at amortized cost		
Accounts receivable	\$ 157	\$ 253
<b>Financial Liabilities:</b>		
Other financial liabilities, recorded at amortized cost		
Accounts payable, accrued liabilities, notes payable and secured subordinated notes	\$ 1,714	\$ 1,094

The Company had neither available for sale, nor held to maturity financial instruments during years ended December 31, 2010 and December 31, 2009.

#### b) Financial Risk Factors

##### *Foreign Exchange Risk*

The Company's revenue from software licensing and related services and e-commerce enabling agreements is transacted in Canadian and U.S. dollar currencies. As the majority of the Company's revenues are realized in U.S. dollar and expenses are transacted in Canadian dollar, the appreciation of the U.S. dollar against the Canadian dollar may have a favorable impact on our results. The Company

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

does not use derivative instruments to manage exposure to foreign exchange fluctuations. During the year ended December 31, 2010, the Company incurred foreign exchange losses in the amount of \$25,000 (2009 - \$4,000, 2008 - \$16,000), which is recorded in general and administrative expenses.

### ***Interest Rate Risk***

The Company has limited exposure to fluctuations in interest rates. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

### ***Credit Risk***

Credit risk arises from the potential that a customer will fail to meet its contractual obligations under a software licensing and related services agreement or an e-commerce enabling agreement.

The Company invests its cash in investments that are of high credit quality. Given these high credit ratings, the Company does not expect any investees to fail to meet their obligations.

In 2010, one customer accounted for 69 percent (2009 – two customers accounted for 62 percent and 19 percent, respectively, 2008 – two customers accounted for 61 percent and 13 percent, respectively) of total revenues. At December 31, 2010, two customers accounted for 32 percent and 30 percent, respectively, (2009 – four customers accounted for 33 percent, 22 percent, 21 percent and 16 percent, respectively) of total accounts receivable.

The following table summarizes the aging of accounts receivable as at the reporting date.

	2010	2009
	(in thousands)	
Current	\$ 100	\$ 102
Past due (61-120 days)	45	91
Past due (> 120 days)	12	60
	\$ 157	\$ 253

The allowance for doubtful accounts recorded as at December 31, 2010 was \$nil (2009 - \$nil), as amounts past due at December 31, 2010 were subsequently collected.

### ***Fair Value***

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The Company's financial instruments carried at fair value on the balance sheet, which consists of cash, are valued using quoted market prices (Level 1). There were no financial instruments categorized in Level 2 (valuation techniques using observable market inputs) or Level 3 (valuation technique using non-observable market inputs) as at December 31, 2010.

The fair value of monetary assets and liabilities approximates amounts at which they would be exchanged between knowledgeable and unrelated persons. The amounts recorded in the consolidated financial statements approximate fair value, with the exception of the secured subordinated series L and N notes as it is not practical to determine the fair value of the notes as at December 31, 2010 considering that they are not publicly traded.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### *Liquidity Risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when due, see Going Concern (See Note 2). The Company manages its liquidity risk by continuously monitoring forecast and actual cash flows.

As at December 31, 2010, the Company's contractual obligations and financial liabilities, including interest payments due by periods over the next five fiscal years, are as follows:

(in thousands)	Carrying		2011	2012	2013	2014	2015
	Value	Total					
Notes payable	\$ 530	\$ 530	\$ 530	\$ -	\$ -	\$ -	\$ -
Secured subordinated notes - principal	561	960	600	-	360	-	-
Secured subordinated notes - interest	-	136	91	36	9	-	-
Accounts payable	404	404	404	-	-	-	-
Accrued liabilities	219	219	219	-	-	-	-
	\$ 1,714	\$ 2,249	\$ 1,844	\$ 36	\$ 369	\$ -	\$ -

## 17. CAPITAL DISCLOSURES

The Company's objective when managing capital is to safeguard its accumulated capital in order to provide adequate return to shareholders by maintaining sufficient levels of funds, in order to support and further expand upon the Company's current base of products and services.

The capital structure of the Company consists of debt, net of cash and equity comprised of issued capital, contributed surplus and deficit. The Company manages its capital structure and makes adjustments to it, based on the level of funds required to manage its operations. In order to achieve these objectives, the Company invests its excess capital in highly liquid financial instruments.

## 18. COMMITMENTS AND CONTINGENCIES

(a) Minimum payments under operating leases are as follows:

<u>Year</u>	<u>Amount</u>
	(in thousands)
2011	\$ 156
2012	156
2013	156
2014	130

(b) During the year ended December 31, 2009, the Company entered into a technology licensing agreement with a Fortune 500 company that provides Northcore with access to a portfolio of intellectual property patents over a six year period for a minimum fee of US \$260,000 over the term of the agreement.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### 19. SUPPLEMENTAL CASH FLOW INFORMATION

The following table sets forth the changes in non-cash operating working capital items resulting from the inflow (outflow) of cash in the year.

	2010	2009	2008
		(in thousands)	
Accounts receivable	\$ 96	\$ 52	\$ (186)
Deposits and prepaid expenses	(1)	(7)	11
Accounts payable	73	(239)	249
Accrued liabilities	144	(27)	342
Deferred revenue	2	(3)	(22)
	\$ 314	\$ (224)	\$ 394

The following table summarizes the non-cash financing activities of the Company.

	2010	2009	2008
		(in thousands)	
Issuance of common shares in settlement of interest payments (Note 10 (c))	\$ 48	\$ 184	\$ 147
Reduction in debt from conversion of secured subordinated notes (Note 8 (j))	(46)	(1,522)	(27)
Reduction in conversion feature from conversion of secured subordinated notes (Note 8 (j))	(112)	(1,367)	(44)
Issuance of common shares for investment in Southcore (Note 4)	-	544	-

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### 20. INVESTMENT IN JOINTLY CONTROLLED COMPANY

On September 23, 2003 the Company established a joint venture with GE Commercial Finance, with each entity holding a 50 percent interest in the joint venture. The joint venture operates under the name of GE Asset Manager, LLC. The joint business venture develops and markets asset management technology to customers in a broad range of industries. Upon the establishment of this joint venture, 1,000,000 share-purchase warrants issued by Northcore to GE vested. The fair value of these warrants of \$188,000, calculated at the vesting date, was reflected on the consolidated balance sheets as an acquired agreement. This acquired agreement was fully amortized as of December 31, 2004.

The consolidated financial statements of the Company reflect the Company's pro rata share of the joint venture's assets, liabilities, and results of operations in accordance with the proportionate consolidation method of accounting. The effect of proportionate consolidation of the joint venture on the Company's consolidated financial statements is summarized as follows:

For the years ended December 31,	2010	2009	2008
	(in thousands)		
<b>Consolidated Balance Sheets</b>			
Current assets	\$ 79	\$ 60	\$ 49
Current liabilities	(65)	(26)	(31)
Net investment	\$ 14	\$ 34	\$ 18
<b>Consolidated Statements of Operations</b>			
Operating revenue	\$ 53	\$ 86	\$ 80
Operating expenses (1)	(9)	(44)	(5)
Net income	\$ 44	\$ 42	\$ 75
<b>Consolidated Statements of Cash Flows</b>			
Operating activities	\$ 25	\$ 8	\$ (27)
Investing activities	-	-	-
Financing activities	-	-	-
Net cash inflow (outflow)	\$ 25	\$ 8	\$ (27)

(1) For the year ended December 31, 2010, operating expenses include a provision for bad debts in the amount of \$nil (2009 - \$43,000, 2008 - \$nil).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

### 21. CANADIAN AND UNITED STATES ACCOUNTING POLICY DIFFERENCES

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles as applied in Canada, which conform in all material respects with generally accepted accounting principles in the United States, except as noted below.

#### (a) Consolidated Financial Statements

##### Consolidated Balance Sheets

	2010 CDN. GAAP	2010 U.S. GAAP	2009 CDN. GAAP	2009 U.S. GAAP
	(in thousands)			
Cash	\$ 90	\$ 90	\$ 226	\$ 226
Accounts receivable	157	157	253	253
Deposits and prepaid expense	36	36	35	35
Capital assets	31	31	47	47
Other assets	-	-	544	544
Deferred charges (Note 21 (b))	-	9	-	19
Accounts payable and accrued liabilities	(623)	(623)	(492)	(492)
Deferred revenue	(29)	(29)	(27)	(27)
Current portion of notes payable	(530)	(530)	(156)	(156)
Current portion of secured subordinated notes (Note 21 (b))	(412)	(519)	-	-
Secured subordinated notes (Note 21 (b))	(149)	(335)	(446)	(880)
Shareholders' deficiency (Note 21 (b))	1,429	1,712	16	431

##### Consolidated Statements of Operations and Comprehensive Loss

	2010	2009	2008
	(in thousands, except per share amounts)		
Loss for the year as reported under Canadian GAAP	\$ (2,918)	\$ (2,409)	\$ (2,355)
Adjustments:			
Accretion of interest on secured subordinated notes (Note 21 (b))	160	508	394
Amortization of deferred charges relating to secured subordinated notes under U.S. GAAP (Note 21 (b))	(10)	(42)	(21)
Amortization of beneficial conversion feature (Note 21 (b))	(119)	(971)	(303)
Loss and comprehensive loss for the year as reported under U.S. GAAP	\$ (2,887)	\$ (2,914)	\$ (2,285)
Basic and diluted loss per share	\$ (0.018)	\$ (0.021)	\$ (0.021)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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### (b) Financial Instruments with Liability and Equity Elements

Under Canadian GAAP, the secured subordinated notes (See Note 8) are recorded based upon the relative fair values of the liability and equity components of the instruments. The liability component is accreted to the face value of the subordinated notes over the term to maturity until the underlying notes are converted into common shares. Under U.S. GAAP, upon issuance, the secured subordinated notes would have been recorded as a liability and reclassified to equity only upon conversion. Accordingly, the interest accretion of \$160,000 (2009 - \$508,000, 2008 - \$394,000) that is recorded under Canadian GAAP is reversed under U.S. GAAP.

Additionally, under Canadian GAAP, the financing costs arising from the issuance of the convertible notes are allocated between the liability and equity components of the notes. Under Canadian GAAP, the Company had previously deferred financing costs associated with the liability component of the notes and amortized them over the term of the related debt instruments. Under HB Section 3855, the carrying value of transaction costs at December 31, 2006 of \$41,000 was charged to opening deficit on transition on January 1, 2007. Under U.S. GAAP, all of the financing costs are deferred and amortized over the term of the underlying debt. As a result, the 2010 amortization expense under U.S. GAAP is \$10,000 (2009 - \$42,000, 2008 - \$21,000) compared to an amortization expense of \$nil (2009 - \$nil, 2008 - \$nil) under Canadian GAAP. In addition, the deferred financing costs are \$9,000 at December 31, 2010 (2009 - \$19,000) under U.S. GAAP as compared to \$nil (2009 - \$nil) under Canadian GAAP. Such deferred financing costs are classified as an asset under U.S. GAAP.

Furthermore, under Canadian GAAP, conversion of debt results in the allocation of any unamortized deferred financing charges associated with that debt to shareholders' deficiency. Under U.S. GAAP, such unamortized financing charges are expensed upon conversion of the associated debt. Accordingly, under U.S. GAAP, an amount of \$4,000 (2009 - \$25,000, 2008 - \$nil), representing the unamortized financing charges associated with the conversion of the Series L notes (2009 - Series I, L and M notes, 2008 - Series G), is expensed. The unamortized financing charges under Canadian GAAP, in the amount of \$nil (2008 - \$nil, 2007 - \$nil), were allocated to contributed surplus upon the conversion of the notes.

Further, under U.S. GAAP, the beneficial conversion feature represented by the excess of the fair value of the shares issuable on conversion of the subordinated notes, measured on the commitment date, over the amount of the loan proceeds to be allocated to the common shares upon conversion would be allocated to additional paid in capital. This results in a discount on the subordinated notes that is recognized as additional interest expense over the term of the subordinated notes and any unamortized balance is expensed immediately upon conversion of the subordinated notes. Accordingly, for U.S. GAAP purposes, the Company has recognized a beneficial conversion feature in the amount of \$nil (2009 - \$340,000, 2008 - \$776,000) relating to the subordinated notes during the year. An interest expense of \$119,000 (2009 - \$971,000, 2008 - \$303,000) results from the amortization of the discount over the term to maturity of those subordinated notes as well as the unamortized discount for those subordinated notes converted during the year. Canadian GAAP does not require the recognition of any beneficial conversion feature.

### (c) Investment in Jointly Controlled Company

Canadian GAAP requires the proportionate consolidation of investments in joint ventures. Proportionate consolidation is generally not permitted under U.S. GAAP; instead investments in joint ventures are accounted for in accordance with the equity basis of accounting.

Although the application of proportionate consolidation has no impact on the Company's loss or shareholders' deficiency, it does increase the amounts reported for the Company's current assets, current liabilities, revenue, expenses and cash flow from operations by the amounts disclosed in Note 20 as compared to the amounts that would otherwise be reported under U.S. GAAP. As allowed under the rules of the Securities and Exchange Commission, this difference has not been reflected in the tables of certain financial statement differences items presented above.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010, 2009 and 2008

(in Canadian dollars)

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### (d) Additional Disclosures as Required in Accordance with U.S. GAAP

U.S. GAAP requires the disclosure of accrued liabilities that exceed five percent of current liabilities. Included in accrued liabilities at December 31, 2010 are accrued interest payable of \$62,000 (2009 - \$53,000) and accrued audit fees of \$57,000 (2009 - \$99,000).

U.S. GAAP requires the disclosure of non-cash interest components incurred during the year. In 2010, the Company incurred \$119,000 (2009 - \$971,000, 2008 - \$303,000) in non-cash interest expense associated with secured subordinated notes.

### (e) Recent United States Accounting Pronouncements

In September 2009, the FASB issued Accounting Standards Update 2009-13, Revenue Arrangements with Multiple Deliverables (Topic 605), which addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. This new standard is effective for the Company's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standard on its consolidated financial statements.

In September 2009, the FASB issued Accounting Standards Update 2009-14, Revenue Arrangements That Include Software Elements (Topic 985). The new guidance is to be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. If a company elects earlier application and the first reporting period of adoption is not the first reporting period in the company's fiscal year, the guidance must be applied through retrospective application from the beginning of the company's fiscal year and the company must disclose the effect of the change to those previously reported periods. The Company is assessing the impact of the new standard on its financial statements.

## 22. SUBSEQUENT EVENT

Subsequent to the year ended December 31, 2010, the Company completed a transaction resulting in the issuance of 10,478,000 equity units, priced at \$0.08 per unit, for gross proceeds of \$838,000 and net proceeds of \$729,000 after deducting financing fees of \$84,000 and legal fees of \$25,000. Each unit consists of one common share and one share-purchase warrant. Each warrant may be converted into a common share at the exercise price of \$0.12 at any time prior to February 14, 2013. In addition, the Company issued to the financing agent, an option to purchase 2,250,000 units at a price of \$0.08 per unit at any time prior to February 14, 2013.

## DIRECTORS

T. Christopher Bulger <sup>(1), (2), (3)</sup>  
CFA, MBA  
Chairman of the Board

Duncan Copeland  
DBA  
Chief Executive Officer

Jim Moskos  
Chief Operating Officer

Rick Robertson <sup>(1), (2)</sup>  
PhD, CA, MBA  
Associate Professor of Business  
Richard Ivey School of Business,  
The University of Western Ontario

## OFFICERS

Duncan Copeland  
Chief Executive Officer

Jim Moskos  
Chief Operating Officer

## CORPORATE OFFICE

Northcore Technologies Inc.  
302 The East Mall, Suite 300  
Toronto, Ontario M9B 6C7  
1 888 287 7467

## AUDITORS

Collins Barrow Toronto LLP  
Toronto, Ontario, Canada

## SHARES OUTSTANDING

Issued: 172,169,836  
December 31, 2010

## REGISTRAR & TRANSFER AGENT

Equity Financial Trust Company  
200 University Avenue, Suite 400  
Toronto, Ontario M5H 4H1  
1 866 393 4891

## STOCK EXCHANGE LISTINGS

Toronto Stock Exchange  
• Symbol: NTI

OTC Bulletin Board  
• Symbol: NTLNF

## ADDITIONAL SHAREHOLDER INFORMATION

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(1) Member of the Audit Committee

(2) Member of the Management Resources and Compensation Committee

(3) Member of the Corporate Governance Committee

