



## **Report to Shareholders**

**Period Ended September 30, 2007**

# IMRIS

November 12, 2007

To our Shareholders,

This report marks IMRIS' first as a public company. This is a very exciting time for us, and I am pleased to report that our third quarter and nine-month period ended September 30, 2007 showed significant growth in sales and order backlog, fuelled by increasing market acceptance of our breakthrough technology.

## **Third Quarter Results Summary (compared year-over-year):**

- Sales totaled \$8.0 million, up sharply from \$0.4 million
- Gross profit was \$0.7 million, up from \$0.1 million
- Gross profit percentage was 8.8%, down from 26.3%
- Operating Expenses totaled \$3.9 million, an increase from \$2.5 million
- Net Loss of \$3.5 million, an increase from \$2.4 million

## **Nine-Month Results Summary (compared year-over-year):**

- Sales totaled \$14.0 million, up sharply from \$0.7 million
- Gross profit was \$1.8 million, up from \$0.1 million
- Gross profit percentage was 12.8%, down from 20.2%
- Operating Expenses totaled \$12.1 million, an increase from \$6.1 million
- Net Loss of \$10.5 million, an increase from \$6.2 million

## **Order Backlog as at September 30, 2007:**

- Totaled \$28.4 million, up 46% year-over-year

The growth in sales and gross profit was largely due to an increase in IMRISneuro system installations. Over the nine-month period, four of our systems have been in various stages of installation, compared with one system installation having been started in the previous year.

The decreases in gross profit percentage were primarily due to discounted prices provided to two strategic customers who have agreed to act as demonstration and visitation sites for prospective customers, as well as a \$1 million non-product related cost to provide room finishes to one of these sites. These installations include a leading adult neurological centre and a leading pediatric hospital. We believe these will provide highly credible and effective reference sites going forward.

The increases in operating expenses and net loss were mainly due to increased staffing levels as we continue to build organizational capacity across all functional areas.

The order backlog as at September 30, 2007 includes orders for two systems that are partially installed and expected to be completed in the fourth quarter of 2007 and six units that are scheduled for delivery in 2008.

Due to IMRIS being in an early growth stage and the high dollar value associated with each system sale, quarter-over-quarter revenue may vary depending on the number and nature of active projects during any given period. However, we expect overall sales and gross margin to continue to grow on an annualized basis due to our growing order backlog.



IMRIS' outlook is positive based on the strength of our current order backlog and order prospects. The recent successful completion of our IPO marks a pivotal phase in IMRIS' evolution. It will allow us to further the commercialization of our IMRISneuro products and proceed with the development of additional applications for our core technology, thereby opening new markets for the company.

Our immediate priorities are to efficiently complete customer installations on hand, convert our promising prospects into new orders and aggressively tackle our stated technology and market development initiatives. We expect that our order backlog will continue to grow as we expand our addressable markets and secure more agreements with leading hospitals around the world.

We look forward to updating you on our progress again early next year.

Yours truly,

David Graves  
Chairman, President and Chief Executive Officer

**IMRIS Inc.**  
100-1370 Sony Place  
Winnipeg, Manitoba  
Canada R3T 1N5

TF. 1.888.304.0114  
T. 204.480.7070  
F. 204.480.7071

[www.imris.com](http://www.imris.com)

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*This interim Management Discussion and Analysis ("MD&A") should be read in conjunction with the interim consolidated financial statements and related notes for the nine months ended September 30, 2007, included herein, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and presented in Canadian dollars. In this interim MD&A, the "Company", "we", "our" and "us" are used to refer to IMRIS Inc. ("IMRIS").*

*This interim MD&A contains forward-looking statements about future events or future performance and reflects management's expectations and assumptions regarding our growth, results of operations, performance and business prospects and opportunities. Such forward-looking statements reflect management's current beliefs and are based on information currently available to us. In some cases, forward-looking statements can be identified by terminology such as "may", "would", "could", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other similar expressions concerning matters that are not historical facts. In particular, statements regarding our future operating results, economic performance and product development efforts are or involve forward-looking statements.*

*A number of factors could cause actual events, performance or results, including those in respect of the foregoing items, to differ materially from the events, performance and results discussed in the forward-looking statements. In evaluating these statements, readers should specifically consider various factors, including the risks outlined under "Risks and Uncertainties", which may cause actual events, performance or results to differ materially from any forward-looking statement. Although the forward-looking statements contained in this interim MD&A are based on what management considers to be reasonable assumptions, there can be no assurance that actual events, performance or results will be consistent with these forward-looking statements, and management's assumptions may prove to be incorrect. These forward-looking statements are made as of the date of interim MD&A and we do not intend, and do not assume any obligation, to update or revise them to reflect new events or circumstances.*

*Unless otherwise indicated, this interim MD&A of our financial results for the period ended September 30, 2007 is as at November 12, 2007.*

### **Overview**

IMRIS is a medical imaging company focused on bringing magnetic resonance imaging ("MRI" or "MR imaging") to surgical procedures. Our MRI system provides near real-time images of patient anatomy to surgical teams, enabling them to make better decisions during surgical procedures with the ultimate goal of improving patient outcomes. The combination of high resolution images, improved patient safety, enhanced surgical efficiency and increased financial viability provided by our system contributes to a surgical imaging solution that we believe has not previously been available to the medical practice. Our flagship product, IMRISneuro, is an integrated neurosurgical MR imaging system which provides all of the benefits of near real-time, high-resolution MR imaging while overcoming the major limitations of other surgical MR imaging systems on the market today.

IMRIS was formed in May 2005 and at that time acquired all of the assets and assumed all of the liabilities of Innovative Magnetic Resonance Imaging Systems Inc. ("Innovative or the "Predecessor Company"). Innovative was formed to further the development of patented intra-operative MR imaging technology licensed from the National Research Council of Canada ("NRC"). These patents were assigned to us by the NRC in exchange for shares in 2005, in conjunction with our acquisition of the Innovative assets. IMRIS amalgamated with Innovative on December 31, 2005. The Company accounted for the purchase of the assets of Innovative using the purchase method.

Since the company's inception in May 2005, we have delivered six commercial systems to customers. All of these initial customers are located in the United States. In addition to these installed systems, we currently have orders for an additional seven systems, including four for delivery in the United States, one for delivery in Canada, one for delivery in India and one for delivery in China.

The systems we sell represent large capital equipment purchases for our customers and are installed over an extended period, typically ranging from five to eight months or more. Our terms of sale are such that our customers generally pay for the system in installments spread out according to a number of milestones which typically include the time of order, delivery of the equipment, completion of installation and final acceptance. Given the project-based nature of these sales, we recognize revenue and related cost of sales on a percentage-of-completion basis as a system is installed.

As a consequence of the limited number of systems sold to date and the high dollar value associated with each sale, revenue recorded from quarter to quarter may vary significantly depending on the number and nature of active projects in any given period. We expect however that our sales and gross profits will increase on an annualized basis due to our growing order backlog.

## **Summary of Selected Financial Information**

The following table sets forth selected financial information for the dates and periods indicated and should be read in conjunction with our interim consolidated financial statements and notes for the nine months ended September 30, 2007.

<b>Statement of Operations and Balance Sheet</b>						
(In CDN dollars)						
(Unaudited)						
	<b>Third quarter ended</b>			<b>Nine months ended</b>		
	<b>September 30</b>		<b>%</b>	<b>September 30</b>		<b>%</b>
	<b>2007</b>	<b>2006</b>	<b>Change</b>	<b>2007</b>	<b>2006</b>	<b>Change</b>
Sales	7,969,788	379,112	2002%	14,020,667	738,157	1799%
Cost of sales	(7,267,342)	(279,591)	2499%	(12,223,047)	(588,768)	1976%
Gross Profit	702,446	99,521	606%	1,797,620	149,389	1103%
As a percentage of sales	8.8%	26.3%		12.8%	20.2%	
Operating expenses						
Administration	1,269,775	630,522	101%	3,510,868	1,804,372	95%
Sales and marketing	736,769	558,431	32%	2,431,318	1,565,402	55%
Customer support and operations	979,915	517,436	89%	2,945,055	904,637	226%
Research and development	696,775	682,744	2%	2,507,452	1,684,344	49%
Amortization	245,133	69,209	254%	692,051	171,885	303%
	3,928,367	2,458,342	60%	12,086,744	6,130,640	97%
Loss before the following	(3,225,921)	(2,358,821)	37%	(10,289,124)	(5,981,251)	72%
Interest income (expense)	(10,780)	22,191	-149%	(40)	27,781	-100%
Amortization of finance costs	-	(12,821)	-100%	-	(38,463)	-100%
Foreign exchange (loss) gain	(222,638)	(13,818)	1511%	(211,861)	(189,805)	12%
Net income (loss) for the period	(3,459,339)	(2,363,269)	46%	(10,501,025)	(6,181,738)	70%
Basic and fully diluted earnings (loss) per share	(0.20)	(0.20)		(0.59)	(0.53)	

## **Operating Results**

### *Sales*

Sales increased by approximately \$7.6 million and \$13.3 million for the three and nine months ended September 30, 2007, respectively, as compared to the previous periods. The increase in revenues for the third quarter and nine months to date was attributable to an increase in IMRISneuro system installations. During the current year we have had four systems in various phases of installation versus one system installation having been started in the previous year.

Sales for the current year included \$13.6 million of revenues associated with new IMRISneuro system installations and \$0.4 million of revenues associated with extended maintenance services.

### *Gross Profit*

Gross profit increased by approximately \$0.6 million and \$1.6 million for the three and nine months ended September 30, 2007, respectively, as compared to the previous period. This increase was attributable to the ramp-up in system installations detailed under *Sales*.

Gross profit, as a percentage of sales, decreased from 26.3% to 8.8% and 20.2% to 12.8% for the three and nine months ended September 30, 2007, respectively, as compared to the previous period. This decrease in gross profit percentage was primarily due to discounted prices provided to two strategic customers who have agreed to act as demonstration and visitation sites for prospective customers and a \$1 million non product related loss recorded in the third quarter on the installation of room finishes for one of these customers. These installations include a leading adult neurological center and a leading pediatric hospital and will provide us with highly credible reference sites to showcase our IMRISneuro product to prospective customers.

### *Operating expenses*

Operating expenses for the third quarter 2007 were approximately \$3.9 million, an increase of approximately \$1.5 million or 60% over the third quarter 2006. Operating expenses were \$12.1 million for the nine months ended September 30, 2007, an increase of approximately \$6.0 million or 97% higher as compared to the first nine months of 2006. The third quarter and year to date increases are reflected across all major functional areas of the company including administration, sales and marketing, customer support and operations, and, research and development. A substantial amount of the increases in these departmental expenses is attributable to increased staff levels. We have expanded our teams in all functional areas to address growth in demand for our products.

At the departmental level, administrative expenses increased by approximately \$1.7 million from \$1.8 million in 2006 to \$3.5 million in 2007 for the nine month period ended September 30. This increase is primarily comprised of increased staff related expenses of approximately \$0.8 million relating to increased salary and benefit costs as well as higher recruiting costs; increased occupancy costs of approximately \$0.5 million relating to the relocation of company operations to a larger facility; increased professional fees of approximately \$0.5 million associated with our SAP implementation and the costs associated with the defense of a lawsuit which has been settled.

Sales and marketing expenses increased by approximately \$0.8 million from \$1.6 million in 2006 to \$2.4 million in 2007 for the nine month period ended September 30. This increase can be entirely attributed to the increase in sales staff and the opening of our sales office in China.

Customer support and operations expense increased by approximately \$2.0 million from \$0.9 million in 2006 to \$2.9 million in 2007 for the nine month period ended September 30. A substantial amount of this increase relates to the addition of staff to meet the ramp-up in production and system installations.

Research and development expenses, before deducting related investment tax credits, were approximately \$2.7 million in the nine month period ending September 2007, an increase of approximately \$0.9 million over the prior year. A substantial amount of this increase relates to the addition of staff to support the commercialization of the IMRISneuro and the early development work on our IMRIScardio system. During the nine months ended September 2007 we recorded \$0.2 million of research and development tax credits versus \$0.1 million in 2006, reducing our net research and development expenses to \$2.5 million for the nine months to date to as compared to \$1.7 million in the prior year period.

Amortization expense increased by approximately \$0.5 million from \$0.2 million in 2006 to 0.7 million in 2007 for the nine month period ended September 30, 2007. The increased amortization expense results primarily from the addition of an IMRISneuro test lab and a customer demonstration suite in mid 2006.

### *Net loss for the period*

Our net loss increased by \$1.1 million and \$4.3 million for the three and nine month periods ended September 30, 2007, respectively. The year to date loss for the period widened from approximately \$6.2 million to \$10.5 million principally as a result of the ramping up of staffing levels as the Company accelerated its commercialization efforts.

## Liquidity and Capital Resources

Our principal capital needs are for funding scientific research and development activities, supporting our sales and marketing activities and funding capital expenditures and working capital. The Company has financed its cash requirements primarily through issuances of securities, advance deposits from customers associated with new customer orders, and scientific research and development investment tax credits.

We had cash or cash equivalents of \$nil as at September 30, 2007, representing a decrease of approximately \$2.9 million from the balance of \$2.9 million at the beginning of the year. The decrease in cash occurred primarily due to the loss in the first nine months of the year of approximately \$10.5 million, which more than offset the \$8.8 million of additional capital raised through the exercise of warrants to purchase common shares and the issuance of additional common shares.

We believe that the completion of our initial public offering (the "Offering") on November 2, 2007, which provided \$35,940,000 in additional share capital (net of related brokerage commissions and expenses of the Offering), will provide IMRIS with sufficient capital resources over the near- to medium-term to continue our efforts to develop the market for our IMRISneuro products, to develop and launch our IMRIScardio products, to build the sales pipeline for our products and to fund our general corporate and working capital needs.

The following table sets forth the summary statement of cash flows for the dates and periods indicated and should be read in conjunction with our interim consolidated financial statements and notes for the nine months ended September 30, 2007.

Statement of Cash Flows (In CDN dollars) (Unaudited)	Third quarter ended			Nine months ended		
	September 30			September 30		
	2007	2006	Change	2007	2006	Change
Cash flows:						
From Operating Activities	(422,582)	(1,299,218)	876,636	(10,319,609)	(1,297,830)	(9,021,779)
Used in Financing Activities	(639,751)	3,497,141	(4,136,892)	8,052,385	3,495,137	4,557,248
Used in Investing Activities	(113,626)	(327,454)	213,828	(645,470)	(501,852)	(143,620)
Net increase (decrease)	(1,175,959)	1,870,469	(3,046,428)	(2,912,694)	1,695,457	(4,608,151)
Cash and Cash Equivalents, opening	1,175,959	680,178		2,912,694	855,190	
Cash and Cash Equivalents, closing	-	2,550,647	(2,550,647)	-	2,550,647	(2,550,647)

### Operating Activities

The cash used in operating activities was approximately \$0.4 million for the third quarter and \$10.3 million year to date. The cash used in the third quarter was comprised of the operating loss for the quarter of approximately \$3.5 million mostly offset by a net increase in working capital of \$2.6 million. The net increase in working capital relates to an increase in customer deposits for recent order commitments and an increase in accrued liabilities recorded for costs related to the Offering and the anticipated loss on a specific system installation.

The cash used year to date primarily reflects the operating loss of approximately \$10.5 million.

### Financing Activities

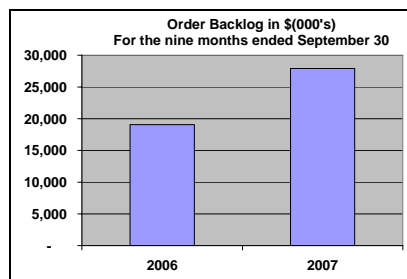
Cash used in financing activities was approximately \$0.6 million for the third quarter which was comprised of deferred charges relating to costs incurred in connection with the Offering partially offset by funds provided from the Company's operating facility.

Cash provided from financing activities was approximately \$8.1 million year to date which was primarily comprised of common share issuances totaling approximately \$8.8 million partially offset by deferred charges incurred in the third quarter. Proceeds from share issuances have been used to fund the Company's operating losses and working capital requirements.

## Investing Activities

The cash used in investing activities was approximately \$0.1 million for the third quarter and \$0.6 million year to date representing capital equipment purchases for operations and research and development.

## Order Book



For order book purposes, the order backlog is defined as the unrecognized portion of the expected revenues from confirmed system sales including systems in the process of being installed and systems to be installed.

During the third Quarter 2007 we received orders for an additional three IMRISneuro systems increasing our order backlog to \$28.4 million as at September 30, 2007 as compared to \$19.5 million as at September 30, 2006. The current order backlog includes orders for two systems which are partially complete and that are expected to be completed in the fourth quarter of 2007 and orders for six systems which are scheduled for delivery in 2008. Management anticipates that the order backlog will continue to grow over the next several quarters as the Company continues to expand its addressable market and converts several expressions of interest into orders.

## Long-term Debt and Contractual Obligations

### NRC IRAP

	September 30, 2007	December 31, 2006
Long-term debt	\$245,837	\$385,466

The Predecessor Company had received \$495,000 under the NRC Industrial Research Assistance Program (“NRC IRAP”) for certain research and development activities. This debt facility was assumed by the Company at the time of the acquisition of Innovative’s assets in 2005. The loan facility is unsecured, non-interest bearing and repayable quarterly at a rate of 1% of gross revenues for the preceding quarter until January 31, 2008. The principal payments may exceed the original contribution amount to a maximum of 150% of the original contribution, or \$742,500 over this period.

In the event that the total amounts repaid on the loan by January 31, 2008 exceed the original contribution amount, there shall be no further amount owing. In the event that the loan has not been fully repaid by January 31, 2008, the term will be extended for a maximum of seven years with the same method of repayment, except that the total principal repayments shall not exceed the original contribution amount.

## Lease Commitments

We have lease commitments in respect of office and manufacturing space as set out below:

	<b>Current Facility</b>	<b>Previous Facility</b>	<b>Total</b>
2007	100,688	18,056	118,744
2008	402,754	72,224	474,978
2009	402,754	60,187	462,941
2010	402,754		402,754
2011	428,858		428,858

During the 2006 year we moved to a new facility. While we still have lease commitments for our previous facility, we have sublet this space to a third party for terms similar to those in the original lease agreement.

## Outstanding Share Data

The following table sets forth our outstanding share data as at the dates given:

	Authorized	September 30, 2007	November 2, 2007 after giving effect to the Initial Public Offering
Common shares	unlimited	\$27,035,019 (20,681,346 common shares)	\$62,975,020 (27,348,013 common shares)
Preferred shares	unlimited	Nil	Nil
Contributed surplus	-	\$287,984	\$287,984

Pursuant to the Initial Public Offering of October 26, 2007, the Company received \$40,000,002 in gross proceeds through the issuance of 6,666,667 common shares at a price of \$6.00 per share. Costs relating to the offering, including underwriter fees, are estimated to be \$4,060,000.

As at September 30, 2007 a total of 3,604,800 stock options were outstanding under the Company's stock option plan. Immediately following the closing of the Offering, the board of directors of the Company indicated the following intentions: (i) to exchange the outstanding and unvested options to purchase 1,000,000 common shares at \$2.25 per share held by the Chief Executive Officer, for fully vested options to purchase 100,000 common shares at \$6.00 per share, and (ii) to issue a new option to the Chief Executive Officer to acquire 400,000 common shares at \$6.00 per share on vesting terms consistent with the Company's stock option plan (provided that said options will vest fully in the event of a change of control). After giving effect to this adjustment, there will be outstanding options granted pursuant to the plan to purchase an aggregate of 3,104,800 common shares.

## Financial Instruments

Our financial instruments consist of cash and cash equivalents, short-term investments, accounts and other receivables, accounts payable, accrued liabilities and long-term debt.

We are subject to credit risk with respect to our accounts receivable to the extent debtors do not meet their obligations and foreign exchange risk with respect to financial instruments denominated in a currency other than the Canadian dollar.

## Related Party Transactions

We lease air travel time from 5343381 Manitoba Ltd., a company which is wholly owned by Centara Corporation, a major shareholder of IMRIS. The amount charged to travel expenses with respect to transactions conducted on a cost recovery basis

with this related party during the nine month period in 2007 was \$407,883 (\$307,314 during the prior year) and the amount charged to deferred share issuance costs was \$35,799 (\$nil in the prior year).

As at September 30, 2007, the balance payable to this related party was \$206,297 (\$240,000 as at December 31, 2006).

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Among the accounting estimates described in the notes to the financial statements, we consider the accounting estimates used in the determination of recognized revenues, the calculation of investment tax credits receivable, the value of goodwill and the valuation of stock options to be critical. Our results as determined by actual events could differ materially from the previously mentioned estimates.

### *Revenue recognition*

We recognize revenues for our system sales on a percentage-of-completion basis as the system is installed. The percentage-of-completion is determined by the ratio of actual costs incurred to date to the estimated cost of completion for the project. In the event that the actual costs of completion differ from the estimated cost we have used in determining the percentage-of-completion, recognized revenues may be over or under-estimated until all costs have been incurred and the project is complete. Funds received from our customers in advance of meeting the criteria for recognition of revenues are recorded as customer deposits until the revenue is recognized. Revenues recognized in advance of the criteria for invoicing to our customer are recorded as unbilled receivables. Accordingly, the reported amounts shown on the balance sheet under customer deposits or unbilled receivables may be over or understated.

### *Investment tax credits*

The Company is entitled to Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible current and capital research and development expenditures incurred in each taxation year. Investment tax credits are recognized when realization of the tax credits is reasonably certain either as an item on the statement of operations or a reduction in deferred development costs depending on where the original costs which give rise to the credits have been recorded. The estimated amounts receivable that we record are subject to audit by the Canada Revenue Agency and therefore the actual amounts received may differ from our estimate.

### *Value of goodwill*

We recorded goodwill on the purchase of the assets of Innovative. The value of goodwill is tested for impairment annually or more frequently if an event or circumstance occurs which we feel may result in an impairment of the value of goodwill.

### *Stock based compensation plan*

From time to time we issue stock options to employees, directors, officers or consultants. We have adopted the recommendations of Section 3870 of the Canadian Institute of Chartered Accountants' Handbook, "Stock Based Compensation and Other Stock Based Payments". Options granted to employees are valued at the grant date using the Black-Scholes option pricing model which requires management to make assumptions as to volatility, exercise date and vesting. The value of the options is expensed over the estimated life of the option. Options granted to non-employees are valued at the grant date using the Black-Scholes option pricing model. The options are expensed at the time the goods are received or services performed, or over the vesting period.

## **Changes in Accounting Policies**

As described in Note 2 of the interim consolidated financial statements for the three and nine month periods ended September 30, 2007, the Canadian Institute of Chartered Accountants (CICA) issued Section 3855 Financial Instruments – Recognition and Measurement; Section 3861 Financial Instruments – Disclosure and Presentation; Section 1530 Comprehensive Income; and Section 3865 Hedges. The Company adopted the new accounting standards as policy effective January 1, 2007. The changes in accounting policy were applied in accordance with transitional provisions contained in each of the applicable sections.

The Financial Instrument standards provide guidance on the recognition, measurement and classification of financial assets and liabilities. These standards also require all derivatives be recognized on the balance sheet at their fair value and specifies how financial instrument gains and losses are to be presented. The Company has identified all financial instruments currently being utilized and disclosed accordingly in Note 2. This classification of certain balance sheet accounts had no impact on the Company's financial statements.

The Comprehensive Income section establishes standards for the presentation and disclosure of items in comprehensive income which will be recorded as a component of shareholders' equity. The Company does not have any items that required separate recognition as other comprehensive income and therefore the adoption of this section had no impact on the Company's financial statements.

The Hedges section establishes new accounting standards on when and how hedge accounting may be applied. The Company currently does not use derivative instruments and therefore the adoption of this section had no impact on the Company's financial statements.

## **Risks and Uncertainties**

The operating results, business prospects and financial position of the Company are subject to a number of risks and uncertainties. If any of the following events described as risks or uncertainties actually occurs, our business, prospects, financial condition and operating results would likely suffer, possibly materially. In that event, the market price of our common shares could decline and investors may lose all or part of their investment. Additional risks and uncertainties presently unknown to us, or that we believe not to be material at this time, may also impair or have a material adverse effect on our operations.

### *Long sales cycle, high unit price and limited quarterly installations*

The high unit price of the IMRISneuro system, as well as other factors, may contribute to substantial fluctuations in our quarterly operating results and share price. The purchase and installation of an IMRISneuro system represents a significant capital project for our customers. Due to the relative size and complexity of these projects, our sales process requires that we engage with a number of different stakeholders within and outside the hospital to assist in making a strong clinical and business case for the IMRISneuro system. This includes neurosurgeons, radiologists, facilities managers, hospital administrators and other hospital staff. As a result, the sales cycle associated with the marketing of our systems is both complex and lengthy, with an average sales cycle of more than twelve months from initial customer engagement to our receipt of a purchase order.

Because of the high unit price of the IMRISneuro system and the relatively limited number of units installed each quarter, each installation currently represents a significant component of our revenue for a particular quarter. If we lose a single customer order or if customers defer installation of an IMRISneuro system for even a short period of time, recognition of a significant amount of revenue may be lost or deferred to a subsequent period.

We are also exposed to sizeable credit risk should any one customer default on payment. Our receivables as at September 30, 2007 include balances from two individual customers who respectively account for 78% and 20% of our combined accounts receivables and unbilled receivables balances. If even a small number of customers were to default on their payments, it could have a material adverse affect on our operations and cash flow.

Because our operating costs are relatively fixed, our inability to recognize revenue in a particular quarter may adversely affect our profitability in that quarter. In addition, while we believe that our backlog of orders provides a better measure at any particular point in time of the long-term performance prospects of our business than our quarterly operating results, investors may attribute significant weight to our quarterly operating results, which may result in substantial fluctuations in our share price.

For the year ended December 31, 2006, one customer accounted for 96% of our revenue from system sales. For the nine months ended September 30, 2007, four customers accounted for 95% of our revenue from system sales. We expect that revenues from a limited number of new customers will account for a large percentage of total revenues in future quarters. Our ability to attract new customers will depend on a variety of factors, including the capability, safety, efficacy, ease of use, price, quality and reliability of our products and effective sales, support, training and service. The loss or delay of individual orders could have a significant impact on revenues and operating results. Our failure to add new customers that would make significant purchases of our products would reduce our future revenues.

If we are unable to fulfill our current purchase orders and other commitments on a timely basis or at all, our ability to generate revenue could be impaired, market acceptance of our products could be adversely affected and hospitals may instead purchase our competitors' products. We currently have eight outstanding purchase orders (two of which are partially complete) and other commitments for our IMRISneuro systems. There can be no assurance that we will recognize revenue in any particular period or at all because some of our purchase orders and other commitments are subject to contingencies that are outside our control. In addition, these orders and commitments may be revised, modified or cancelled, either by their express terms, as a result of negotiations or by project changes or delays. The installation process for an IMRISneuro system is long and involves multiple stages, the completion of many of which is outside of our control. If we experience any failures or delays in completing the installation of these systems, our reputation would suffer and we may not be able to sell additional systems. Substantial delays in the installation process also increase the risk that a customer would attempt to cancel a purchase order. This would have a negative effect on our revenues and results of operations.

#### *Limited operating history and accumulated deficit*

We acquired all of the assets and assumed all of the liabilities of Innovative in 2005. Accordingly, we have a limited operating history from which investors can evaluate our business and prospects. We have a large accumulated deficit, we expect future losses, and we may not achieve or maintain profitability. We have incurred substantial losses since inception and we expect to incur additional operating losses for the next several years, primarily as a result of the expansion of our marketing and sales efforts, the research and development costs of our IMRIScardio solution and the additional costs of operating as a public company. The extent of our future losses and the timing of profitability are highly uncertain, and we may never achieve profitable operations. If the time required to generate significant revenues and achieve profitability is longer than anticipated, we may not be able to continue our operations. Our net loss for the year ended December 31, 2006 was \$7,955,896 and was \$10,501,026 for the nine months ended September 30, 2007. As of September 30, 2007, we had an accumulated deficit of \$22,004,679. Our prospects must be considered in light of the risks and uncertainties encountered by an early-stage company in the continuously-evolving surgical imaging market. If we cannot successfully address these risks, our business and financial condition would suffer.

#### *Lack of product diversity*

Larger companies have the ability to manage their risk through diversification. However, we currently lack diversification, in terms of both the nature and geographic scope of our business. As a result, we could potentially be more impacted by factors affecting the medical device industry in general, our IMRISneuro system in particular or the regions in which we operate than we would if our business were more diversified. Currently, our only product ready for commercialization is the IMRISneuro system. We expect to generate substantially all of our revenue for the foreseeable future from sales of the IMRISneuro system and multiyear service plans for the IMRISneuro system. If we are unable to sustain or grow sales of the IMRISneuro system, we may not generate sufficient revenue to support our business. Accordingly, we are dependent on our ability to market and sell the IMRISneuro system. Any factor materially and/or adversely affecting our ability to market and sell the IMRISneuro system or pricing and demand for the IMRISneuro system may have a material and adverse effect on our financial condition and results of operations.

#### *Dependence on suppliers*

We currently depend on Siemens to supply the MRI scanner at the core of our IMRISneuro system under an OEM re-sale agreement. Our IMRISneuro system is designed around the Siemens MRI scanner, with its associated software, diagnostic coils and controls. Our agreement with Siemens was entered into as of November 2005 for a five-year term with automatic renewal annually thereafter, subject to six months advance written notice of termination by either party. The agreement may be terminated earlier in the event of insolvency or equivalent proceedings against either party or in the event of a change of control or similar sale transaction affecting IMRIS where the buyer or controlling shareholder is a direct competitor to Siemens. If for any reason we could not obtain MRI scanners from Siemens, there is no certainty that we could find another vendor willing to supply an MRI scanner for IMRISneuro and a change in the MRI scanner would require a major redesign of the IMRISneuro system, which could take a year or more to implement. We are also dependant on Siemens to provide support and maintenance services to our customers under contract to IMRIS; if Siemens' services became unavailable, any resulting service issues could disrupt our customer relationships and cause damage to our reputation.

We purchase certain other components of our system from outside vendors, including radio-frequency shielding systems (which are required to protect the MRI scanner from radio interference), certain hardware components for our SIMS and operating room booms and lights. For the majority of our system components, we do not have long-term supply contracts with the suppliers; however, we attempt to establish dual sourcing for most of these other components of our system and we

believe that we would be able to establish alternative sources for these components, subject to any regulatory qualifications, as may be required. It is possible that a disruption of the supply of key components could result in increased costs and delays in deliveries of IMRISneuro systems, which could adversely affect our reputation and results of operations. Additionally, any transition to alternate manufacturers or suppliers would likely result in operational problems and increased expenses and could delay the shipment of, or limit our ability to provide our products. We cannot assure investors that we would be able to enter into agreements with new manufacturers or suppliers on commercially reasonable terms or at all. As a result, we may be unable to meet the demand for the IMRISneuro system, or face increased costs and delays in deliveries of IMRISneuro systems, either of which could harm our ability to generate revenue and damage our reputation. In addition, any delay in components might cause us to have insufficient spare parts to service existing installed systems, which could lead to customer dissatisfaction.

We believe it may be necessary to find alternative manufacturers for key components of the IMRISneuro system over time as our quantity and quality demands evolve, but we may not be able to identify an alternative manufacturer in a timely fashion. Any transition to alternate manufacturers or suppliers would likely result in operational problems and increased expenses and could delay the shipment of, or limit our ability to provide, our products. Furthermore, we will need to verify that any new manufacturer meets our technical specifications and maintains facilities, procedures and operations that comply with our quality requirements. We will also have to assess any new manufacturer's compliance with all applicable regulations and guidelines, which could further impede our ability to manufacture our products in a timely manner. If the change in manufacturer results in a significant change to the product, a new 510(k) clearance from the U.S. Food and Drug Administration, or FDA, or similar foreign clearance may be necessary, which would likely cause substantial delays. The occurrence of any of these events could harm our ability to meet the demand for the IMRISneuro system in a timely manner or within budget.

#### *Development of IMRIScardio and industry focus*

To date, the primary application for our surgical MR imaging system has been neurosurgical procedures. In addition to developing new neurological applications and products, we are leveraging the IMRISneuro technology platform to target a second major application area, interventional cardiovascular procedures. We intend to work with Siemens to develop the IMRIScardio system, which is aimed initially at the near real-time assessment of cardiovascular interventions. Development of IMRIScardio will require integration of our MR imaging system with a fluoroscope, appropriate modifications of our MR compatible surgical table, the development of appropriate surgical coils and other unforeseen adaptations. We cannot assure investors that we will be able to successfully develop or commercialize the IMRIScardio system, or that demand for the IMRIScardio system will meet our expectations.

In addition to neurosurgical and interventional cardiovascular procedures, we believe our products and related technologies can be applied in different medical practices and we will continue to assess other applications for our MRI system platform. We have limited financial and managerial resources and therefore may be required to focus on selected products and applications and to forego efforts with regard to other products and applications. We may fail to focus on the most profitable areas or our decisions may not produce viable commercial products and may divert our resources from more profitable market opportunities. Moreover, we may devote resources to developing products in these additional areas but may be unable to justify the value proposition or otherwise develop a commercial market for such products. In that case, the return on investment in these additional areas may be limited, potentially negatively affecting our operating results.

#### *Reliance on key personnel*

We are dependent on certain of our key employees; in particular, we are highly dependent on the members of our senior management, operations and research and development staff. The loss of one or more of these individuals could adversely affect our business. We expect to rapidly expand our operations and grow our research and development, sales and marketing and administrative operations. This expansion is expected to place a significant strain on our management and will require hiring a significant number of qualified personnel. Accordingly, recruiting and retaining such personnel in the future will be critical to our success. Although we have done so in the past and expect to be able to do so in the future, we cannot assure investors that we will be able to attract and retain skilled and experienced personnel. Competition for qualified personnel in the medical device industry is intense and finding and retaining qualified personnel with experience in our industry is very difficult. We believe there are only a limited number of individuals with the requisite skills to serve in many of our key positions and we compete for key personnel with other medical equipment and software manufacturers and technology companies, as well as universities and research institutions. It is difficult to hire and retain these persons, and we may be unable to replace key persons if they leave or fill new positions requiring key persons with appropriate experience. A significant portion of our compensation to our key employees is in the form of stock option grants. A prolonged depression in our share price could make it difficult for us to retain our employees and recruit additional qualified personnel. We do not

maintain, and do not currently intend to obtain, key employee life insurance on any of our personnel. If we fail to hire and retain personnel in key positions, we may be unable to grow our business successfully.

#### *Lack of supporting clinical data*

The effectiveness of procedures performed using the IMRISneuro system are not yet supported by long-term clinical data and the medical community has not yet developed a large body of peer-reviewed literature that supports the IMRISneuro system's safety and efficacy. Although we believe that the IMRISneuro system has advantages over competing products and technologies, we do not have sufficient clinical data demonstrating these advantages for all applications because it is relatively new. If future studies call into question the safety or efficacy of our products, our business, financial condition or results of operations could be adversely affected.

#### *Market competition and technological advances*

The medical device industry in general, and the field of surgical imaging in particular, is subject to intense and increasing competition and rapidly evolving technologies. Radiation therapy, chemotherapy and other drugs offer existing means of treating the diseases that are dealt with using surgical imaging. In addition, many government, academic and business entities are investing substantial resources in research and development of treatments and new products that may render surgical imaging obsolete, including radiation treatment, new drug treatments and gene therapy. Successful developments that result in new approaches for treatments could reduce the attractiveness of our products or render them obsolete. MRI competes with other surgical imaging technologies such as CT, fluoroscopy and ultrasound for market share in the overall surgical imaging market. The market for neurosurgical MR imaging is highly competitive, with a number of companies providing competing surgical MR systems.

Because our products often have long development and government approval cycles, we must anticipate changes in the marketplace and the direction of technological innovation and customer demands. To compete successfully, we will need to continue to demonstrate the advantages of our products and technologies over well-established alternative procedures, products and technologies, and convince neurosurgeons, cardiovascular interventionists, radiologists, facilities managers, hospital administrators, other hospital staff at various stages and other healthcare decision makers of the advantages of our products and technologies.

Our current competitors or other companies may at any time develop new surgical imaging solutions. If we are unable to develop products that compete effectively against the products of existing or future competitors, our net revenue could decline. Some of our competitors may compete by changing their pricing model or by lowering the price of their surgical imaging solutions or ancillary supplies. If these competitors' pricing techniques are effective, it could result in downward pressure on the price of our products. If we are unable to maintain or increase our selling prices in the face of competition, we may not be able to improve our gross margins.

Moreover, many of our competitors are large medical systems suppliers and have considerably greater resources at their disposal than we do in terms of technology, manufacturing, product development, marketing, distribution, sales, commercialization, capital resources and human resources. Many competitors have more experience in obtaining domestic and foreign regulatory approvals. Therefore, we cannot assure investors that we can successfully compete with present or potential competitors or that such intense competition will not have a materially adverse effect on our business, financial condition or results of operations.

In addition to the competition that we face from technologies performing similar functions to the IMRISneuro system, competition also exists for the limited capital expenditure budgets of our customers. A potential purchaser may be forced to choose between two items of capital equipment. Our ability to compete may also be adversely affected when purchase decisions are based largely upon price, since the IMRISneuro system is a premium priced system due to its greater functionality compared to traditional systems. If we are unable to market the IMRISneuro system more effectively than competing products, which could be purchased as an alternative to the IMRISneuro system using the same budget at comparable or lower prices, we may be unable to maintain our current growth rate.

#### *Patent protection and trade secrets*

Our success depends, in part, on our ability to maintain or obtain and enforce patent and other intellectual property protections for our processes and technologies, to preserve our trade secrets and to operate without infringing upon the proprietary rights of third parties or having third parties circumvent the rights that we own or license. We have obtained patents and filed applications in the United States, Canada, and internationally and may, in the future, seek additional patents or file patent

applications. Significant aspects of our technology are currently protected as trade secrets, for which we may or may not file patent applications when appropriate. There can be no assurance that patents owned or licensed by IMRIS will be valid and we may not be able to successfully obtain and enforce patents and maintain trade secret protection for our technology. We cannot assure investors that any of our pending patent applications will issue with commercially useful claims or that the inventions when built will perform as required, or that the patents granted to us will be commercially useful. Setbacks in these areas could negatively affect our ability to compete and could materially and adversely affect our business, financial condition and results of operations.

Patents may provide some degree of protection for our intellectual property; however, patent protection involves complex legal and factual determinations and is therefore uncertain. We cannot assure investors that our patents or patent applications will be valid or will issue over prior art, or that patents will issue from the patent applications we have filed or will file. Additionally, we cannot assure investors that the scope of any claims granted in any patent will provide us with adequate protection for the processes used by us currently or in the future. We cannot be certain that the creators of our technology were the first inventors of inventions and processes covered by our patents and patent applications or that they were the first to file. Accordingly, we cannot assure investors that our patents will be valid or will afford us with protection against competitors with similar technology or processes. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary information. Monitoring unauthorized use of our confidential information is difficult and we cannot be certain that the steps we take to prevent unauthorized use of our confidential information will be effective. In addition, the laws governing patent protection continue to evolve and are different from one country to the next, all of which causes further uncertainty in the usefulness of a patent. In addition, our issued patents or patents licensed to us may be successfully challenged, invalidated, circumvented or unenforceable so that our patent rights would not create an effective competitive barrier. Moreover, the laws of some countries may not protect our proprietary rights to the same extent as do the laws of the United States and Canada. Although we have attempted to obtain patent coverage for our technology where available and appropriate, there are aspects of the technology for which patent coverage was never sought nor received. There are also countries in which we sell or intend to sell our products, but have no patents or pending patent applications. Our ability to prevent others from making or selling duplicate or similar technologies will be impaired in those countries in which we have no patent protection. If we are not able to adequately protect our intellectual property and proprietary technology, our competitive position, future business prospects and financial performance will be adversely affected.

Unpatented trade secrets, technological innovation and confidential know-how are also important to our success. Although we seek to protect our proprietary information through confidentiality agreements and other appropriate means, these measures may not effectively prevent disclosure of our proprietary information, and, in any event, we cannot assure investors that others will not independently develop the same or similar information or gain access to the same or similar information. In view of these factors, our intellectual property positions have a degree of uncertainty.

### *Intellectual property litigation*

Patents issued or licensed to us may be infringed by the products or processes of others. The cost of enforcing patent rights against infringers, if such enforcement is required, could be significant, and the time demands could interfere with our normal operations. There has been substantial litigation and other proceedings regarding patent and other intellectual property rights in the medical technology industry. We may become a party to patent litigation and other proceedings. The cost to us of any patent litigation, even if resolved in our favor, could be substantial. Some of our competitors may be able to sustain the costs of such litigation more effectively than we can because of their substantially greater financial resources. Litigation may also absorb significant time and could divert our management's attention from our core business. Litigation also puts our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing. Additionally, we may provoke third parties to assert claims against us.

Furthermore, it is possible that patents issued or licensed to us may be challenged successfully by third parties in patent litigation. Patent applications which relate to or affect our business may have been filed by others and may conflict with our technologies or patent applications, this could reduce the scope of patent protection which we could otherwise obtain or even lead to refusal of our patent applications. It is also possible for others to develop products which have the same effect as our products on an independent basis or to design around the technology protected by our patents. In any event, if we are unable to secure or to continue to maintain a preferred position, our products could become subject to competition from the sale of generic or equivalent products. We could also become involved in interference proceedings in connection with one or more of our patents or patent applications to determine priority of invention.

We cannot be certain that we are the creator of inventions covered by pending patent applications or that we were the first to file patent applications for any such inventions. We cannot assure investors that our patents, once issued, would be declared by a court to be valid or enforceable, or that a competitor's technology or product would be found to infringe our products. In the event that a court was to find that we were infringing upon a valid patent of a third party, we could be required to pay a

substantial damage award, develop non-infringing technology, enter into royalty-bearing licensing agreements or stop selling our products. We cannot assure investors that we could enter into licensing arrangements at a reasonable cost, or at all, or develop or obtain alternative technology in respect of patents issued to third parties that incidentally cover our products. Any inability to secure licenses or alternative technology could result in delays in the introduction of some of our products or even lead to prohibition of the development, manufacture or sale of certain of our products.

We may be subject to claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers. As is common in the medical device industry, we employ individuals who were previously employed at other medical equipment companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

#### *Shift from research and development to commercialization*

We are shifting our focus in respect of our IMRISneuro system from research and development towards commercialization. The continued success of our commercialization efforts will depend on a number of financial, logistical, technical, legal, regulatory, competitive, economic and other factors, the outcome of which we cannot predict and some of which will be out of our control. In particular, we believe that the successful commercialization of the IMRISneuro system will be contingent upon our ability to achieve widespread adoption of the IMRISneuro system among surgeons and hospitals, maintain our relationships with our suppliers, obtain sufficient quantities of components for the IMRISneuro system, establish adequate sales and marketing capabilities, and successfully market the IMRISneuro system. Successful commercialization will also depend on whether any adverse effects result from use of the IMRISneuro system or unfavorable publicity develops in respect of the IMRISneuro system, as well as the emergence of new or existing products as competition for the IMRISneuro system that are proven to be more effective or more cost-effective. If we fail to successfully implement our commercialization plans, our revenues and profitability may be adversely affected.

We have a small sales force with limited experience selling, marketing and distributing IMRISneuro, which could impair our ability to increase revenues. If we are unable to increase our sales force significantly in the foreseeable future, we may be unable to generate the revenues we have projected in our business plan. Factors that may inhibit our sales and marketing efforts include: our inability to recruit and retain adequate numbers of qualified sales and marketing personnel; the inability of sales personnel to obtain access to or persuade adequate numbers of hospitals and physicians to purchase and use our products; unforeseen costs associated with maintaining and expanding an independent sales and marketing organization; and increased government scrutiny with respect to marketing activities in the healthcare industry.

#### *Ability to manage growth*

Our future financial performance, our ability to commercialize the IMRISneuro and IMRIScardio systems and to compete effectively will depend, in part, on our ability to manage future growth effectively. Our ability to manage growth will require us to continue to implement and improve our administrative, accounting and management systems and to recruit, integrate and train new employees, including additional management, administrative, distribution, sales and marketing personnel. Our manufacturing, assembly and installation process is complex and we must effectively scale this entire process to satisfy customer expectations and changes in demand. We also expect to increase the number of sales and marketing personnel as we expand our business. We cannot be certain that our personnel, systems, procedures and internal controls will be adequate to support our future operations. Any failure to effectively manage our growth could impede our ability to successfully develop, market and sell our products and our business may be harmed.

#### *Foreign exchange fluctuations*

We currently generate a significant portion of our sales in U.S. dollars but most of our expenses are denominated in Canadian dollars. To date, we have not used forward exchange contracts to hedge exposures denominated in U.S. dollars or any other derivative instrument for trading, hedging or speculative purposes. As such, we are exposed to fluctuations in the exchange rate between the U.S. dollar and the Canadian dollar as a result of the translation into Canadian dollars of our balance sheet and income statement items denominated in U.S. dollars.

### *Additional financing requirements*

We believe that the net proceeds from the public offering, together with our cash reserves and cash from operations, will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next two to three years. If our estimates of revenue, expenses, or capital or liquidity requirements change or are inaccurate, or if cash generated from operations is insufficient to satisfy our liquidity requirements, we may arrange additional financings. In the future, we may also arrange financings to give us financial flexibility to pursue attractive acquisition or investment opportunities that may arise, although we currently do not have any acquisitions or investments planned. We may pursue future financings through various means, including equity investments, issuance of debt, joint venture projects, licensing arrangements or other means. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms or at all. Our ability to obtain additional financing may be impaired by such factors as the capital markets, both generally and specifically in the medical device industry and the fact that we are a new enterprise without a proven operating history. If the amount of capital we are able to raise from financing activities, together with our revenues from operations, is not sufficient to satisfy our capital needs, we may not be able to develop or enhance our products, execute our business and growth plans, take advantage of future opportunities, or respond to competitive pressures or unanticipated customer requirements. If any of these events occurs, it could adversely affect our business, financial condition and results of operations. Any future equity financings that we undertake are likely to be dilutive to the existing shareholders, as we issue additional common shares. Also, the terms of securities we issue in future capital transactions may include preferences that are more favorable for our new investors.

### *Regulatory matters*

Products intended for diagnostic and therapeutic use for humans are governed by a wide array of regulatory authorities in various jurisdictions. For most of these products in most jurisdictions, applicable statutes and regulations require testing and government review and approval prior to marketing the product. This procedure can take a number of years and involves the expenditure of substantial resources. Any failure or delay by us to obtain regulatory approvals or clearances could adversely affect the marketing of any products developed by us and our ability to receive product revenue. We cannot assure investors that any of our planned products will be approved by any regulatory authority on a timely basis or at all. Also, in the event that a regulatory authority revokes any approvals granted in respect of our products, our business, financial condition and results of operations could be adversely affected. In addition, regulatory authorities in countries in which we market and sell our products have the authority to require the recall of our products in the event of material deficiencies or defects in design or manufacture or in some cases, for safety or efficacy concerns. A government mandated recall, or a voluntary recall by us, could occur as a result of component failures, manufacturing errors or design defects, including defects in labeling and user manuals. Any recall could divert management's attention, cause us to incur significant expenses, harm our reputation with customers, negatively affect our future sales and business, require redesign of the IMRISneuro system, harm our operating results, and result in a decline in our share price. In these circumstances, we may also be subject to significant enforcement action. If any of these events were to occur, our business, financial condition and results of operations could be adversely affected.

Numerous statutes and regulations govern the manufacture and sale of medical devices in the United States, Canada and other countries where we intend to market our products. In addition to the approval of products, such laws and regulations govern, among other things, the approval of manufacturing facilities, testing procedures and controlled research, manufacturing practices, marketing, advertising and labeling of products, record keeping, post-market surveillance and the reporting of adverse events. In addition, we must comply with U.S. federal and state healthcare anti-kickback laws and other healthcare fraud and abuse laws that affect the marketing of medical devices. Failure to comply with statutes and regulations administered could result in warning letters, fines and other civil penalties, unanticipated expenditures, withdrawal of regulatory approval, delays in approving or refusing to approve a product, product recall or seizure, interruption of production, operating restrictions, injunctions, criminal sanctions and exclusion from certain public health care programs. We and our suppliers are also subject to numerous federal, state, provincial and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of hazardous or potentially hazardous substances. In addition, advertising and promotional materials relating to medical devices are, in certain instances, subject to regulation by the Federal Trade Commission in the United States, Health Canada and the Competition Bureau in Canada and equivalent regulators in other jurisdictions. We and our manufacturers and suppliers may be required to incur significant costs to comply with such laws and regulations in the future, and such laws and regulations may have an adverse effect on our business. Our failure or the failure of our manufacturers and suppliers to comply with current or future regulatory requirements may have a material adverse effect on our business, financial condition or results of operations.

### *Manufacturing and development concerns*

Our in-house manufacturing operations are conducted at a single location in Winnipeg, Manitoba and any disruption at our facility could increase our expenses. We do not maintain a backup manufacturing facility and we therefore depend on our current facility for the continued operation of our business. We take precautions to safeguard our facility, including insurance, health and safety protocols, and off-site storage of computer data. However, a natural disaster could cause substantial delays in our manufacturing operations, damage or destroy our manufacturing equipment or inventory, and cause us to incur additional expenses. The insurance we maintain against natural disasters may not be adequate to cover our losses in any particular case. With or without insurance, damage to our manufacturing facility or our other property, or to any of our suppliers, due to a natural disaster or casualty event may have a material adverse effect on our business, financial condition and results of operations.

We have limited experience in manufacturing and assembling our products and may encounter manufacturing problems at our manufacturing facilities or otherwise experience manufacturing delays that could result in lost revenue. The IMRISneuro system is complex, and requires the integration of a number of components from several sources of supply. We must manufacture and assemble these complex systems in commercial quantities in compliance with regulatory requirements and at an acceptable cost. Additionally, while we believe that our manufacturing facility will be adequate for our expected growth and foreseeable future demands for the next two to three years, in order to meet our anticipated market demand after that time we will need to increase our manufacturing capacity. Increasing the manufacturing capacity of our facilities will require the investment of additional funds and the hiring and retaining of additional management and technical personnel who have the necessary manufacturing experience. We may not successfully complete any required increase in manufacturing capacity on a timely basis or at all. If our manufacturing capacity does not keep pace with product demand, we will not be able to fulfill orders in a timely manner, which in turn may have a negative effect on our financial results and overall business. Conversely, if demand for our products decreases, the fixed costs associated with excess manufacturing capacity may adversely affect our financial results.

### *Reliance on partners*

We work with a number of our customers and suppliers in designing, developing and marketing our systems. Currently, our most important strategic relationship is with Siemens, who supplies the superconducting magnet at the core of our system and with whom we work closely in connection with the sales and marketing of our IMRISneuro system. We have also signed a (non-binding) letter of intent with Siemens to develop, market, sell and service an integrated system offering for the interventional cardiovascular market. Siemens and certain of our other strategic partners are large, global organizations with diverse product lines and interests that may diverge from our interests in commercializing our products. Accordingly, our strategic partners may not devote adequate resources to our product development, or may experience financial difficulties, change their business strategy or undergo a business combination that may affect their willingness or ability to fulfill their obligations to us. The failure of one or more of our key strategic partners could have a material adverse effect on our financial condition, results of operations and cash flow. Furthermore, if we are unable to enter into additional partnerships in the future, or if our current or future partnerships fail, our ability to develop and commercialize products could be impacted negatively and our revenues could be adversely affected. There can be no assurances that we will be able to establish these strategic relationships, or, if established, that the relationships will be maintained, particularly if members of our management team leave our company.

### *Status of healthcare reimbursement*

Medical institutions will typically bill the services performed with our products to various third-party payers, such as government health administration authorities, private health coverage insurers and other organizations. Our ability to commercialize products successfully may depend in part on the extent to which reimbursement for the cost of such products and related treatments will be available. Third-party payers are increasingly challenging the price of medical products and services and instituting cost containment measures to control or significantly influence the purchase of medical products and services. Significant uncertainty exists as to the reimbursement status of newly approved healthcare products and we cannot assure investors that adequate third-party coverage will be available to establish price levels sufficient for us to realize an appropriate return on our investment in product development. In the event that our customers are unable to obtain adequate reimbursement for the use of the IMRISneuro system or other products we may develop, market acceptance of our products would be adversely affected.

Future legislative or regulatory changes to the healthcare system may affect our business. Even if third-party payers provide adequate coverage and reimbursement for procedures using our products, adverse changes in third-party payers' general

policies toward reimbursement could preclude market acceptance for our products and materially harm our sales and revenue growth, which could cause our share price to decline. Future legislative or policy initiatives directed at reducing costs could be introduced in the United States, Canada and other countries where we intend to market our products. We cannot predict the impact on our business of any legislation or regulations related to the healthcare system that may be enacted or adopted in the future.

In addition, reimbursement and healthcare payment systems in international markets vary significantly by country and, within some countries, by region. In many international markets, payment systems may control reimbursement for procedures performed using new products as well as procurement of these products. As economies of emerging markets develop, these countries may implement changes in their healthcare delivery and payment systems. Furthermore, healthcare cost containment efforts similar to those underway in the United States are prevalent in many of the other countries in which we intend to sell our products and these efforts are expected to continue. Market acceptance of our products in a particular country may depend on the availability and level of reimbursement in that country.

### *Research and development risk*

A principal component of our business strategy is to expand our product offering to fully exploit the core technologies that we have developed for IMRISneuro. As such, our organic growth and long-term success is partially dependent on our ability to successfully develop and market new products and we will likely incur significant research and development expenditures. We cannot be certain, however, that any investment in research and development will yield technically feasible or commercially viable products. Product development is subject to regulatory overview and approval at significant costs. Failure to introduce new products, or failure or delays in obtaining regulatory approval could materially and adversely affect our operations and financial condition.

Certain companies have claimed exclusive patent, copyright and other intellectual property rights to technologies in the diagnostics industry. If these technologies relate to our planned products, we would be obliged to either seek licenses to use this technology or obtain opinions of invalidity or non-infringement or appropriately redesign products. In the event that these alternatives are not possible, we may be precluded from marketing such products, which could adversely impact our revenues and financial condition.

### *Potential product liability*

Medical products involve an inherent risk of product liability claims and associated adverse publicity. We currently maintain liability insurance coverage in the aggregate amount of \$10 million. While we believe such insurance coverage to be adequate, there is no guarantee that future claims based on product liability will not exceed such amounts. In addition, should it prove impossible to obtain this type of insurance at reasonable rates or to otherwise protect us against potential liability proceedings, we could be required to cease the commercialization of products that we have developed or even be prevented from beginning the commercialization of new products. Our obligation to pay indemnities or to withdraw a product following complaints could materially and adversely affect our financial condition, results of operations and cash flow.

### *Warranty claims*

Our costs could substantially increase if we receive a significant number of warranty claims. We typically provide our customers with a one year material and workmanship warranty on their purchase of the IMRISneuro system. We have only a limited history of commercial placements from which to judge our rate of warranty claims. If product returns or warranty claims increase, we could incur unanticipated additional expenditures for parts and service. In addition, our reputation and goodwill in the surgical imaging market could be damaged. While we have established reserves for liability associated with product warranties, unforeseen warranty exposure in excess of those reserves could materially and adversely affect our financial condition, results of operations and cash flow.

### *International operations*

We are currently expanding our sales and marketing efforts to markets outside of North America. In the future, we expect international sales of our products to account for a significant portion of our revenue, which exposes us to risks inherent in international operations. To accommodate our international sales, we have and will need to further invest financial and management resources to develop an international infrastructure that will meet the needs of our customers. Accordingly, we will face additional risks resulting from our international operations including:

- difficulties in enforcing agreements and collecting receivables in a timely manner through the legal systems of many countries outside North America;

- the failure to fulfill foreign regulatory requirements to market our products on a timely basis or at all;
- availability of, and changes in, reimbursement within prevailing foreign healthcare payment systems;
- difficulties in managing foreign relationships and operations, including any relationships that we establish with foreign sales or marketing employees and agents;
- limited protection for intellectual property rights in some countries;
- fluctuations in currency exchange rates;
- the possibility that foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade;
- the possibility of any material shipping delays;
- significant changes in the political, regulatory, safety or economic conditions in a country or region;
- protectionist laws and business practices that favor local competitors; and
- trade restrictions, including U.S. prohibitions and restrictions on exports of certain products and technologies to certain nations as well as the imposition of, or significant changes to, the level of tariffs, customs duties and export quotas.

If we fail to overcome the challenges we encounter in our international operations, our business may be materially and adversely affected.

### *Unforeseen events*

Our business may be harmed by a natural disaster, terrorist attacks or other unanticipated problems. Our manufacturing and head office facilities are located in a single building in Winnipeg, Manitoba. Despite precautions taken by us, a natural disaster or other unanticipated problems at this building could interrupt our ability to manufacture our products or operate our business. These disasters or problems may also destroy our product inventories. While we carry insurance for certain natural disasters and business interruption, any prolonged or repeated disruption or inability to manufacture our products or operate our business could result in losses that exceed the amount of coverage provided by this insurance, and in such event could harm our business.

## **Outlook**

With our key technology benefits of high resolution MR images, improved patient safety, enhanced surgical efficiency and increased financial viability for hospitals, we believe that IMRIS is well-positioned to capitalize on the growing market for surgical imaging. Accordingly, we have focused our efforts to date on positioning the Company for anticipated growth in demand for our products. We have gained significant market acceptance for our IMRISneuro product suite since the formation of the company in 2005, which is best reflected in our growing sales and order backlog.

Our strategies for near-term growth and value-creation include the continued expansion of our efforts to commercialize our IMRISneuro products by (a) increasing our geographic coverage within the U.S.A, Asia and Europe and (b) developing highly focused marketing programs that target neurosurgeons and neurosurgical facilities. We also intend to further develop our IMRIScardio product suite, which we believe will open an entirely new market and revenue stream for the company.

Our longer term objectives include the innovation and development of high value solutions for specific surgical applications, the strengthening of our technology base and competitive barriers, and the growth of recurring revenue sources.

We expect that our efforts will result in a continued growth of our revenues and our order backlog in the quarters and years to come.

**IMRIS INC.**

**CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

**September 30, 2007**

**November 12, 2007**

**(Date Issued)**

IMRIS INC.  
Consolidated Balance Sheet  
(In CDN dollars)  
(unaudited)

	September 30, 2007	December 31, 2006
<b>Assets</b>		
Current assets		
Cash and cash equivalents	-	2,912,694
Accounts receivable	2,970,951	22,645
Unbilled receivables	606,692	704,536
Investment tax credits receivable (note 3i)	485,767	338,561
Inventory (note 4)	2,422,179	542,829
Prepaid expenses	434,513	302,062
	<u>6,920,102</u>	<u>4,823,327</u>
Property, plant & equipment (note 5)	4,221,918	3,576,448
Accumulated amortization	(1,318,450)	(659,912)
	<u>2,903,468</u>	<u>2,916,536</u>
Deferred share issuance costs (note 3g)	975,022	-
Goodwill	6,462,808	6,462,808
Other intangible assets (note 6)	379,817	413,330
	<u>7,817,647</u>	<u>6,876,138</u>
<b>Total assets</b>	<u><u>17,641,217</u></u>	<u><u>14,616,001</u></u>
<b>Liabilities and shareholders' equity</b>		
Current Liabilities		
Bank indebtedness (note 7)	349,977	-
Accounts payable and accrued liabilities	5,405,321	1,819,400
Customer deposits	6,299,670	5,543,665
Current portion of capital lease obligation (note 9)	10,682	10,114
	<u>12,065,650</u>	<u>7,373,179</u>
Long term liabilities		
Long term debt - IRAP (note 8)	245,837	385,466
Long term portion of capital lease obligation (note 9)	11,406	19,538
	<u>257,243</u>	<u>405,004</u>
<b>Total liabilities</b>	<u>12,322,893</u>	<u>7,778,183</u>
See note 12 for Commitments		
Shareholders' equity		
Share capital (note 10b)	27,035,019	18,107,332
Warrants (note 10c)	-	93,264
Contributed surplus (note 10d)	287,984	140,876
Deficit	(22,004,679)	(11,503,654)
	<u>5,318,324</u>	<u>6,837,818</u>
<b>Total liabilities and shareholders' equity</b>	<u>17,641,217</u>	<u>14,616,001</u>

IMRIS INC.  
Consolidated Statement of Income  
(In CDN dollars)  
(unaudited)

For the period ended September 30, 2007	Three months ended		Nine months ended	
	2007	2006	2007	2006
Sales	7,969,788	379,112	14,020,667	738,157
Cost of sales	7,267,342	279,591	12,223,047	588,768
Gross profit	702,446	99,521	1,797,620	149,389
	8.81%	26.25%	12.82%	20.24%
Operating expenses				
Administrative	1,269,775	630,522	3,510,868	1,804,372
Sales and marketing	736,769	558,431	2,431,318	1,565,402
Customer support and operations	979,915	517,436	2,945,055	904,637
Research and development	696,775	682,744	2,507,452	1,684,344
Amortization	245,133	69,209	692,051	171,885
Total operating expenses	3,928,367	2,458,342	12,086,744	6,130,640
Loss before the following	(3,225,921)	(2,358,821)	(10,289,124)	(5,981,251)
Other expense				
Foreign exchange loss (gain)	222,638	13,818	211,861	189,805
Interest (income) expense	10,780	(22,191)	40	(27,781)
Amortization of financing expense	-	12,821	-	38,463
Total other expense	233,418	4,448	211,901	200,487
Income (loss) before taxes	(3,459,339)	(2,363,269)	(10,501,025)	(6,181,738)
Income taxes				
Current	-	-	-	-
Future	-	-	-	-
Total taxes	-	-	-	-
Net income (loss) for the period	(3,459,339)	(2,363,269)	(10,501,025)	(6,181,738)
Basic earnings (loss) per share (note 10e)	(0.20)	(0.20)	(0.59)	(0.53)
Diluted earnings (loss) per share (note 10e)	(0.20)	(0.20)	(0.59)	(0.53)

IMRIS INC.  
Consolidated Statement of Retained Earnings  
(In CDN dollars)  
(unaudited)

For the period ended September 30, 2007	Three months ended		Nine months ended	
	2007	2006	2007	2006
Retained earnings (deficit), beginning of period	(18,545,340)	(7,366,224)	(11,503,654)	(3,547,755)
Net income (loss) for the period	(3,459,339)	(2,363,269)	(10,501,025)	(6,181,738)
Retained earnings (deficit), end of period	(22,004,679)	(9,729,493)	(22,004,679)	(9,729,493)

IMRIS INC.  
Consolidated Cash Flow  
(In CDN dollars)  
(unaudited)

For the period ended September 30, 2007	Three months ended		Nine months ended	
	2007	2006	2007	2006
<b>OPERATING ACTIVITIES</b>				
Net loss for the period:	(3,459,339)	(2,363,269)	(10,501,025)	(6,181,738)
Items not affecting cash				
Amortization	245,133	69,209	692,051	171,885
Amortization of financing charges	-	12,821	-	38,463
Compensation expense relating to stock options	61,750	29,584	156,908	88,750
	(3,152,456)	(2,251,655)	(9,652,066)	(5,882,640)
Changes in non-cash working capital items				
Accounts receivable	(197,727)	151,268	(2,948,306)	158,465
Unbilled receivables	(436,592)	-	97,845	860,992
Investment tax credits receivable	(338,329)	(84,641)	(147,206)	(253,921)
WIP	91,098	(111,755)	(186,922)	(131,282)
Inventory	(865,219)	(135,597)	(1,879,351)	(180,065)
Prepaid expenses	301,943	75,395	(132,451)	(303,653)
Accounts payable and accrued liabilities	3,065,072	(141,309)	3,585,921	(499,979)
Accrued liabilities	2,132,345	(307,035)	2,406,812	(544,874)
Customer deposits	1,200,726	1,087,321	756,005	4,802,971
	2,729,874	952,437	(667,543)	4,584,810
	(422,582)	(1,299,218)	(10,319,609)	(1,297,830)
<b>FINANCING ACTIVITIES</b>				
Proceeds from issuance of share capital	67,900	3,501,000	8,824,623	3,502,831
Increase in bank indebtedness	349,977		349,977	
Increase in deferred share issuance costs	(975,022)	-	(975,022)	-
Proceeds from issuance of warrants				(231)
Repayment of long term debt	(80,043)	(3,859)	(139,629)	(7,463)
Repayment of obligation under capital lease	(2,563)	-	(7,564)	-
	(639,751)	3,497,141	8,052,385	3,495,137
<b>INVESTING ACTIVITIES</b>				
Capital asset purchases	(113,626)	(327,454)	(645,470)	(501,850)
<b>NET (DECREASE) AND INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,175,959)</b>	<b>1,870,469</b>	<b>(2,912,694)</b>	<b>1,695,457</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>1,175,959</b>	<b>680,178</b>	<b>2,912,694</b>	<b>855,190</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>-</b>	<b>2,550,647</b>	<b>-</b>	<b>2,550,647</b>

## 1. NATURE OF BUSINESS

IMRIS Inc. (the "Company") was incorporated in May 2005 and acquired all of the assets and assumed all of the liabilities of Innovative Magnetic Resonance Imaging Systems Inc. ("Innovative") pursuant to an asset purchase agreement dated May 20, 2005. The activities of Innovative have been carried on within IMRIS Inc. since that time. Innovative was amalgamated with the Company on December 31, 2005.

## 2. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2007, the Company adopted the following new accounting standards relating to financial instruments, as issued by the Canadian Institute of Chartered Accountants: Section 3855 Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; Section 1530, Comprehensive Income; and Section 3865, Hedges. These changes in accounting policy were applied in accordance with the transitional provisions contained in each of these sections.

### *Financial Instruments*

Section 3855, Financial Instruments – Recognition and Measurement, and Section 3861, Financial Instruments – Disclosure and Presentation, provide guidance for the recognition, measurement, presentation and disclosure of financial assets, financial liabilities and non-financial derivatives. These standards require financial assets, liabilities and derivatives to initially be recognized at fair value. After initial recognition, financial instruments are measured at fair value, amortized cost or cost, depending on the classification of the financial instruments. These standards also require the Company to recognize and measure derivative instruments embedded in host contracts that were issued on or after January 1, 2003.

The following is a summary of the Company's financial instruments, their classifications and measurement basis, and the financial statement impact of adopting the new standards.

- Cash and cash equivalents are classified as held-for-trading and are measured at fair value with changes in fair value recognized in net income. This classification had no impact on the Company's financial statements at the time of adoption.
- Accounts receivable and unbilled receivables are classified as loans and receivables and are measured at amortized cost. This classification had no impact on the Company's financial statements at the time of adoption.
- Accounts payable and accrued liabilities and long term debt are classified as other liabilities and are measured at amortized cost. This classification had no impact on the Company's financial statements at the time of adoption.

The carrying value of cash and cash equivalents equals fair value. The carrying values of accounts receivable, unbilled receivables, investment tax credits receivable and accounts payable and accrued liabilities approximate their fair value due to their short term nature. The carrying value of long term debt approximates its fair value because it is anticipated that the outstanding balance will be repaid within the year.

### *Comprehensive Income*

Section 1530, Comprehensive Income, establishes standards for the reporting and display of comprehensive income. The Company does not have any items that required separate recognition as other comprehensive income and therefore the adoption of this section did not have any impact in the Company's financial statements.

### *Hedges*

Section 3865, Hedges, establishes standards on when and how hedge accounting may be applied. The Company does not use derivative instruments and therefore the adoption of this section did not have any impact in the Company's financial statements.

### 3. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies of the Company include the following:

a) *Basis of consolidation*

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary IMRIS, Inc. All intercompany transactions and balances are eliminated on consolidation.

b) *Revenue recognition*

The Company generates revenues from three principal activities: system sales, sales of ancillary products and services, and extended maintenance services.

Revenues for system sales are recognized on a percentage of completion basis as systems are installed. The degree of completion is generally determined by the ratio of actual costs incurred to date to estimated total costs. Any projected losses are recognized immediately. Funds received from customers in advance of meeting the criteria for revenue recognition are recorded as customer deposits until such time as the revenue is recognized. Revenues recognized in advance of the criteria for invoicing to the customer are recorded as unbilled receivables where the collection of the receivable is probable.

Revenues from ancillary products and services are recognized upon delivery or as the services are rendered, respectively. Revenues from extended maintenance service agreements are recognized rateably over the life of the service agreement. Revenues from both ancillary products and services and extended maintenance service agreements are based on pre-determined or determinable sales prices and are only recognized when the collection of the receivable is probable.

c) *Cash and cash equivalents*

Cash and cash equivalents include cash on hand and short-term investments with maturities of three months or less from the date of acquisition.

d) *Inventories*

Materials are valued at the lower of cost and net realizable value. Cost of materials is determined on the basis of the invoiced value of goods. Work in progress inventories are valued at the lower of cost and net realizable value.

e) *Capital assets*

The Company records all capital asset acquisitions at their original cost and they are amortized over their estimated useful life using the straight line method at the following rates:

Computer software	3 years
Computer equipment	3 years
Office furnishings and equipment	5 years
Assembly & test equipment	5 years
Demonstration suite & tradeshow equipment	3-5 years
Leasehold improvements	Lesser of their useful life and the term of lease
Assets under capital lease	Policy consistent with respective asset class

f) *Goodwill and other intangible assets*

*Goodwill*

Goodwill represents the excess of the purchase price over fair value of the identifiable net tangible assets and intangible assets purchased at the date of acquisition. Goodwill is tested for impairment annually or more frequently when an event or circumstance occurs that indicates that goodwill might be impaired.

### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

f) *Goodwill and other intangible assets (continued)*

When the carrying amount exceeds the fair value, an impairment loss is recognized in the statement of operations in an amount equal to the excess.

*Patents*

Patents are accounted for at cost. Amortization is based on their estimated useful life which is generally the life of the patent, using the straight line method. The average remaining life of the patents at the time of acquisition in May 2005 was 11 years.

*Deferred financing charges*

In 2005, the Company recognized deferred financing charges which represented the fair value of shares that were issued at nominal value to the provider of the Company's operating line of credit. The deferred finance charges were being amortized on a straight-line basis over the estimated life of the credit facility. However, the Company ceased using this credit facility and therefore the unamortized amount of the financing charges were charged to operations during the year ended December 31, 2006.

g) *Deferred share issuance costs*

The Company has accrued and deferred the costs incurred up to September 30, 2007 relating to its initial public offering (see note 17). Once the offering is complete, these costs will be netted against the proceeds received and accounted for as a reduction of share capital.

h) *Research and development expenditures*

The Company incurs costs for activities which relate to research and development of new products. Research costs are expensed as incurred. Development costs are capitalized and amortized over the expected future benefit period if they meet generally accepted accounting criteria for deferral and amortization.

No development costs were capitalized in the nine month period ended September 30, 2007, or the year ended December 31, 2006.

i) *Investment tax credits*

The Company is entitled to Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible current and capital research and development expenditures incurred in each taxation year. Investment tax credits are recognized when realization of the tax credits is reasonably certain either as an item on the statement of operations and deficit or a reduction in deferred development costs or capital assets depending on where the original costs which gave rise to the tax credits have been recorded.

In the nine month period ended September 30, 2007, research and development tax credits of \$147,206 have been accrued as a receivable and have been recognized in operations as a \$221,158 reduction of research and development expense and a \$73,952 increase of capital assets. In the 2006 fiscal year, the full amount of the research and development tax credits received pertaining to 2005 was \$432,431 and had been recorded as a reduction of research and development expenses. As well in 2006, research and development tax credits of \$338,561 had been accrued as a receivable and had been recognized in the financial statements by a \$190,657 reduction of research and development expenses and a \$147,904 reduction of capital assets.

j) *Stock-based compensation*

The Company uses the fair value method to measure compensation expense at the date of granting of stock options to employees. The fair value of options is determined using the Black-Scholes option pricing model and is amortized to earnings over the vesting period with the related credit recorded as contributed surplus. Upon exercise of these stock options, amounts previously credited to contributed surplus are reversed and credited to share capital.

### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

k) *Warrants*

The Company accounts for warrants by measuring the fair value of the warrant at the date on which the respective warrant is issued. When warrants are issued in conjunction with shares of the Company, the cash proceeds received are prorated between share capital and warrants based on the relative fair value of each. The fair value of the warrants is determined using the Black-Scholes option pricing model. When warrants are exercised, cash received upon exercise and the amounts previously credited to warrants are reversed and credited to share capital.

l) *Income taxes*

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse.

m) *Foreign currency translation*

Foreign currency accounts are translated to Canadian dollars as follows:

Monetary items at the year-end exchange rate.

Non-monetary items at the exchange rate prevailing at the date of the transaction.

Revenue and expense items at the rate of exchange prevailing at the time of the transaction.

Exchange gains or losses on translation of foreign currencies are included in net earnings.

n) *Use of estimates*

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the year. Significant estimates include the percentage completion for the systems being installed, the valuation allowance relating to the future income tax assets, the useful lives of capital assets, the amortization of intangible assets, the calculation of investment tax credits receivable, the assumptions used in the determinations of stock-based compensation costs and the fair value information used for purposes of performing the annual goodwill impairment test. Actual results could differ from those estimates. Changes in estimates are recorded in the accounting period in which these changes are determined.

### 4. INVENTORY

	September 30 <u>2007</u>	December 31 <u>2006</u>
Materials	\$ 2,044,750	\$ 352,321
Work in progress	377,429	190,508
	<u>\$ 2,422,179</u>	<u>\$ 542,829</u>

**5. CAPITAL ASSETS**

	September 30 <u>2007</u>		December 31 <u>2006</u>	
	<u>Cost</u>	Accumulated <u>Amortization</u>	<u>Cost</u>	Accumulated <u>Amortization</u>
Computer software	\$ 165,956	\$ 60,652	\$ 163,917	\$ 27,159
Computer equipment	413,571	177,756	327,709	87,699
Office furnishings & equipment	404,305	125,354	325,809	57,524
Assembly & test equipment	2,165,413	772,138	1,975,830	462,509
Demonstration suite & tradeshow equipment	819,911	116,559	573,570	-
Leasehold improvements	220,671	59,573	177,523	23,416
Assets under capital lease	32,090	6,418	32,090	1,605
	4,221,918	1,318,450	3,576,448	659,912
Net book value	\$2,903,468		\$2,916,536	

**6. OTHER INTANGIBLE ASSETS**

	September 30 <u>2007</u>	December 31 <u>2006</u>
Patents	\$ 379,817	\$ 413,330
Deferred financing charges	-	-
	\$ 379,817	\$ 413,330

During the nine month period ended September 30, 2007, amortization of \$33,513 (\$44,684 for the year ended December 31, 2006) relating to the patents was charged to operations. In 2006, the Company ceased to use the line of credit facility to which the deferred financing charges related and the total outstanding balance of these charges was charged to operations during the year ended December 31, 2006. As a result, total amortization expense for the nine months ended September 30, 2007 was zero (\$38,463 for the nine month period ended September 30, 2006).

**7. BANK INDEBTEDNESS**

	September 30 <u>2007</u>	December 31 <u>2006</u>
Operating Loan	\$ 349,977	\$ -

The company has established an operating facility with a Canadian chartered bank in amount of up to \$2,500,000 which is repayable upon demand and bears interest at the prime rate of the bank. The facility is secured by a guarantee provided by the company's majority shareholder, Centara Corporation.

**8. LONG-TERM DEBT**

	September 30 <u>2007</u>	December 31 <u>2006</u>
NRC Industrial Research Assistance Program	\$ 245,837	\$ 385,466

The long-term loan under the NRC Industrial Research Assistance Program results from a refundable contribution in the amount of \$495,000 under which the NRC contributed to funding certain research and development activities of the Predecessor Company. The loan facility is unsecured, is non-interest bearing, and is repayable quarterly as to principal only until January 31, 2008 at a rate of 1% of the Company's gross revenues for the preceding quarter. The principal payments may exceed the original contribution amount, to a maximum of 150% of the original contribution, or \$742,500 during this period. Any repayments in excess of the original principal amount will be charged to royalty expense as incurred.

In the event that the total amounts repaid against the loan by January 31, 2008 exceed the original contribution amount there shall be no further amount repayable. In the event the loan has not been fully repaid by January 31, 2008, the term will be extended for up to an additional seven years with the same method of repayment, except that the total principal repayments shall then not exceed the original contribution amount.

**9. OBLIGATION UNDER CAPITAL LEASE**

The following schedule details the future minimum lease payments relating to the capital lease together with the balance of the obligation:

2007	\$ 2,954
2008	11,816
2009	8,863
	<u>23,632</u>
Less amount representing interest	(1,545)
	<u>22,087</u>
Less current portion	(10,682)
	<u>\$11,406</u>

The obligation under capital lease is secured by the asset to which the capital lease relates. The lease expires in September 2009 and includes an implicit interest rate of 6.6%. This rate is approximately equal to what the Company could be expected to currently negotiate in the market, as such the carrying value approximates the fair value of the debt. During the nine month period ended September 30, 2007, the Company paid interest expense on the obligation under capital lease of \$1,298 (\$514 for the year ended December 31, 2006).

## 10. CAPITAL STOCK

a) *Authorized*

The Company's share capital consists of an unlimited number of common shares.

b) *Issued and outstanding*

The issued share capital of the Company is as follows:

Common Shares	Number of Shares	Consideration
Issued and outstanding as at December 31, 2005	11,268,902	\$12,452,325
Shares issued April 17, 2006 pursuant to option exercise (i)	1,650	1,831
Shares issued July 8, 2006 for cash (ii)	1,488,889	3,350,000
Shares issued July 28, 2006 for cash (iii)	20,000	34,000
Shares issued July 31, 2006 for cash (iv)	52,000	117,000
Shares issued October 18, 2006 pursuant to exercise of warrants for cash (v)	2,072,545	2,062,176
Shares issued November 2, 2006 for cash (vi)	40,000	90,000
Issued and outstanding as at December 31, 2006	14,943,986	\$18,107,332
Issued and outstanding as at December 31, 2006	14,943,986	\$18,107,332
Shares issued upon exercise of warrants (vii)	3,108,818	3,093,264
Shares issued May 17, 2007 for cash (viii)	2,222,221	5,000,000
Shares issued June 6, 2007 for cash (ix)	219,547	493,981
Shares issued June 29, 2007 for cash (x)	81,510	183,398
Shares issued June 29, 2007 for cash (xi)	35,264	79,344
Shares issued September 24 2007 for cash (xii)	70,000	77,700
Issued and outstanding as at September 30, 2007	20,681,346	\$27,035,019

- i) On April 17, 2006 pursuant to an option exercise, the Company issued 1,650 common shares at \$0.97 per share for cash consideration of \$1,600. As a result of this transaction \$231 was transferred from contributed surplus to share capital.
- ii) On July 8, 2006 the Company issued 1,488,889 common shares at \$2.25 per share for cash consideration of \$3,350,000.
- iii) On July 28, 2006 the Company issued 20,000 common shares to an employee for \$1.71 per common share for total cash proceeds of \$34,000.
- iv) On July 31, 2006 the Company issued 52,000 common shares to a director of the Company for \$2.25 per common share for total cash proceeds of \$117,000.
- v) On October 18, 2006 certain investors exercised 2,072,545 of their warrants to purchase common shares for consideration of \$0.965 per common share for total cash proceeds of \$2,000,000. As a result of this transaction \$62,176 was transferred from warrants to share capital.
- vi) On November 2, 2006 the Company issued 40,000 common shares to an employee for \$2.25 per common share for total cash proceeds of \$90,000.

**10. CAPITAL STOCK (continued)**

*b) Issued and outstanding (continued)*

- vii) On May 17, 2007 certain investors exercised 3,108,818 of their warrants to purchase common shares for consideration of \$0.965 per common share for total cash proceeds of \$3,000,000. As a result of the transaction \$93,264 was transferred from warrants to share capital.
- viii) On May 17, 2007 the Company issued 2,222,221 common shares for \$2.25 per common share for total cash proceeds of \$5,000,000.
- ix) On June 6, 2007 the Company issued 219,547 common shares for \$2.25 per common share for total cash proceeds of \$493,981.
- x) On June 29, 2007 the Company issued 81,510 common shares to employees for \$2.25 per common share for total cash proceeds of \$183,398
- xi) On June 29, 2007 the Company issued 35,264 common shares to employees for \$2.25 per common share for total cash proceeds of \$79,344.
- xii) On September 24, 2007 pursuant to an option exercise, the Company issued 70,000 common shares to an employee for \$.97 per common share for cash consideration of \$67,900. In addition to the cash consideration, \$9,800 was transferred from contributed surplus to share capital.

*c) Warrants*

	<u>Number of Warrants</u>	<u>Fair Value</u>
Warrants outstanding December 31, 2005	5,181,363	\$ 155,440
Warrants exercised during the year	(2,072,545)	(62,176)
Warrants outstanding December 31, 2006	3,108,818	\$ 93,264
Warrants exercised during the period	(3,108,818)	(93,264)
Warrants outstanding September 30, 2007	-	\$ -

*d) Stock-based compensation plan*

On May 20, 2005 the Company established a stock option plan (the "Plan") for the employees, directors, officers and consultants of the Company and any of its subsidiaries which governs all options granted under the Plan. Under the Plan, options to purchase common shares of the Company may be granted by the Board of Directors. The exercise price of the options granted is established by the Board of Directors based on the fair market value of the common shares as at the date of the grant. The maximum number of common shares which may be issued pursuant to options granted under the Plan is 4,000,000 common shares of the Company.

Options granted under the Plan generally vest over a four year period and may be exercised in whole or in part as to any vested options prior to the expiry time as follows: 25% on or after the first anniversary of the grant date increasing 6.25 percent per quarter thereafter until fully vested after four years. Options expire six years after the date of the grant. The vesting of options granted under the plan ceases upon the death or the termination of employment of the participant or the participant ceases to be a director, and the participant thereafter has 90 days to exercise any vested and unexpired options, failing which any unexercised options shall lapse. The Board of Directors, at their discretion, may accelerate the vesting period of individual grants as deemed appropriate.

The Board of Directors may accelerate the vesting of all unvested options in the event of certain change of control transactions, including without limitation a take over bid, merger or other structured acquisition; and may further force the exercise of any and all vested options, and/or may cancel or replace any unvested options in any manner as the Board deems reasonable in its unfettered discretion.

**10. CAPITAL STOCK (continued)**

*d) Stock-based compensation plan (continued)*

The outstanding options and the activity relating to these options are as follows:

	September 30 <u>2007</u>		December 31 <u>2006</u>	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of period	2,270,300	\$ 1.58	1,171,100	\$ 0.97
Granted	1,528,000	2.25	1,159,000	2.17
Exercised	(70,000)	0.97	(1,650)	0.97
Cancelled	-	-	-	-
Forfeited	(123,500)	1.05	(58,150)	1.02
Outstanding, end of period	3,604,800	\$1.88	2,270,300	\$ 1.58

The following table summarizes the options outstanding at September 30, 2007:

Year granted	Number of options outstanding	Number of options exercisable	Exercise price	Expiry date
2005	1,000,800	528,176	\$ 0.97	2011
2006	161,000	54,188	1.71	2012
2006	990,000	161,250	2.25	2012
2007	1,453,000	6,250	2.25	2013
	3,604,800	749,864	\$ 1.88	

The estimated fair value of options granted during the nine month period ended September 30, 2007 is \$538,560 (\$371,250 for the year ended December 31, 2006) and the options had a weighted average granted-date fair value of \$0.35 per option. This estimate of the fair value on the date of grant used the Black-Scholes option pricing model with the following assumptions:

	September 30, <u>2007</u>
Risk-free interest rate	approximately 4%
Dividend yield	0%
Expected life of the options	4 years

As the Company is a non-public enterprise, the minimum value method is utilized, which does not take into account the expected volatility of the underlying stock.

The stock-based compensation costs calculated for the nine month period ended September 30, 2007, and the year ended December 31, 2006 were \$156,908, and \$118,338 respectively. These amounts were expensed in the respective periods and credited to contributed surplus.

Contributed surplus balance December 31, 2005	\$22,538
Stock based compensation expense during the year	118,338
Contributed Surplus balance December 31, 2006	\$140,876
Stock based compensation expense during the year	156,908
Options exercised during the period and credited to share capital	(9,800)
Contributed Surplus balance September 30, 2007	\$287,984

**10. CAPITAL STOCK (continued)**

*e) Earnings per share reconciliation*

The following table provides a reconciliation of the information used to calculate basic and diluted earnings per share:

	Nine month period Ended September 30, 2007	Nine month period Ended September 30, 2006
Net loss – basic and diluted	\$(10,501,025)	\$ (6,181,738)
Weighted average shares outstanding - basic	17,734,348	11,744,333
Dilutive effect of outstanding stock options and warrant	-	-
Weighted average shares outstanding – diluted	17,734,348	11,744,333
Basic loss per share	\$ (0.59)	\$ (0.53)
Diluted loss per share	\$ (0.59)	\$ (0.53)

**11. INCOME TAXES**

*a) Income tax expense*

Income tax expense differs from the amount that would be computed by applying the statutory income tax rates to loss before income taxes. A reconciliation of income taxes calculated at the statutory rates to the actual tax provision is as follows:

	Nine month period Ended September 30, 2007	Year ended December 31, 2006
Statutory tax rate	36.12%	36.62%
Tax recovery at statutory rate	\$(3,792,971)	\$(2,950,402)
Effect of:		
Non-deductible items	67,863	82,312
Benefit of future tax assets Not recognized	3,725,107	2,868,090
Income tax expense	\$ -	\$ -

## 11. INCOME TAXES (continued)

### b) Future income taxes

The Company has not recorded any future income tax assets in these financial statements because a valuation allowance has been provided against the full amount of the future income tax assets. The balances of future income taxes as at September 30, 2007 and December 31, 2006 represent the future benefit of unused tax losses and temporary differences between the tax and accounting bases of assets and liabilities. The major items giving rise to future income tax assets and liabilities are presented below:

	September 30 <u>2007</u>	December 31 <u>2006</u>
Non-capital losses	\$6,827,819	\$ 3,069,184
Capital Assets	394,873	(501,998)
Intangible assets	(79,087)	(55,250)
Research and development Expenditures	3,426,442	1,836,409
Reserves not taken for tax purposes	154,218	2,030,090
Total future income assets	<u>10,724,265</u>	<u>6,378,435</u>
Valuation allowance	(10,724,265)	(6,378,435)
Net future income tax asset	<u>\$ -</u>	<u>\$ -</u>

### c) Non-capital losses

As at September 30, 2007, Company has non-capital losses of approximately \$21.3 million available to reduce income taxes payable which expire in the following years:

2008	\$1.0 million
2009	0.9 million
2010	2.2 million
2014	0.7 million
2015	2.3 million
2026	1.3 million
2027	12.9 million

The Company also has unutilized federal and provincial scientific research and experimental development investment tax credits of \$1,531,596 and \$1,859,040 respectively. The tax benefit of these investment tax credits has not been recognized in the financial statements.

## 12. COMMITMENTS

As at September 30, 2007 the Company has entered into lease commitments for its office and manufacturing space. The aggregate remaining lease obligation is \$1,888,274 and the minimum annual lease payments required for the next five years are as follows:

	Current Facilities	Previous Facilities	Total
2007	\$ 100,688	\$ 18,056	\$ 118,744
2008	402,754	72,224	474,978
2009	402,754	60,187	462,940
2010	402,754		402,754
2011	428,858		428,858

During the 2006 fiscal year, the Company moved facilities and while it still has lease commitments relating to the previous facilities, it has been able to sublet this space to a third party for terms similar to those as the original lease agreement.

### 13. FOREIGN EXCHANGE AND CREDIT RISK

a) *Foreign exchange risk*

Foreign exchange risk is the risk to the Company's earnings that arise from fluctuations in foreign exchange rates and the degree of volatility of those rates. A significant amount of the Company's purchases and sales are denominated in foreign currencies and therefore it is exposed to foreign exchange fluctuations. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

b) *Credit risk*

The Company is subject to credit risk with respect to its accounts receivable and unbilled receivables to the extent that debtors do not meet their obligations. The Company's receivables include balances owing from two individual customers who respectively account for 78% and 20% of the combined accounts receivables and unbilled receivables balances.

### 14. SEGMENTED INFORMATION

The Company operates as one business segment that develops, assembles and installs surgical imaging systems used in medical applications as well as providing ancillary products and services and extended maintenance services.

Revenue attributable to geographic locations, based on the location of the customer, is as follows:

	Three months ended		Nine months ended	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Canada	\$ 31,500	\$ 43,695	\$ 215,817	\$ 177,460
USA	7,823,114	335,417	13,689,676	560,697
India	115,174	-	115,174	-
	<u>\$ 7,969,788</u>	<u>\$ 379,112</u>	<u>\$ 14,020,667</u>	<u>\$ 738,157</u>

During the nine month period ended September 30, 2007 revenues from four individual customers amounted to \$3,567,520, \$4,361,492, \$2,799,667 and \$2,643,127 respectively all of whom were located in the United States. The capital assets relating to the Company's operations which are located in Canada are \$2,829,414 (\$2,908,367 as at December 31, 2006). The capital assets relating to the Company's operations which are located in the U.S. are \$8,611 (\$8,169 as at December 31, 2006). All of the goodwill balance is attributable to the Company's operations located in Canada.

### 15. RELATED PARTY TRANSACTIONS

The Company leases air travel time from 5343381 Manitoba Ltd, a company which is wholly owned by the majority shareholder of IMRIS Inc. The amount charged to travel expenses during the nine month period ended September 30, 2007 totaled \$407,883 and the amount charged to deferred share issuance costs totaled \$35,799 with respect to transactions with this related party (\$307,314 for the year ended December 31, 2006) and were transacted on a cost recovery basis and recorded at the exchange amount. The payable balance owing to 5343381 Manitoba Ltd. as at September 30, 2007 was \$206,297 (\$240,000 as at December 31, 2006).

### 16. COMPARATIVE FIGURES

Certain prior year figures have been reclassified to conform with the current year's presentation.

### 17. SUBSEQUENT EVENT

The Company closed an initial public offering of its common shares on November 2, 2007 raising gross proceeds of \$ 40,000,002, through the issuance of 6,666,667 common shares at a price of \$ 6.00 per share. Costs relating to the offering, including underwriter fees of \$ 2,400,000, are estimated to be \$4,060,000 excluding any issuance of shares pursuant to an over-allotment option granted to the underwriters.

The Company intends to use the net proceeds to continue commercialization of its systems, fund additional research and development initiatives and finance general corporate and working capital requirements.

## **IMRIS Inc.**

### **Shareholder Information**

#### **Corporate Office**

100 – 1370 Sony Place  
Winnipeg, Manitoba  
R3T 1N5  
Phone: 204-480-7070 or 1-888-304-0114  
Fax: 204-480-7071  
Email: [info@imris.com](mailto:info@imris.com)  
Website: [www.imris.com](http://www.imris.com)

#### **Transfer Agent and Registrar**

Computershare Investor Services Inc.  
Toronto, Ontario  
Phone: 1-800-564-6253

#### **Auditors**

Deloitte & Touche LLP  
360 Main Street, Suite 2300  
Winnipeg, Manitoba  
R3C 3Z3

#### **TSX Symbol**

IM

#### **Investor Relations**

Ron Sabourin  
Executive Vice President, Finance  
and Chief Financial Officer  
IMRIS Inc.  
Tel: 204-480-7090  
Email: [rsabourin@imris.com](mailto:rsabourin@imris.com)

Susan McLeod  
Manager, Marketing Communications  
IMRIS Inc.  
Tel: 204-480-7094  
Email: [smcleod@imris.com](mailto:smcleod@imris.com)