THE WESTAIM CORPORATION

ANNUAL REPORT 2008

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Contents

All figures are in Canadian dollars, unless otherwise stated.

LETTER TO SHAREHOLDERS

2008 was a year of transition for The Westaim Corporation. Taking into account weakening economic conditions, market volatility and a credit crisis that has affected economies on a global scale, the Board of Directors focused on preserving the Company's resources through its ongoing review of strategic alternatives.

Cost containment programs and the monetization of non-core assets were the primary objectives in 2008. As a result of these efforts, Westaim ended the year with $46.8 million in consolidated cash and cash equivalents, compared to $31.0 million at December 31, 2007. Westaim's unconsolidated cash position, excluding cash and cash equivalents held by its 74.7 per cent owned affiliate NUCRYST Pharmaceuticals Corp., was $18.0 million. In addition, Westaim held asset-backed commercial paper (ABCP) with a book value of $4.3 million at December 31, 2008.

Cost savings were realized from lower corporate costs and lower discontinued operations costs at iFire and together with net proceeds of nearly $10 million from the sale of iFire's assets and intellectual property, Westaim's financial position has been significantly strengthened moving into 2009.

With the completion of the restructuring of Canada's third-party ABCP, Westaim's investment in ABCP was written down by a further 20 per cent during the year to $4.3 million or 50 per cent of its original face value of $8.5 million. Westaim has available credit commitments of up to $4.7 million from a major Canadian bank secured by the Company's ABCP holdings which add to our capital base. We will continue to monitor the market value of these assets and will be opportunistic in divesting our exposure to ABCP.

NUCRYST also took measures to preserve and manage its cash position. As part of a broader effort to reduce its overall cost structure, NUCRYST consolidated its U.S. research and development activities into its Fort Saskatchewan, Alberta operation and relocated its corporate headquarters from Wakefield Massachusetts to a smaller facility in Princeton, New Jersey.

NUCRYST continued focused research efforts on the potential use of its NPI 32101 nanocrystalline silver powder for the treatment of conditions involving both infection and inflammation. NUCRYST was pleased to report that the Smith & Nephew Acticoat™ family of dressings was expanded in 2008 with the introduction of Acticoat Flex™. This new Acticoat™ dressing was approved by Health Canada late in the year with an anticipated global product launch in 2009. Acticoat™ Flex utilizes NUCRYST's patented SILCRYST™ nanocrystalline silver technology and is designed to conform to the contour of difficult-to-protect areas such as the knee or elbow joints.

The US $0.80 cent per share return of capital to NUCRYST shareholders approved at a meeting of NUCRYST shareholders in February 2009 was another milestone for Westaim that sets the stage for maximizing our resources and building the value of the Company. Westaim's unconsolidated cash position was strengthened by approximately $14 million as a result of this transaction.

In 2009, NUCRYST will continue its focused drive to profitability. With respect to Westaim's investment position in NUCRYST, we will continue to review alternatives to maximize the value of our 74.7 per cent stake in the best interest of our shareholders.

Moving forward, Westaim is in an enviable position with no debt and a strong cash position, which is particularly favorable given the broader market's current liquidity and credit issues. We are well-positioned to pursue new investment and business opportunities for the Company.

On behalf of the Board of Directors, I would like to acknowledge the support and commitment that has been demonstrated by all stakeholders over the past year. Our commitment to maximizing shareholder value remains steadfast.

G. A. (Drew) Fitch,
President & CEO

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis of the results of operations and financial condition for the years ended December 31, 2008 and December 31, 2007 was prepared as at February 12, 2009 and should be read in conjunction with the Consolidated Financial Statements of The Westaim Corporation for the years ended December 31, 2008 and December 31, 2007 and the accompanying notes thereto. Additional information relating to The Westaim Corporation, including its annual information form, is available on SEDAR at www.sedar.com and the Company's website (as hereinafter defined) at www.westaim.com. All dollar amounts contained herein are denominated in Canadian dollars unless otherwise specified.

DESCRIPTION OF THE BUSINESS

The Westaim Corporation (“Westaim” or the "Company") is a holding company with a 75% investment in Nucryst Pharmaceuticals Corp. ("Nucryst"), a company that develops, manufactures and commercializes innovative medical products that fight infection and inflammation. The Company also owns iFire Technology Ltd. (“iFire”), a company that until late 2007 had been developing a novel flat panel display technology. The Company's strategy has been to develop the independent technical, operating and marketing and sales capabilities of its technology investments through the early years of product introduction and commercialization with the objective of taking these technologies public through initial public offerings. In December 2005, Nucryst completed an initial public offering of its common shares and its shares trade on the NASDAQ Stock Market and the Toronto Stock Exchange.

In the second quarter of 2007, the Company announced that it was undertaking a review of its business strategy and announced operational changes at iFire and organizational changes at the corporate offices of the Company. At iFire, staffing levels were initially reduced to a core team focused on advancing phosphor performance and reducing variability in luminance, life and uniformity. In November 2007, the Company announced that it was further reducing staff levels at iFire and would seek a buyer for the business, facilities and intellectual property associated with iFire’s proprietary technology. Development efforts on iFire’s technology were discontinued at that time. Corporate management and administrative staff levels in Fort Saskatchewan and Calgary were also reduced as part of the broader reorganization. In the first quarter of 2008, the Company determined that maximum value would be realized by selling the individual assets of iFire including buildings, equipment, and intellectual property. In December 2008, iFire sold its equipment for net proceeds after fees, costs and termination amounts of $8.2 million and reported a gain of $5.3 million. Subsequent to year end, the Company sold the intellectual property and other intangible assets relating to iFire for net proceeds of approximately $1.1 million. The Company continues to seek a purchaser for iFire’s land and building.

During 2008, the Board of Directors continued to review strategic alternatives to maximize value for shareholders and on October 3, 2008, the Company announced it had entered into a reorganization agreement under which the Company would acquire several closely held businesses that provide products and services in the western Canadian construction industry. The proposed reorganization was subject to certain conditions and to approval of the shareholders of the Company. Notice of the special meeting of shareholders to be held November 21, 2008, letter of transmittal, form of proxy and an information circular for the special meeting were mailed to shareholders on October 15, 2008. Conditions to the reorganization were not met and, as a consequence, on November 4, 2008 the reorganization agreement was terminated and the shareholders’ meeting called for November 21, 2008 was cancelled.

On December 1, 2008, the Company requisitioned a special meeting of shareholders of Nucryst Pharmaceuticals Corp. to consider the reduction of the stated capital of Nucryst for the purpose of distributing US $0.80 cash per common share to the shareholders of Nucryst. On December 19, 2008, Nucryst called a special meeting of shareholders to be held on February 12, 2009 and at the special meeting, shareholders approved the return of capital totaling approximately US $14.7 million to be distributed to shareholders on February 25, 2009. The return of capital will reduce Westaim’s consolidated cash position by approximately $4.6 million representing the amount to be paid to Nucryst’s minority shareholders.

The Company is continuing to review strategic alternatives and will examine all possible options for its longer-term structure as it considers new investment opportunities to grow the value of the Company.

CONSOLIDATED RESULTS

OVERVIEW

For the year ended December 31, 2008, the Company reported a net loss of $10.2 million compared to a net loss of $58.0 million in 2007. The loss from continuing operations was $1.7 million in 2008, compared to a loss of $2.8 million in 2007. The reduction in the loss from continuing operations resulted from lower corporate costs at Westaim in 2008, lower losses related to Westaim’s investment in Canadian asset-backed commercial paper (“ABCP”), and a $7.3 million favourable variance in foreign exchange gains. These favourable variances were partially offset by a gain on the sale of capital assets of $8.7 million and by $10.1 million in milestone revenue at Nucryst, both reported in 2007. Revenues from continuing operations for the year ended December 31, 2008 were $22.4 million compared to $31.8 million in 2007. The reduction reflects the $10.1 million milestone revenue earned by Nucryst in 2007.

CONSOLIDATED RESULTS

OVERVIEW (continued)

The loss from discontinued operations of $8.5 million for the year ended December 31, 2008 compared to a loss of $55.2 million in 2007 relates to the discontinuance of operations at iFire in 2007 and includes a write-down of capital assets and intangible assets of $7.4 million in 2008 compared to a write-down of $22.1 million in 2007. Loss from discontinued operations in 2008 also includes a gain on the sale of capital assets held for sale of $5.3 million.

The basic and diluted net loss per common share was $0.11 in 2008 compared to $0.62 in 2007. The basic and diluted net loss per common share from continuing operations was $0.02 in 2008 and $0.03 in 2007. The basic weighted average number of common shares outstanding was 94.2 million and 94.1 million in 2008 and 2007 respectively.

Continuing operations primarily reflect corporate costs and the results of the Company's operating subsidiary, Nucryst. A comparison of operating costs from continuing operations in 2008 compared to 2007 is as follows:

($millions)	2008	% of Revenue	2007	% of Revenue*
Manufacturing	$ 12.6	56%	$ 14.6	67%
Research and development	4.6	20%	6.4	29%
General and administrative	9.7	43%	9.3	43%
Depreciation and amortization	1.9	8%	2.1	10%
Corporate costs	5.1	23%	10.9	50%
	$ 33.9		$ 43.3	

* revenue excludes Nucryst milestone revenue of $10.1 million earned in 2007.

Manufacturing costs relates to the production of Acticoat™ wound care products by Nucryst and the reduction in costs is primarily the result of production efficiencies implemented in 2008 and slightly lower sales volumes. The decrease in research and development expenses reflects significantly lower spending at Nucryst in 2008 as a result of fewer and more focused research and development programs. The increase in general and administrative costs reflects the cost of shutting down Nucryst's operations in Wakefield, Massachusetts.

Corporate costs decreased by $5.8 million to $5.1 million in 2008 primarily due to the one-time corporate restructuring costs of $4.9 million incurred in 2007.

Foreign exchange gains were $3.5 million in 2008 compared to a loss of $3.8 million in 2007. The 2008 gain reflects the impact of the weakening Canadian dollar on U.S. dollar denominated working capital balances during the year primarily at Nucryst and the 2007 loss reflects the strengthening Canadian dollar during that year. The Canadian dollar to U.S. dollar December 31 exchange rates were as follows: 2008 – 1.225; 2007 – 0.0988; and 2006 – 1.1653. Interest income of $0.7 million in 2008 was $1.1 million lower than 2007, resulting from lower average interest rates in 2008 compared to 2007. In addition, the Company recorded interest income on its investments in ABCP in 2007 until the $33 billion market for third party ABCP became illiquid in August 2007. Losses related to the Company's investment in ABCP totaled $1.7 million in 2008 compared to $5.1 million in 2007. These losses are more fully discussed under *"Liquidity and Capital Resources"* below.

In 2008, the Company reported a dilution gain of $6.0 million and a gain on sale of investments of $0.5 million related to the divestiture of former non-core subsidiaries. These transactions are discussed in Note 4 to the Company's audited consolidated financial statements for the year ended December 31, 2008. A gain on sale of investment of $2.6 million was reported in 2007 relating to the sale of shares of a former subsidiary in the fourth quarter. Earlier in 2007, this former subsidiary had issued shares to private investors which resulted in the Company reporting a dilution gain of $4.5 million.

In 2007, the Company also reported an $8.6 million gain on sale of its Fort Saskatchewan real estate and a $1.2 million write-down of capital assets at Nucryst.

Non-controlling interest reflects the proportionate share of Nucryst's results allocated to minority shareholders. The Company's interest in Nucryst was 74.7% at December 31, 2008 compared to 74.5% at December 31, 2007.

Discontinued operations are discussed more fully below under "*Discontinued Operations*" and in Note 3 to the audited consolidated financial statements of the Company for the year ended December 31, 2008.

Net income in the fourth quarter of 2008 was $2.7 million compared to a net loss of $26.8 million in 2007. Loss from continuing operations in the fourth quarter of 2008 was $1.2 million compared to income of $1.2 million reported in 2007. Operating results in the fourth quarter of 2007 reflects higher earnings in Nucryst driven by US $5.0 million milestone revenue and gain on sale of investments of $2.6 million, offset by write-downs and losses relating to ABCP totaling $2.1 million. Income from discontinued operations in the fourth quarter of 2008 of $4.0 million includes a gain on the sale of equipment of $5.3 million while the loss in the fourth quarter of 2007 of $28.0 million includes a $22.1 million write-down of iFire's capital assets.

CONSOLIDATED RESULTS (continued)

OPERATIONS

Performance Measures

The Company uses financial and technical performance measures to track corporate performance. The Company and its subsidiaries develop comprehensive long-range plans and annual plans with a view to maximizing long-term shareholder value. Success of each business segment is measured on its ability to achieve performance milestones within a specified timeframe. These milestones generally relate to specific operational and research related targets and are reviewed and updated on a regular basis during the year. Financial milestones are also set and measured. Financial performance may relate to sales activity for commercial products or the achievement of results within operating expense and capital budget targets.

Subsidiaries

The Company has one operating business segment – Nucryst. Until late 2007, the Company's operations were organized into two business segments – Nucryst and iFire.

♦ ***Nucryst Operations***

Nucryst develops, manufactures and commercializes innovative medical products that fight infection and inflammation. Nucryst's patented technology enables it to convert silver's microcrystalline structure into an atomically disordered nanocrystalline coating which Nucryst believes enhances silver's natural antimicrobial properties. In addition, Nucryst's nanocrystalline silver has exhibited potent anti-inflammatory properties in pre-clinical studies.

In December 2005, Nucryst completed its initial public offering of 4.5 million common shares. Westaim owned 74.7% of Nucryst's common shares at December 31, 2008. Westaim's return on its investment in Nucryst is dependent on a number of factors beyond its control. See "Risks and Uncertainties".

Wound Care Products – Acticoat™ Burn Dressings and Acticoat™ 7 Dressings, targeting the burn and chronic wound markets, were developed and sold by Nucryst until May 2001 when a series of agreements were completed with Smith & Nephew plc ("Smith & Nephew") under which Smith & Nephew acquired an exclusive global license to Nucryst's SILCRYST™ antimicrobial coating technology, together with Nucryst's U.S. and Canadian Acticoat™ burn dressing business, the Acticoat™ trademark, various regulatory approvals and certain manufacturing equipment that Nucryst leased back. Nucryst continues to manufacture Acticoat™ products exclusively for Smith & Nephew and, until September 30, 2007, received reimbursement for all manufacturing costs plus royalty payments and milestone payments based on Smith & Nephew's global sales. On September 30, 2007, Nucryst signed amended agreements with Smith & Nephew, further discussed below. All payments under the agreements with Smith & Nephew are made to Nucryst in US dollars.

Nucryst's license to Smith & Nephew grants Smith & Nephew the exclusive worldwide right to market, distribute and sell Acticoat™ products using Nucryst's SILCRYST™ coatings for use on non-minor dermal wounds or burns in humans (the "Field") including improvements to those products, and any new products developed with Smith & Nephew using Nucryst's SILCRYST™ coatings or powders in the Field. This exclusive right does not apply to other types of products outside the Field that Nucryst may develop using its technology, such as pharmaceutical products. The license and development agreement expires in May 2026, although it may be terminated earlier by either party if the other party fails to cure a material breach of the agreement, suspends its operations or ceases to carry on business or files for bankruptcy or takes other similar actions. There are currently six product families with SILCRYST™ coatings manufactured by Nucryst for Smith & Nephew at its Fort Saskatchewan plant: Acticoat™ Burn, Acticoat™ 7, Acticoat™ Absorbent, Acticoat™ Moisture Control, Acticoat™ Site, and Acticoat™ Post-Op. In the fourth quarter of 2008, Nucryst announced that Health Canada granted marketing approval for a new SILCRYST™ product, Acticoat™ Flex Barrier Dressing. This product will simplify the dressing of wounds for difficult to protect articulating regions such as knee or elbow joints with its unique elastic design that contours to body surfaces. Approvals from other countries for Acticoat™ Flex are anticipated in 2009, including a U.S. Food and Drug Administration ("FDA") 510(k) clearance. Smith & Nephew has indicated that it expects to launch the Acticoat™ Flex product in North America and Europe during 2009.

Agreements with Smith & Nephew – On September 30, 2007, Nucryst signed amended agreements with Smith & Nephew for the manufacture and sale of Acticoat™ products. Until September 30, 2007, Nucryst's revenues under its agreements with Smith & Nephew consisted of manufacturing cost reimbursements, royalties, payments upon the achievement of specified milestones and reimbursement for costs incurred in connection with the development or improvement of SILCRYST™ products covered by the agreements with Smith & Nephew. Manufacturing costs were recorded both as offsetting revenue and expense items in the consolidated statement of operations upon shipment to Smith & Nephew. Effective September 30, 2007, the method of calculating manufacturing cost reimbursement and development cost reimbursement changed. Nucryst continues to earn royalty revenues based upon Smith & Nephew's sales of Acticoat™ products to its customers. Royalty revenue varies in proportion to increases or decreases in Smith & Nephew's sales of its Acticoat™ products. Nucryst also continues to receive milestone payments upon Smith & Nephew's achievement of specified sales thresholds of Acticoat™ products and upon the achievement of specified regulatory events. To the end of 2008, Nucryst had earned US $29.0 million of a potential US $56.5 million in milestone payments.

CONSOLIDATED RESULTS

OPERATIONS (continued)

The material ongoing changes to the agreements effective September 2007, are as follows:

– Under the previous agreements, the price paid by Smith & Nephew for Acticoat™ products was Nucryst's fully allocated cost of goods sold including equipment depreciation. The costing mechanism has been amended effective January 1, 2007 to a fixed overhead charge plus direct costs incurred in manufacturing Acticoat™ products.
– The overhead charge payable by Smith & Nephew in 2007 through 2009 has been fixed at a minimum floor amount equal to the 2007 overhead charge. This floor amount is payable by Smith & Nephew regardless of the actual volume of Acticoat™ products ordered by Smith & Nephew. Nucryst may use any actual overhead cost savings achieved by Nucryst until 2009 to offset an annual manufacturing cost rebate in the amount of US $4.5 million that Nucryst has agreed to make to Smith & Nephew in 2007 through 2009. In 2010, the parties expect to establish new fixed prices after taking into account the cost savings achieved by Nucryst in the previous three years.
– A non-compete clause has been deleted from the original agreements to allow Smith & Nephew to broaden its wound care dressings product line to include other forms of silver. In exchange, Smith & Nephew's exclusive license has been limited to existing Acticoat™ products and such new wound care or burn products that the parties agree to develop together using Nucryst's Silcryst™ technology.
– New wound care and burn products developed alone by Nucryst that contain Nucryst's nanocrystalline silver technology will be initially offered to Smith & Nephew. If Smith & Nephew declines to commercialize any of these products, Nucryst will be free to pursue other commercialization options.
– Nucryst will contribute its own internal development costs towards the joint development of new products with Smith & Nephew up to a maximum amount per year equivalent to 1.5% of Smith & Nephew's sales of Acticoat™ products in the year. This replaces a system whereby Smith & Nephew reimbursed Nucryst for all of its product development costs. Nucryst did not receive any reimbursement for development costs in 2008.

New Product Development – Nucryst is continuing pre-clinical research efforts to develop a topical cream containing its nanocrystalline silver powder, referred to as NPI 32101, as a 510(k) prescription topical device for the treatment of dermatological conditions. Clinical studies have shown the cream to be stable, cosmetically acceptable and in invitro testing to have broad spectrum antimicrobial activity. In July 2007, the FDA granted Nucryst 510(k) clearance for a prescription topical cream containing NPI 32101 as a broad-spectrum antimicrobial barrier cream to organisms including *Pseudomonas aeruginosa, Staphyloccocus aureus*, including strains resistant to methicillin – or MRSA. Nucryst is actively exploring commercialization options through partnering opportunities and the potential market for this new product will be largely dependent on the distribution channel alternatives determined by a marketing partner.

In the third quarter of 2007, Nucryst filed a 510(k) submission to the FDA to expand the claims and indications for its barrier cream in the relief of the signs and symptoms of dermatoses. Nucryst has received a request from the FDA for additional information regarding this submission and Nucryst has requested an extension of time regarding its response to the FDA as it reviews commercial alternatives for the barrier cream. While these additional claims and indications would expand the potential market for the barrier cream, the application for this expansion was withdrawn without prejudice until the barrier cream is marketed under the initial 510(k) clearance.

With the closure of the Wakefield, Massachusetts research center, Nucryst has decreased its pharmaceutical development capabilities and does not expect to incur significant costs around its existing pharmaceutical programs. Nucryst remains focused on looking for development opportunities with third parties in various clinical areas, but does not expect to develop additional pharmaceuticals applications for NPI 32101 without development partners.

♦ ***Nucryst Financial Results***

Nucryst's operating loss for the year ended December 31, 2008 was $6.4 million compared to a loss of $0.6 million in 2007.

The financial results of Nucryst are summarized as follows:

($millions)	2008	2007
Wound care product revenue	$ 27.2	$ 26.3
Manufacturing cost rebate	(4.8)	(4.6)
Milestone revenue	–	10.1
Total revenue	$ 22.4	$ 31.8
Manufacturing costs [(1)]	$ 13.7	$ 15.9
Wound care gross margin excluding milestone revenue	$ 8.7	$ 5.8
Operating loss	$ (6.4)	$ (0.6)

[(1)] Manufacturing costs include related depreciation

CONSOLIDATED RESULTS

OPERATIONS (continued)

Revenue – Wound care product revenue reflects licensing royalties and manufacturing revenue relating to Acticoat™ products sold by and produced for Smith & Nephew. Total revenue for the year ended December 31, 2008 was $22.4 million compared to $31.8 million for the year ended December 31, 2007. Product related revenues, before manufacturing cost rebates and milestone revenue, were $27.2 million in 2008 compared to $26.3 million in 2007, an increase of $0.9 million or 3.4%. In general. revenues were impacted by a decrease in product revenue related to lower shipments to Smith & Nephew offset by higher fixed overhead recoveries on products shipped. Nucryst recovers an agreed amount of fixed overhead from Smith & Nephew regardless of the volume of product shipped. In 2007, Nucryst earned $10.1 million in milestone revenue resulting from the amendments to the Smith & Nephew and from the achievement of a specified sales threshold.

Manufacturing Costs – Manufacturing costs, including related depreciation, for the year ended December 31, 2008 were $13.7 million compared to $15.9 million for the year ended December 31, 2007. The reduction is primarily due to the combined effect of manufacturing cost savings realized in 2008 through the implementation of efficiencies in Nucryst's manufacturing processes and a 5% decline in units shipped. Nucryst realized reductions in manufacturing and overhead costs through lower employee levels and manufacturing process improvements. Nucryst plans to continue to manage its manufacturing costs to achieve further cost reductions in 2009.

Gross Margin – Gross margin excluding milestone revenue for the year ended December 31, 2008 was $8.7 million compared to $5.8 million for the year ended December 31, 2007. This improvement in gross margin, excluding milestone revenue, is primarily the result of lower manufacturing costs and fixed overhead cost savings. Pursuant to the revised agreements with Smith & Nephew, Nucryst is required to pay a US $4.5 million manufacturing cost rebate in 2007, 2008 and 2009. These rebates will continue to impact Nucryst's gross margin in those years to the extent that Nucryst is unable to realize and maintain manufacturing overhead cost reductions sufficient to offset these rebates.

Research and development costs at Nucryst of $4.6 million in 2008 were $1.8 million lower than in 2007 primarily attributable to the reduction in research and development staff levels and the curtailment of pharmaceutical research.

General and administrative costs for the year ended December 31, 2008 were $9.7 million compared to $9.3 million for the year ended December 31, 2007. The increase of $0.4 million is attributable primarily to costs associated with the fourth quarter closure of the Wakefield, Massachusetts facility and higher professional fees, partially offset by a decrease in general and administrative costs at the Fort Saskatchewan facility, lower royalty costs, and a decline in stock option compensation expense recognized in the year. Nucryst continues to review its general and administrative costs and expects that the changes it has implemented and expects to implement in 2009 will further reduce its general and administrative costs in 2009.

A $0.2 million capital asset write-off of leasehold improvements was reported in 2008 as a result of the closure of Nucryst's Wakefield, Massachusetts facility.

Capital spending at Nucryst totaled $1.2 million in 2008 compared to $2.1 million in 2007 and in both years related primarily to projects in Fort Saskatchewan, Alberta. Capital spending is expected to be lower in 2009 than 2008. Nucryst's research activities were consolidated in Fort Saskatchewan, Alberta in late 2008 with the closure of Nucryst's Wakefield facility. Nucryst's manufacturing operations are located in Fort Saskatchewan, Alberta and it also maintains an office in Princeton, New Jersey.

- ***Nucryst Outlook***

The overall combined impact of the amendments to the Smith & Nephew agreements discussed above could have a material adverse effect on Nucryst's quarterly financial results in subsequent periods depending on the timing of payments made to and received from Smith & Nephew, Smith & Nephew's sales of Acticoat™ products, the achievement of cost savings by Nucryst, and the receipt by Nucryst of further milestone payments. In the longer term, Nucryst expects the amendments to the agreements to further facilitate its ongoing efforts to expand Nucryst's business opportunities while enabling it to continue to support Smith & Nephew to realize the future growth potential of the Acticoat™ products. The markets for Acticoat™ wound care products continue to be highly competitive as new silver products enter the market.

Outside of its Smith & Nephew agreements, Nucryst is continuing efforts to extend its nanocrystalline silver technology to develop pharmaceutical products and other medical devices to combat infection and inflammation. Nucryst is exploring commercialization avenues for a topical barrier cream containing NPI 32101 as well as discussing other product applications for its coating technology outside of wound care.

In addition to its efforts to expand its revenue base, Nucryst has been reviewing its overall operations and reducing the level of expenditures, particularly in certain development areas. In the fourth quarter of 2008, Nucryst closed its Wakefield, Massachusetts research center and relocated its corporate headquarters to Princeton, New Jersey. Nucryst remains focused on looking for development opportunities with third parties in various clinical areas, but does not expect to develop additional pharmaceuticals applications for NPI 32101 without commercial partners. Nucryst does not expect to earn milestone revenue in 2009.

CONSOLIDATED RESULTS

OPERATIONS (continued)

Nucryst's cash position will be reduced by the return of capital to shareholders approved on February 12, 2009 and payable on February 25, 2009. Nucryst's cash balance at December 31, 2008 of $28.8 million will be reduced by approximately $18.0 million or 62%. This reduced cash balance is still sufficient to allow Nucryst to execute its 2009 business plan.

Nucryst may be impacted by the current global worldwide recession. Nucryst is reliant on the ability of Smith & Nephew to continue to market its products and the global recession may result in both a reduction in sales volumes and pressure on product pricing. The nature of Nucryst's wound care products, however, is that they are in demand by burn victims and sufferers of chronic wounds regardless of economic circumstances. As noted in the *"Liquidity and Capital Resources"* section on page 9, Nucryst is taking steps to ensure its long-term viability in light of current economic circumstances.

Discontinued Operations

iFire – iFire, based in Toronto, Ontario, had been developing a proprietary flat panel display with solid state, thick-film dielectric electroluminescent ("TDEL") technology and with primary application in the large screen television market. Significant performance improvements achieved by incumbent flat panel TV manufacturers and more demanding specification improvement targets for iFire caused the forecast product development timeline to extend past the timeframe originally expected by the Company. As a result, on November 13, 2007, the Company decided to discontinue further development of iFire's TDEL technology and to seek a buyer for the iFire assets. iFire's financial results, balance sheet and cash flows are therefore reported as discontinued operations in the Company's 2008 audited consolidated financial statements. iFire's operations in 2008 focused on selling its equipment and intellectual property.

iFire Financial Results – The loss at iFire for the year ended December 31, 2008 was $8.5 million compared to $55.2 million in 2007.

Operating costs at iFire were substantially reduced in 2008 as a result of staff reductions that were undertaken in the second half of 2007 and the first half of 2008. Operating costs were $6.4 million in 2008 compared to $33.1 million in 2007. Included in these amounts are restructuring costs primarily relating to staff reductions of $2.8 million in 2008 compared to $3.9 million in 2007. All expected future costs relating to staff reductions amounting to $0.9 million have been fully accrued at December 31, 2008. Depreciation of capital assets was discontinued in November 2007 when iFire was classified as a discontinued operation for accounting purposes. As a result, no depreciation or amortization expense was recorded in 2008 compared to an expense of $13.6 million in 2007.

Generally accepted accounting principles require that assets held for sale be recorded in the financial statements at the lesser of cost or net realizable value. The Company assessed the net realizable value of iFire's assets at December 31, 2007 and concluded that a write-down of $22.1 million was required. Additional write-downs of $7.1 million were reported in the first quarter of 2008. In the fourth quarter of 2008, iFire sold its equipment to an overseas buyer for net proceeds after fees, costs, taxes and termination amounts of $8.2 million and reported a gain on the sale of these assets of $5.3 million. In 2008, iFire entered into an agreement to sell its intellectual property and other intangible assets. This sale was subject to several conditions, including iFire obtaining certain consents and approvals. The proceeds related to intellectual property will be less than the book value of the intangible assets available for sale and as a result these assets were further written down by $0.3 million in the fourth quarter of 2008. This transaction was completed in January 2009 for net proceeds of approximately $1.1 million. No material gain or loss is expected to be reported on this transaction. The Company's manufacturing building used by iFire in Toronto, Ontario remains for sale and has a book value of $1.0 million.

iFire Outlook – iFire's operations in 2009 will be limited to overseeing the delivery of its assets to the purchaser and to seek a buyer or tenants for the iFire owned and leased buildings. All employees are expected to be terminated by the end of the first quarter of 2009 and future operating costs will be limited to lease obligations and facility operating costs until the buildings can be sold or sublet. Staff levels have been reduced from 141 at December 31, 2006 to 25 at December 31, 2007 to 9 at December 31, 2008.

Details of the financial impact of discontinued operations are disclosed in Note 3 to the Company's 2008 audited consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

The Company's business plans are developed to ensure that research and development and operating costs do not overextend the Company's financial resources. The Company's 2009 consolidated business plan indicates that Nucryst will have sufficient cash and cash equivalents to fund its operations in 2009 and the Company will have sufficient cash and cash equivalents to fund the reduced activities at iFire and the Company's corporate operations in 2009.

LIQUIDITY AND CAPITAL RESOURCES (continued)

At December 31, 2008, the Company had consolidated cash and cash equivalents of $46.8 million compared to $31.0 million at December 31, 2007. The Company's improvement in liquidity of $15.8 million resulted from the following items:

The Westaim Corporation – Increase in cash in 2008	
	($millions)
Net proceeds on the sale of iFire equipment	$ 8.2
iFire operations and severance costs	(5.7)
Net proceeds on divestiture of non-core subsidiaries	6.3
Nucryst operations *(discussed below)*	9.8
Nucryst capital expenditures	(1.2)
Other operations	(1.6)
Increase in cash	$ 15.8

At December 31, 2008, Nucryst had cash and cash equivalents of $28.8 million compared to $17.8 million at December 31, 2007. These funds are not accessible to the Company. The Company had $18.0 million at December 31, 2008 compared to $13.2 million at December 31, 2007 to fund its own operations and the operations of iFire.

Nucryst's $11.0 million improvement in its cash position primarily reflects net cash from operations of $9.8 million mainly as the result of the collection of US $5.0 million in milestone revenue accrued in the fourth quarter of 2007 and improvements in non-cash working capital.

As part of the Company's strategic plan to maximize the value of its assets, on December 1, 2008 the Company requisitioned a special meeting of the shareholders of Nucryst to consider the return of capital to Nucryst shareholders of approximately US $14.7 million or US $0.80 per share. This meeting was held on February 12, 2009 and the shareholders approved the return of capital to be distributed on February 25, 2009. This will result in a net reduction of approximately $4.6 million of consolidated cash with the payment of approximately US $3.7 million to Nucryst's minority shareholders. Nucryst's cash position will be reduced by approximately $18.0 million while the Company's corporate cash position will increase by approximately $13.4 million.

As the result of reduced activity and staff reductions, the Company's corporate costs were significantly less than 2007. All expected staff reduction costs have been accrued at December 31, 2008. These accruals, which total $2.7 million are expected to be paid over the course of 2009.

No capital expenditures are expected at iFire and no major capital expenditures are planned for Nucryst in 2009.

The Company has no debt. In 2008, the Company entered into a credit arrangement with a major financial institution. The credit agreement, which was extended in January 2009 until March 31, 2009, allows the Company to borrow up to $6.3 million and is secured by ABCP with a face value of $6.3 million. It is expected that this facility will be replaced by a $4.7 million facility with an initial three year term in the first quarter of 2009.

Asset-backed commercial paper

In the third quarter of 2007, global financial markets experienced an unprecedented credit and liquidity crisis. Dominion Bond Rating Service ("DBRS") placed ABCP "Under Review with Developing Implications" following an announcement in August 2007 that a consortium representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement regarding ABCP (the "Montreal Proposal"). Under this proposal, the affected ABCP would be converted into term floating rate notes.

On September 6, 2007, a Pan Canadian Committee (the "Committee") was formed to oversee the proposed restructuring process of the ABCP and on December 23, 2007, the Committee approved an agreement in principle to restructure the ABCP issued by 20 trusts covered by the Montreal Proposal, which includes the investments held by the Company. On March 17, 2008, a court order was obtained through which the restructuring of the ABCP would occur under the protection of the Companies Creditors Arrangement Act ("CCAA"). The restructuring was voted upon and approved on April 25, 2008 on the basis of all ABCP investments being a single class for the purpose of voting and on June 25, 2008 a court order sanctioning the restructuring of the ABCP was made pursuant to the CCAA. On August 18, 2008, the Court of Appeal for Ontario upheld the sanction order and on September 19, 2008, the Supreme Court of Canada denied leave to appeal the Court of Appeal for Ontario's decision. Subsequent to this dismissal, the Committee announced that the process of tendering existing ABCP securities in exchange for new restructured notes had begun.

Under the restructuring plan, all of the ABCP are being exchanged for longer dated notes that match the maturity of the underlying reference assets in the proposed structure. The restructuring also pools certain series of ABCP which are supported in whole or in part by underlying synthetic assets. Under this arrangement, there are three distinct restructuring solutions for (1) Traditional-ABCP which is supported solely by traditional securitized assets, (2) Synthetic-ABCP which is supported by synthetic assets, or a combination of synthetic and traditional securitized assets, and (3) Ineligible-ABCP supported primarily by U.S. sub-prime mortgage assets.

LIQUIDITY AND CAPITAL RESOURCES (continued)

At September 30, 2007, the Company held ABCP with a book value of $14.1 million which reflected a face value of $17.1 million and a reduction in fair value of $3.0 million recorded in the third quarter of 2007. In the fourth quarter of 2007, the Company sold 50% of its holdings in ABCP with a face value of $8.5 million and a book value of $7.0 million for proceeds of $6.0 million. This sale resulted in a loss on the sale of the ABCP of $1.0 million.

On March 20, 2008, the Committee issued an Information Statement containing details about the proposed restructuring. Based on this and other public information it was estimated that, of the $8.5 million of ABCP which the Company held at December 31, 2008 and December 31, 2007:

- $0.6 million is represented by traditional securitized assets and the Company will, on restructuring, receive replacement Traditional Asset Tracking long-term floating rate notes.
- $7.7 million is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term floating rate notes. The Company expected to receive replacement notes with par values as follows:
    - Class A-1: $5.7 million
    - Class A-2: $1.5 million
    - Class B and C: $0.5 million
- $0.2 million is represented by assets that have an exposure to U.S. mortgages and sub-prime mortgages. On restructuring, the Company will receive Ineligible Asset Tracking long-term floating rate notes.

The Company has classified its ABCP as long-term investments held-for-trading. The ABCP in which the Company has invested has not traded in an active market since mid-August 2007 and there are currently no market quotations available. The Company has estimated the fair value of its investments in ABCP considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. In accordance with generally accepted accounting principles, when the market for a financial instrument is not active, the fair value should be estimated using an appropriate valuation technique. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the Committee and the risks associated with the long-term floating rate notes. The Company has used a probability-weighted discounted cash flow approach to value its ABCP investments at December 31, 2008 and December 31, 2007 which considered expected interest rates, fixed/floating interest rate swaps, credit spreads, estimated restructuring fees and estimated renegotiated maturity dates. The assumptions used in this model include: average risk free interest rate of 2.5%; weighted average discount rate of 11.3%; and average maturity of long-term notes of 8.1 years.

The Company was required to use management estimates when calculating this fair value. Interest and discount rates vary by each of the different replacement long-term floating rate notes to be issued as they have different credit ratings and risks. Interest and discount rates also vary by the different probable cash flow scenarios that have been modeled. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. An increase in the estimated discount rates of 1 percent would reduce the estimated fair value of the Company’s investment in ABCP by approximately $0.3 million. Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets. As a result of this valuation, the Company has determined the estimated fair value of the investment in ABCP to be $4.3 million at December 31, 2008.

This represents a reduction in the estimated fair value of $1.7 million from December 31, 2007 primarily as a result of worsening credit markets. The total reduction in the fair value of ABCP amounts to $4.3 million at December 31, 2008, of which $2.6 million was recorded in 2007. The decrease in fair value in 2008 was primarily due to the deterioration in the credit market, reductions in the DBRS credit ratings and increases in liquidity premiums resulting in higher discount rates.

Based on management’s assumptions, the fair value of the Company’s holdings of ABCP could range from $3.9 million to $4.4 million. Continuing uncertainties regarding the value of the assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a change in the fair value of the Company's investment in the ABCP which would impact the Company's results from operations. The Company has sufficient other cash resources and credit facilities to satisfy its financial obligations as they come due over the next twelve months.

On January 21, 2009, the Committee announced the successful implementation of the restructuring plan and that interest payments in respect of interest accrued since the original liquidity disruption in August 2007 to August 31, 2008 (net of restructuring costs) would be made in two installments based on the ABCP note type. Upon the restructuring, the Company received replacement notes (“New Notes”) as follows which reflect the descriptions reported above. The reduction in face value from $8.5 million to $8.4 million is primarily related to realized losses on certain underlying investments and restructuring costs incurred in the restructuring process.

LIQUIDITY AND CAPITAL RESOURCES (continued)

Notes	Maturity Date	Interest Rate (2)	Face Amount ($millions)
MAV II Class A-1	July 15, 2056 (1)	BA – 0.5%	$ 5.7
MAV II Class A-2	July 15, 2056 (1)	BA – 0.5%	1.4
MAV II Class B	July 15, 2056 (1)	BA – 0.5%	0.2
MAV II Class C	July 15, 2056 (1)	BA + 20%	0.2
MAV III Various	December 13, 2027 to July 15, 2056	not finalized (3)	0.8
Other	–	–	0.1
			$ 8.4

(1) Maturity date reflects legal maturity date. Latest maturity date of underlying assets is December 20, 2016.
(2) BA rate is Canadian dollars Bankers Acceptance interest rate with a maturity of 90 days.
(3) Interest rates for MAV III notes have not been finalized.

The MAV II Class A-1 and MAV II Class A-2 notes were assigned an investment grade rating of "A" by the DBRS in January 2009. The MAV II Class B and MAV II Class C notes and MAV III notes have not been rated by the DBRS. Accounting for the exchange of the notes will include settlement of the original notes and recognition of the New Notes. The New Notes will be measured at fair value on initial recognition. The New Notes will be classified as held-for-trading under the Company's Financial Instruments policy which will require them to be fair valued at each period end with changes in fair value included in the consolidated statement of operations in the period in which they arise. Until an active market develops for the New Notes, the fair value will be determined using a discounted cash flow approach based on the maximum use of inputs observed from market conditions on subsequent reporting dates. The fair values may change materially in subsequent periods. As part of the note exchange, the Company received a payment of $0.2 million which was its share of the accumulated interest in the conduit trusts from August 2007 to August 2008. This interest as well as estimated unpaid interest to December 31, 2008 has been included in the Company's fair value calculation at December 31, 2008.

The illiquidity of the ABCP will not have an impact on the Company's ability to complete its 2009 business plan. The Company's accounting for ABCP is discussed more fully in note 7 to the Company's 2008 audited consolidated financial statements.

CURRENT GLOBAL ECONOMIC UNCERTAINTY

Overview

The current global economic uncertainty has not had a significant impact on the Company compared to many other Canadian public companies as a result of the Company's strong balance sheet. At December 31, 2008, the Company, excluding Nucryst, had $18.0 million in cash and cash equivalents and no debt. These funds are invested in Government of Canada Treasury Bills or Bankers Acceptances of Schedule A Canadian Chartered Banks. The Company's cash position will improve with receipt of approximately $13.4 million in March 2009 from the Nucryst return of capital discussed above. The Company's 75% investment in Nucryst could be affected by adverse changes in the equity markets or by changes in Nucryst's operations over which the Company has no control.

As noted in the "*Description of Business*" section, the Board of Directors is actively reviewing strategic alternatives with the objective of realizing maximum shareholder value. At the same time, recognizing that the Company has no ongoing sources of revenue, operating costs have been further reduced through the reduction of staff and the consolidation of corporate facilities. As a result, corporate costs in 2009 are expected to be significantly lower than the $5.1 million reported in 2008.

In addition to its cash position, the Company has land and buildings in Toronto which the Company believes has value in excess of their book value of $1.0 million.

The Company's investment in ABCP has been written down by 50% from its face value of $8.5 million to an estimated fair value of $4.3 million. With the completion of the ABCP restructuring in the first quarter of 2009, the Company will continue to monitor the market value of these assets but has no immediate plans or need to liquidate this investment.

The Company has commitments with respect to employee severance obligations and long-term Board and management compensation that at December 31, 2008 totaled $3.5 million. The Company has a long-term site restoration provision of $6.6 million which is only payable in the event that site remediation takes place on industrial sites formerly owned by the Company. Known remediation costs in the amount of $0.3 million are expected to be paid in 2009 against which equal indemnification payments are expected to be recovered from the previous owner of these industrial sites, with the effect that the net cash cost to the Company is expected to be nominal.

Operations

Nucryst's operations may be negatively impacted by the current economic slowdown. It is possible that worldwide demand for its SILCRYST™ wound care products will slow and that competition and price pressures will increase in the coming year.
Nucryst's products, however, may not be as negatively impacted as other consumer products as they are used by hospitals and medical practitioners whose clients have specific medical needs.

CURRENT GLOBAL ECONOMIC UNCERTAINTY (continued)

Nucryst is reliant on Smith & Nephew as it is Nucryst's only customer for its SILCRYST™ products. A deterioration in Smith & Nephew's financial condition could negatively impact Nucryst. Nucryst's liquidity is not expected to be affected by write-offs of accounts receivable as all of its sales are to Smith & Nephew and no write-offs have been reported in prior years. Nucryst has one specific contractual financial obligation in 2009 in the form of a US $4.5 million payment to Smith & Nephew discussed under "*Nucryst Operations*" above.

Nucryst has been proactive in reducing its overhead costs by closing its office and laboratory facilities in Wakefield, Massachusetts and reducing operating staff at its production facility in Fort Saskatchewan, Alberta. In addition, Nucyst has been successful in reducing unit production costs and these benefits are expected to continue to be realized in 2009.

The return of capital in March 2009 will reduce Nucryst's cash balance by approximately $18.0 million. Nucryst management believes that Nucryst will continue to have sufficient cash resources to operate successfully beyond 2009.

DIVIDENDS

No dividends were paid in 2008 or 2007. The Company's current policy is to retain its cash reserves to finance operations.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and reported in Canadian dollars. The Company's accounting policies are disclosed in note 2 to the Company's 2008 audited consolidated financial statements.

The Company has established detailed policies and control procedures that are intended to ensure that management judgments and estimates are well controlled, independently reviewed and consistently applied from period to period. The following are key policies that may impact the Company's financial condition and results from operations and that require significant judgments by management. Management believes that its estimates for determining the valuation of the Company's assets and liabilities are appropriate.

Revenue Recognition – The Company recognizes revenue from direct sales to third parties when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable, and collection is reasonably assured. The Company's revenues earned under license agreements consist primarily of product revenue, royalties and payments upon the achievement of specific milestones. For products manufactured under license, revenue is recorded at the date of shipment. Royalty revenue is earned based on a percentage of sales revenue earned by the licensee on its sales to third parties. Revenue relating to the achievement of milestones under licensing agreements is recognized when the milestone event has occurred. Manufacturing cost rebates paid annually are recorded as a reduction to revenue evenly throughout the year. Nucryst may also derive revenue from research activities and this revenue is recognized as services are performed.

Research and Development Costs – Development costs are capitalized once the Company has determined that commercialization criteria concerning the product or process have been met. The Company reviews the progress of research and development initiatives on a regular basis and has determined that, in 2008 and 2007, no development costs should be deferred and amortized.

Site Restoration Costs – Future site restoration costs have been estimated by qualified employees or contractors of the Company taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and possible uses of the site. Provision details are based on cost estimates provided by independent consultants. Significant judgment is required in the determination of these provisions and the Company takes a conservative approach in not accruing potential recoveries from third parties where indemnifications are in place. It is the Company's view that where remediation costs will be incurred many years into the future, third party recoveries cannot be estimated with certainty. Revisions to cost estimates and the recovery of actual remediation costs could result in material changes to the provision in future periods. Also see "Environmental Matters".

Income Taxes – The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in the consolidated financial statements. In determining the provision for income taxes and, in particular, any future tax asset, the Company interprets tax legislation in a variety of jurisdictions and makes assumptions about the timing and certainty of the reversal of the future tax assets. Changes to these interpretations could have a material effect on income tax provisions in future periods.

Stock Based Compensation – GAAP requires that the fair value method of accounting for stock options must be recognized in the consolidated financial statements.

Variable Interest Entities ("VIEs") – VIEs include entities where the equity invested is considered insufficient to finance the entity's activities. Under GAAP, the Company is required to consolidate VIEs if the investments held in these entities and/or the relationships with them result in the Company being exposed to a majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both, based on a calculation outlined by the standard setters. The Company currently does not have any VIEs.

CRITICAL ACCOUNTING POLICIES (continued)

Financial Instruments – All financial assets and liabilities are accounted for using one of five available accounting models, being held-to-maturity, available-for-sale, held-for-trading, loans and receivables and other liabilities. All financial instruments classified as available-for-sale, held-for-trading, and derivative financial instruments meeting certain recognition criteria, are carried at fair value. Changes in the fair value of financial instruments designated as held-for-trading and recognized derivative financial instruments are charged or credited to the statement of operations for the current period, while changes in the fair value of financial instruments designated as available-for sale are charged or credited to other comprehensive income and charged or credited to the statement of operations when the instrument is sold. All other financial assets and liabilities are accounted for at amortized cost depending upon the nature of the instrument. Financial assets and liabilities designated as held-to-maturity are initially recognized at their fair values, with any resulting premium or discount from the fair value being amortized to income or expense using the effective interest method. After their initial fair value measurement, they are measured at amortized cost using the effective interest method. Transaction costs related to the acquisition of financial instruments held-for-trading are expensed as incurred. Transaction costs with respect to instruments not classified as held-for-trading are recognized as an adjustment to the cost of the underlying instruments, when they are recognized, and amortized using the effective interest method.

The following is a summary of the accounting model the Company has elected to apply to each of its significant categories of financial instruments:

Cash and cash equivalents	held-for-trading
Short-term investments	held-for-trading
Long-term investments	available-for-sale
Long-term investments - ABCP	held-for-trading
Accounts receivable	loans and receivables
Accounts payable and accrued liabilities	other liabilities
Long-term debt	other liabilities

Derivative instruments are recorded at fair value unless exempted from derivative treatment as normal purchases and sales. All changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case, changes in fair value are recorded in other comprehensive income (loss).

RECENTLY ADOPTED AND PENDING ACCOUNTING PRONOUNCEMENTS

Recently adopted and pending accounting pronouncements

Effective January 1, 2008, the Company adopted two new CICA standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" which replaced Section 3861 "Financial Instruments – Disclosure and Presentation". The new Disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new presentation standard carries forward the former presentation requirements. The Company determined that the implementation of these new standards did not have any impact on the Company's financial position or results of operations. The disclosures related to these sections are reported in note 16 to the Company's 2008 consolidated financial statements.

Effective January 1, 2008, the Company adopted CICA Section 3031 "Inventories". This Section relates to the accounting for inventories and revises and enhances the requirements for assigning costs to inventories. The Company determined that the implementation of this Section did not have any material impact on its consolidated financial statements.

In November 2006, the CICA issued new Handbook Section 1535 "Capital Disclosures", effective for annual and interim periods beginning on or after October 1, 2007. This Section establishes standards for disclosing information about an entity's capital and how it is managed in order that a user of the financial statements may evaluate the entity's objectives, policies and processes for managing capital. The Company's capital disclosures are reported in note 17 to the Company's 2008 consolidated financial statements.

Future accounting pronouncements

In February 2008, the CICA issued new Handbook Section 3064 "Goodwill and Intangible Assets", replacing Handbook Section 3062 "Goodwill and Other Intangible Assets" and Handbook Section 3450 "Research and Development Costs". The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Handbook Section 3062. The Company has determined that the adoption of this new section will not have a material impact on its consolidated financial statements.

RECENTLY ADOPTED AND PENDING ACCOUNTING PRONOUNCEMENTS (continued)

International financial reporting standards

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP and International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, the AcSB announced that January 1, 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP, affecting interim and annual financial statements relating to fiscal years after this time. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company is currently assessing the impact of the convergence of Canadian GAAP with IFRS on results of operations, financial position and disclosures. A high level analysis has been completed to identify areas affected by the change. The Company will provide disclosures of the key elements of its plan and progress on this transaction as the information becomes available during the transition period.

To transition to IFRS, the Company must apply "IFRS 1 – First Time Adoption of IFRS" which sets out the rules for first time adoption. In general, IFRS 1 requires an entity to comply with each IFRS effective at the reporting date for the entity's first IFRS financial statements as if the Company had always reported under IFRS. This requires that an entity apply IFRS to its opening IFRS balance sheet as at January 1, 2010.

Management continues to assess the impact that IFRS will have on the Company including accounting policies, financial reporting and information technology. The nature and extent of the project may be significantly impacted by changes in the strategic direction of the Company.

RISKS AND UNCERTAINTIES

Westaim may be unable to develop commercially viable products.

Some of the Company's products, such as Nucryst's potential wound care products, are still in the development stage. The Company will continue to incur research and development costs before any of these products are commercially viable, and there is no assurance that any of its products will ever reach this stage or that the products will achieve the level of market penetration expected. Some or all of the technological obstacles that will need to be overcome in order to make these products commercially viable may prove to be insurmountable.

If Westaim or its subsidiaries fail to raise the capital necessary to fund its operations, they may be unable to advance the development and commercialization of their technologies.

A commitment of substantial resources by the Company, its subsidiaries and its collaborators to conduct research and development into new products will be required to successfully commercialize products under development. The Company or its subsidiaries may not be able to raise additional capital at the time it is needed to complete product development. Additional capital may be required to fund operations, continue the research and development of product candidates and commercialize products. If the Company or its subsidiaries are unable to raise additional funds when required, it may be necessary to delay, reduce or eliminate some or all of their development programs.

Westaim's success is dependent upon its ability to form partnerships to develop and sell its products.

The Company's and its subsidiaries' ability to successfully develop, manufacture and market their current and proposed products will depend, to a large extent, on their ability to form partnerships or joint ventures with established corporations or other collaborators. Except as described elsewhere in this document, the Company and its subsidiaries have not yet entered into any material partnerships or joint ventures for the development or marketing of these products, nor will they necessarily be able to do so in the future. The Company and its subsidiaries may be unable to find suitable partners or form a partnership or joint venture on terms that are beneficial. If the Company and its subsidiaries do enter into a partnership or joint venture, they may suffer losses if the partner becomes insolvent or otherwise fails to meet its obligations.

Westaim's products may become technologically obsolete.

The Company and its subsidiaries compete, and intend to compete, in markets that are characterized by rapid adaptation to technological change. These markets include, but are not limited to, the medical devices and pharmaceuticals markets. The current and future products of the Company and its subsidiaries may be quickly rendered obsolete and unmarketable. The Company and its subsidiaries will need to continually develop new products and enhance existing products to keep pace with evolving technologies, customer preferences and industry standards.

Westaim is developing products for highly competitive markets.

The Company and its subsidiaries face, and will face, competition from a number of other companies including major domestic and international companies which have substantially greater financial, technical, marketing, sales, distribution and other resources. Many of these competitors may also have greater name or brand recognition. Competitors may produce more technologically-advanced products, at a lower cost, than the Company or its subsidiaries are capable of producing.

RISKS AND UNCERTAINTIES (continued)

Competition may cause the Company or its subsidiaries to lose market share and may reduce profit margins on any products that it is able to sell.

Westaim may be unable to protect its intellectual property.

In order to succeed, the Company and its subsidiaries will need to prevent their intellectual property from being misappropriated by third parties. To protect their intellectual property, the Company and its subsidiaries rely primarily on their confidentiality agreements, physical security at research and manufacturing facilities, as well as the copyright, trade secret, trademark and patent laws of Canada, the United States, and other countries in which the Company and its subsidiaries conduct, or will conduct, business. The laws of other countries may not protect intellectual property rights to the same extent as the laws of Canada and the United States and, in any event, the methods that the Company and its subsidiaries have chosen may fail to adequately prevent misappropriation of their intellectual property.

The Company and its subsidiaries cannot provide assurance that they will succeed in obtaining new patents; that they will be able to enforce existing patents against third parties; or that existing patents will not be successfully challenged by third parties. Even if the Company and its subsidiaries are able to prevent the misappropriation of intellectual property, others may independently and legally develop technologies that are substantially equivalent or superior.

Westaim may become involved in expensive intellectual property, product liability or other litigation.

The Company and its subsidiaries may be required to commence litigation to enforce their intellectual property rights. Others may claim that the Company or its subsidiaries have infringed upon their intellectual property rights and commence litigation.

Some of the Company's and it subsidiaries' existing and proposed products, such as Nucryst's medical devices and pharmaceuticals, are part of a class of product that is particularly vulnerable to product liability litigation for a number of reasons:

- These types of products are extremely complex and the Company and its subsidiaries may fail to discover product faults, despite their best efforts to do so;
- These types of products will interact with very complex biological and man-made systems and may interact with these systems in harmful ways that the Company and its subsidiaries were unable to anticipate, despite their best efforts to do so; and
- Because these products may be used by a large number of people, if these products do cause harm, the Company or its subsidiaries may be exposed to a large number of claims for damages.

The Company and its subsidiaries have tried to protect themselves against product liability litigation by including limitation of liability provisions in some of their sales agreements. There is no assurance, however, that existing or future limitation of liability provisions will be sufficient to protect the Company and its subsidiaries in all circumstances, nor can assurance be provided that any of these provisions will be held to be enforceable by the Courts.

The Company believes that it has obtained sufficient product liability insurance coverage to protect it against claims. However, the wording of its insurance policies may exclude some claims. Furthermore, the Company cannot provide assurance that its insurance limits will be sufficient, nor can it ensure that it will be able to acquire satisfactory insurance in the future.

The Company may also be subject to other litigation as a result of entering into agreements or terminating agreements in the course of normal operations or actual or proposed reorganizations or strategic alliances. Any such litigation, if successful, could have an adverse effect on the Company and its results of operations.

Westaim may be unable to retain the required highly skilled people.

The Company's technology businesses are dependent upon the talents and knowledge of certain key individuals in each of the businesses. The marketplace for people with these skills is highly competitive, and the Company may not be able to retain a sufficient number of people with the skills that it requires. The Company provides competitive remuneration and incentives for the retention of key personnel.

Westaim is subject to certain risks because of the international character of its business.

The Company estimates that sales to international customers accounted for over 90% of its consolidated net sales in the fiscal year ended December 31, 2008 and the Company anticipates that international sales will continue to represent a material portion of consolidated net sales in the future. International sales are subject to inherent risks, including variations in local economies, fluctuating exchange rates, greater difficulty in the collection of accounts receivable, changes in tariffs and other trade barriers, adverse foreign tax consequences and burdens of complying with a variety of foreign laws. The Company may also encounter exchange rate risk in the event international sales are denominated in a currency other than Canadian dollars.

The Company's financial results are reported in Canadian dollars. A significant portion of the Company's revenue and expenses, as well as accounts payable, accounts receivable and other balance sheet items, are frequently denominated in currencies other than the Canadian dollar, primarily in United States dollars. Fluctuations in the exchange rate between these other currencies and the Canadian dollar could reduce the Company's reported revenue, increase the Company's costs or give rise to a charge related to foreign currency translation, all of which could adversely affect operating results.

RISKS AND UNCERTAINTIES (continued)

Westaim's investment in third party asset-backed commercial paper may be overstated.

The Company has estimated the fair value of its investment in ABCP. There is currently no market for ABCP and in accordance with GAAP the Company has made assumptions to calculate the estimated fair value of the ABCP. There is no assurance that the estimated fair value reported approximates the actual value that will be realized.

Westaim's success is dependent on the success of Nucryst.

Westaim's shareholdings in Nucryst represent a substantial portion of Westaim's assets. Nucryst completed its initial public offering in December 2005 and although Westaim continues to hold a majority interest in Nucryst, Westaim now has a limited ability to control the operations of Nucryst and the associated costs, which could adversely affect Westaim's financial performance. Westaim's return on its investment in Nucryst will depend upon a number of factors that may be beyond Westaim's control, including the risk factors set forth above that relate to Nucryst. In addition, Nucryst is subject to several additional risks including, but not limited to the following:

- Nucryst is dependent on its relationship with Smith & Nephew and Smith & Nephew's performance under contractual agreements. Smith & Nephew is currently Nucryst's only customer;
- Nucryst has a history of net losses and negative cash flow from operations; this will likely continue in the future and Nucryst's cash resources may not be adequate to accomplish its objectives;
- A global recession could negatively affect the demand for Nucryst's products sold to Smith & Nephew which could negatively affect Nucryst's liquidity and the recorded value of Nucryst's accounts receivable, inventory and capital assets;
- Nucryst's proposed products will require regulatory approval before Nucryst is allowed to sell them. The regulatory approval process will be lengthy and expensive and Nucryst will have the burden of proving that its products are safe and effective. Even if regulatory approval is obtained, such approval could cause Nucryst's products to become prohibitively expensive. There is no assurance that Nucryst will ever obtain regulatory approval to sell any of its proposed products, or that the conditions imposed by regulators will be satisfactory to Nucryst. Regulatory requirements imposed on Nucryst's products could limit Nucryst's ability to test, manufacture and commercialize its products;
- Nucryst's ability to commercialize its medical products successfully will depend in part on the extent to which reimbursement for the cost of such products and related treatments will be available from government health administration authorities, private health insurers and other organizations and there can be no assurance that adequate third party coverage will be available for Nucryst to realize an appropriate return on its investment in product development; and
- Nucryst's tax pools are subject to review and potential disallowance, in whole or in part, by the Canada Revenue Agency ("CRA") in Canada and the Internal Revenue Service in the United States upon audit of Nucryst's federal income tax returns, and Nucryst cannot predict the results of any such review. In 2005, the CRA commenced an examination of Nucryst's Canadian income tax returns for 2001 and 2002 and in December 2007, Nucryst received correspondence from the CRA proposing certain transfer pricing adjustments with respect to income allocations between Nucryst's Canadian and U.S. entities for those years. Any reassessments to be issued by the CRA, on an aggregate basis, could result in a material effect on Nucryst's consolidated financial statements, although at this time, the potential impact cannot be reasonably estimated.

A failure on the part of Nucryst to properly manage the above risks, or any of the other risks it is subject to, will have an adverse impact on the value of Westaim's investment in Nucryst.

VOLATILITY OF SHARE PRICE

Market prices for securities of companies developing new technologies are generally volatile. Factors such as announcements of technological innovations, new commercial products, patents, the development of proprietary rights, results of clinical trials, regulatory actions, publications, quarterly financial results, the Company's financial position, public concern over the safety of biotechnology and nanotechnology, future sales of shares by the Company or by our current shareholders, and other factors, could have a significant effect on the market price and volatility of the Company's common shares.

The price of the common shares may be volatile even though there have been no material changes in the Company's business or finances. In the past, securities class action litigation has often been brought against companies that experience volatility in the market price of their securities. Moreover, market prices for stocks of technology companies frequently reach levels that bear no relationship to the operating performance of such companies. These market prices generally are not sustainable and are subject to wide variations. Whether or not meritorious, litigation brought against the Company could result in substantial costs, divert management's attention and resources and harm the Company's financial condition and results of operations.

ENVIRONMENTAL MATTERS

Nucryst's operations are subject to extensive federal, state, provincial and municipal environmental statutes, regulations and policies, including those promulgated by the Occupational Safety and Health Administration, the EPA, Environment Canada, Alberta Environment, the Department of Health Services, and the Air Quality Management District, that govern activities and operations that may have adverse environmental effects such as discharges to air and water, as well as handling and disposal practices for solid and hazardous wastes.

ENVIRONMENTAL MATTERS (continued)

Some of these statutes and regulations impose strict liability for the costs of cleaning up, and for damages resulting from sites of spills, disposals, or other releases of contaminants, hazardous substances and other materials and for the investigation and remediation of environmental contamination at properties leased or operated by Nucryst and at off-site locations where Nucryst has arranged for the disposal of hazardous substances.

Nucryst has not been required to make material expenditures to comply with current environmental statutes, regulations and policies.

The Company's provision for site restoration at December 31, 2008 and 2007 amounted to $6.6 million. The provision relates primarily to site restoration costs associated with soil and groundwater reclamation and remediation costs. The Company expects to spend only nominal amounts in future years unless a plant site formerly owned by the Company is decommissioned.

MARKET FOR SECURITIES

The common shares of The Westaim Corporation are listed on The Toronto Stock Exchange ("TSX") under the symbol "WED" and until October 18, 2007 were also listed on NASDAQ. On April 10, 2007, the Company received notice from NASDAQ that, for 30 consecutive business days, the bid price of the Company's common stock listed on NASDAQ had closed below US $1.00, which is in contravention of NASDAQ's Marketplace Rules. The Company was given 180 calendar days to regain compliance by achieving a bid price at or above US $1.00 per share for a minimum of ten consecutive days. The Company did not regain compliance with the bid price requirement. Effective October 18, 2007, the Company's shares were delisted from the NASDAQ national market and suspended from trading. Over the previous 12 months, more than 80% of the Company's trading by volume had occurred on the TSX.

On October 20, 2008, the Company announced its intention to deregister and terminate its reporting obligations associated with its previous NASDAQ listing under section 12(g) and 15(d) of the *U.S. Securities and Exchange Act of 1934*, as amended, and filed a Form 15-F with the Securities Exchange Commission ("SEC") which immediately suspended the Company's United States reporting obligations. These reporting obligations were formally terminated in January 2009 after a 90 day waiting period. The deregistration and termination had no effect on the Company's common shares or on its shareholders as the Company continues to trade on the TSX.

OUTSTANDING SHARE DATA

The Company's authorized share capital consists of an unlimited number of common shares, preferred A shares and preferred B shares. As at December 31, 2008 and February 12, 2009, there were 94,214,632 common shares outstanding. There were no preferred shares outstanding at December 31, 2008 and February 12, 2009.

The Company maintains an employee and director stock option plan under which the Company may grant options for up to 10,955,445 shares of common stock of the Company at an exercise price equal to the closing market price of the Company's stock for the trading day immediately preceding the date of grant. As at December 31, 2008 and February 12, 2009, there were 4,098,597 options outstanding.

CONTRACTUAL COMMITMENTS

($000)	Payments due by Period				
As at December 31, 2008	Total	Less than 1 Year	1 - 3 Years	3 – 5 Years	More than 5 Years
Capital lease obligations	$ –	$ –	$ –	$ –	$ –
Operating lease obligations	8,568	1,713	3,462	2,205	1,188
Contractual obligations	5,786	5,786	–	–	–
Supplier purchase obligations [1]	1,261	1,261	–	–	–
Other long-term liabilities reflected on the Company's consolidated balance sheet	–	–	–	–	–
	$ 15,615	$ 8,760	$ 3,462	$ 2,205	$ 1,188

[1] Included in supplier purchase obligations are commitments for capital expenditures totaling $41 and agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms.

DISCLOSURE CONTROLS AND PROCEDURES ("DC & P")

DC & P are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed with or submitted to various securities regulators is recorded, processed, summarized and reported within the time periods specified. This information is gathered and reported to the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), so that timely decisions can be made regarding disclosure.

DISCLOSURE CONTROLS AND PROCEDURES ("DC & P") (continued)

The Company's management, under the supervision of, and with the participation of, the CEO and CFO, have designed and evaluated the Company's DC & P, as required in Canada by "National Instrument – 52-109, Certification of Disclosure in The Company's management, under the supervision of, and with the participation of, the CEO and CFO, have designed and evaluated the Company's DC & P, as required in Canada by "National Instrument – 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings". Based on this evaluation, the CEO and CFO have concluded that, as of December 31, 2008, the Company's DC & P were effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING ("ICFR")

Designing, establishing and maintaining adequate ICFR is the responsibility of the Company's management. ICFR is a process designed by, or under the supervision of, senior management, and effected by the Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Company's consolidated financial statements in accordance with GAAP. Management is responsible for establishing and maintaining ICFR and has designed such controls to ensure that the required objectives of these internal controls have been met. Management uses the Internal Control – Integrated Framework to evaluate the effectiveness of internal control over financial reporting, which is a recognized and suitable framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company continually reviews and enhances its systems of controls and procedures. However, because of the inherent limitations in all control systems, management acknowledges that ICFR will not prevent or detect all misstatements due to error or fraud.

As of December 31, 2008, the CEO and the CFO of the Company have evaluated the effectiveness of the Company's ICFR. Based on those evaluations, the CEO and CFO have concluded that as at December 31, 2008, the controls and procedures were operating effectively. There are no material weaknesses that have been identified by management in this regard.

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table sets forth certain financial information for the Company for 2006 to 2008:

($000, except per share data)	Year ended Dec. 31, 2008	Year ended Dec. 31, 2007	Year ended Dec. 31, 2006
Revenue from continuing operations	$ 22,397	$ 31,830	$ 27,591
Loss from continuing operations [1]	(1,735)	(2,830)	(12,861)
Loss per common share from continuing operations – basic and diluted	(0.02)	(0.03)	(0.14)
Net loss	(10,235)	(58,033)	(50,557)
Net loss per common share – basic and diluted	(0.11)	(0.62)	(0.54)
Total assets	77,277	83,387	148,339
Total long-term debt	–	–	8,000
Dividends declared	–	–	–

[1] As disclosed in Note 3 to the audited consolidated financial statements, and discussed in this MD&A, the iFire business segment has been accounted for as a discontinued operation in 2008, 2007 and 2006.

QUARTERLY INFORMATION

($000, except per share data)	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Revenue from continuing operations	$ 5,209	$ 4,754	$ 5,466	$ 6,969
Income (loss) from continuing operations	3,227	(1,887)	(1,851)	(1,224)
Income (loss) per common share from continuing operations – basic and diluted	0.03	(0.02)	(0.02)	(0.01)
Net (loss) income	(6,857)	(3,002)	(3,122)	2,746
Net (loss) income per common share – basic and diluted	(0.07)	(0.03)	(0.03)	0.03

($000, except per share data)	Q1 2007	Q2 2007	Q3 2007	Q4 2007
Revenue from continuing operations	$ 6,131	$ 6,686	$ 7,839	$ 11,174
Income (loss) from continuing operations	1,898	2,875	(8,772)	1,169
Income (loss) per common share from continuing operations – basic and diluted	0.02	0.03	(0.09)	0.01
Net loss	(6,700)	(7,388)	(17,138)	(26,807)
Net loss per common share – basic and diluted	(0.07)	(0.08)	(0.18)	(0.28)

QUARTERLY INFORMATION (continued)

The net loss in the first quarter of 2008 includes a dilution gain of $6.0 million. This was offset by a write-down of capital assets at iFire of $7.1 million included in discontinued operations. The net loss in the third quarter of 2008 includes a write-down of $0.9 million in the value of the Company's investment in ABCP. The net income in the fourth quarter of 2008 includes a $5.3 million gain on the sale of capital assets at iFire included in discontinued operations partially offset by an additional $0.9 million write-down in the value of ABCP.

The net loss in the first quarter of 2007 was impacted by a dilution gain of $4.5 million. The net loss in the second quarter of 2007 was impacted by the gain on sale of capital assets of $8.6 million, partially offset by $4.3 million in reorganization costs, including severance. The net loss in the third quarter of 2007 was impacted by restructuring costs of $2.3 million and increased depreciation expense of $2.2 million. In addition, the third quarter of 2007 was impacted by a $3.0 million write-down in the value of the Company's investment in ABCP. Revenues in the third quarter of 2007 were impacted by a $5.0 million milestone payment offset by a $4.5 million manufacturing cost rebate. Net income in the fourth quarter of 2007 was impacted by milestone revenue of US $5.0 million and gain on sale of an investment of $2.6 million offset by losses relating to ABCP of $2.1 million. Discontinued operations in the fourth quarter of 2007 were impacted by a $22.1 million write-down in the value of capital assets at iFire.

Forward Looking Statements

Certain portions of this Management's Discussion and Analysis, as well as other public statements by Westaim, contain forward-looking statements. In particular, the words "strategy", "may", "will", "continue", "developed", "objective", ""potential", "exploring", ""could", "expect", "expected", "expects", "indicates", and words and expressions of similar import, are intended to identify forward-looking statements. Such forward-looking statements include but are not limited to statements concerning the expectation that Nucryst and Smith & Nephew will establish new fixed prices in 2010; Nucryst's exploration of commercialization options through partnering opportunities; estimates and assumptions regarding the value of the Company's investment in asset-backed commercial paper; computation of values expected to be received upon exercise of stock options; commercialization strategies, alternatives and objectives; technology development and investment strategies; strategic alternatives to maximize value for shareholders; the market potential of new Nucryst products and the effect thereon of distribution channel decisions and evaluations; the development of new products using NPI 32101; Nucryst's expectation that it will not develop additional pharmaceutical applications for NPI 32101 without commercial or development partners; statements relating to Nucryst's payment of manufacturing cost rebates to Smith & Nephew and the impact of such payments on Nucryst's gross margin; Nucryst's expectations regarding reduction of general and administrative expenses in 2009; expectations regarding lower capital spending in 2009; the potential material adverse effects of amendments to Nucryst's agreements with Smith & Nephew on Nucryst's quarterly financial results in subsequent periods; Nucryst's expectation that amendments to its agreements with Smith & Nephew will facilitate its ongoing efforts to expand its business opportunities and to support Smith & Nephew to realize the future growth potential of ActicoatTM products; statements regarding Nucryst having sufficient cash to execute its 2009 business plan; the potential for Nucryst to be impacted by a global recession, including reductions in sales volumes, pressure on product pricing, slowing of demand for its wound care products, increasing competition and price pressures, and the possibility that Nucryst's products many not be as negatively impacted as other consumer products; that proceeds relating to sale of iFire's intellectual property will be less than the book value of such assets, and that no material gain or loss is expected to be reported on the transaction; statements regarding iFire's operations in 2009 being limited to delivery of assets to purchasers and seeking purchasers; statements regarding termination of iFire employees and iFire's operating costs; expectations and assumptions relating to the Company's 2009 business plan, including Nucryst having sufficient cash and cash equivalents to fund its operations and new product development beyond 2009 and the Company having sufficient cash and cash equivalents to fund the Company's corporate operations including iFire activities; anticipated changes to the cash position of Nucryst and of the Company as a result of the return of capital from Nucryst to Westaim; expectations relating to capital expenditures and capital commitments; expectations regarding the Company's credit facility; affect of adverse changes in equity markets or Nucryst's operations; expectations regarding lower corporate costs in 2009; the Company's belief regarding the value of its land and buildings in Toronto; statements respecting expected remediation costs and indemnification payments, and resulting nominal net cash cost to the Company of remediation; the possibility that a deterioration in Smith & Nephew's financial condition could negatively impact Nucryst; the expectation that Nucryst's liquidity is not expected to be affected by write-offs of accounts receivable since all of its sales are to Smith & Nephew and no write-offs have been reported in prior years; management's belief that its estimates for determining the valuation of the Company's assets and liabilities are appropriate; the Company's view that where remediation costs will be incurred many years into the future, third party recoveries cannot be estimated with certainty and that revisions to cost estimates and the recovery of actual remediation costs could result in material changes to the provision in future periods; that changes to interpretations of tax legislation could have a material effect on income tax provisions in future periods; the Company's determination that the adoption of new accounting standards will not have a material impact on its consolidated financial statements; the statements made in the sections on Risks and Uncertainties, Volatility of Share Price, and Environmental Matters; These statements are based on current expectations that are subject to risks, uncertainties and assumptions and the Company can give no assurance that these expectations are correct. The Company's actual results could differ materially from those anticipated by forward-looking statements for various reasons generally beyond our control, including but not limited to: (i) market and competing technology developments which might affect the ability or willingness of potential iFire partners or purchasers of any of iFire's assets or business to manufacture and market products based on iFire's technology; (ii) cost estimates based upon assumptions which may prove to be unrealistic; (iii) delays or problems in receiving regulatory approvals for Nucryst's products, including from the FDA; (iv) the degree to which Smith & Nephew plc succeeds in selling Acticoat™ products; (v) unexpected obstacles or complexities associated with developing iFire or Nucryst technology, manufacturing processes and new applications; (vi) patent and technical hurdles which might inhibit or delay the ability of Nucryst to develop or commercialize technologies or products; (vii) general economic, market, financing, regulatory and industry developments and conditions in the industries that the Company and Nucryst serve, which among other things might affect the demand for electronic materials and pharmaceutical products or the ability to raise new capital or affect potential partner ability to contribute financially; (viii) the activities of our competitors and technological developments that diminish the attractiveness of our products; and (ix) other risk factors set forth in the Company's Annual Report or Annual Information Form. The Company disclaims any intention or obligation to revise forward-looking statements whether as a result of new information, future developments or otherwise. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.

WESTAIM

February 12, 2009

**MANAGEMENT'S RESPONSIBILITY
FOR FINANCIAL INFORMATION**

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report have been prepared by, and are the responsibility of, the management of The Westaim Corporation. Financial information contained throughout this annual report is consistent with the financial statements. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgements when appropriate. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. In meeting our responsibility for the reliability and timeliness of financial information, the Corporation maintains and relies upon a comprehensive system of internal controls including organizational, procedural and disclosure controls. The Audit Committee, which is comprised of three Directors, none of whom is an officer of the Company, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors who approve the consolidated financial statements.

As at December 31, 2008, I, as The Westaim Corporation's Chief Executive Officer and Chief Financial Officer, have determined that the Corporation's internal control over financial reporting is effective. I have certified the annual filings of The Westaim Corporation as required in Canada by National Instrument 52-109 (Certification of Disclosures in Issuers' Annual and Interim Filings).

The consolidated financial statements have been audited by Deloitte & Touche LLP, the independent auditors, in accordance with generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

G.A. (Drew) Fitch
President and Chief Executive Officer
and Chief Financial Officer

Auditors' Report

To the Shareholders of
The Westaim Corporation

We have audited the consolidated balance sheets of The Westaim Corporation as at December 31, 2008 and 2007 and the consolidated statements of loss, comprehensive loss, deficit and cash flow for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

Deloitte + Touche LLP

Chartered Accountants
Edmonton, Canada

February 12, 2009

THE WESTAIM CORPORATION
Consolidated Balance Sheets

(thousands of Canadian dollars)	December 31 2008	December 31 2007
ASSETS		
Current		
Cash and cash equivalents	$ 46,768	$ 30,993
Accounts receivable	6,272	14,931
Inventories (note 6)	3,535	4,373
Other	772	674
Current assets held for sale (note 3)	2,436	590
	59,783	51,561
Investments (note 7)	4,262	5,968
Capital assets (note 8)	11,486	12,581
Capital assets held for sale (note 3)	1,103	10,086
Intangible assets (note 9)	643	799
Intangible assets held for sale (note 3)	-	2,392
	$ 77,277	$ 83,387
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities (note 21)	$ 6,956	$ 7,018
Accounts payable and accrued liabilities held for sale (note 3)	2,885	1,443
	9,841	8,461
Deferred gain (note 4)	-	218
Provision for site restoration (note 12)	6,580	6,580
	16,421	15,259
Non-controlling interest (note 5)	10,854	11,757
Guarantees (note 14)		
Commitments and contingencies (note 15)		
Shareholders' equity		
Capital stock (note 13)	426,280	426,262
Contributed surplus (note 13)	8,718	7,769
Accumulated other comprehensive income (loss) (note 2r)	1,120	(1,779)
Deficit	(386,116)	(375,881)
	50,002	56,371
	$ 77,277	$ 83,387

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the Board:

Ian W. Delaney
Director

Frank W. King
Director

THE WESTAIM CORPORATION
Consolidated Statements of Operations and Consolidated Statements of Comprehensive Loss and Deficit

(thousands of Canadian dollars except per share data)	Year Ended December 31 2008	Year Ended December 31 2007
Revenue	$ 22,397	$ 31,830
Costs		
Manufacturing	12,603	14,617
Research and development	4,582	6,356
General and administrative	9,666	9,348
Depreciation and amortization	1,937	2,093
Corporate costs (note 21)	5,068	10,856
Operating loss	(11,459)	(11,440)
Foreign exchange gain (loss)	3,510	(3,804)
Interest	712	1,822
Change in fair value of third party asset-backed commercial paper (note 7)	(1,706)	(4,048)
Loss on sale of third party asset-backed commercial paper (note 7)	-	(1,067)
Write-down of capital assets (note 8)	(215)	(1,203)
Gain on sale of investments (note 4)	534	2,648
Gain on sale of capital assets (note 8)	-	8,722
Dilution gain (note 4)	6,000	4,525
Gain (loss) on issuance and repurchase of shares of subsidiary (note 5)	96	(134)
Non-controlling interest (note 5)	804	1,293
Loss from continuing operations before income taxes	(1,724)	(2,686)
Income tax expense (note 10)	(11)	(144)
Loss from continuing operations	(1,735)	(2,830)
Loss from discontinued operations net of income taxes (note 3)	(8,500)	(55,203)
Net loss	$ (10,235)	$ (58,033)
Loss per common share (note 18)		
Continuing operations - basic and diluted	$ (0.02)	$ (0.03)
Net loss - basic and diluted	(0.11)	(0.62)
Weighted average number of common shares outstanding		
Basic	94,207,494	94,069,547
Diluted	94,207,494	94,069,547

Consolidated Statements of Comprehensive Loss

Net loss	$ (10,235)	$ (58,033)
Unrealized gain (loss) on translation of net foreign operations (note 2c)	2,899	(1,103)
Comprehensive loss	$ (7,336)	$ (59,136)

Consolidated Statements of Deficit

Deficit at beginning of year	$ (375,881)	$ (317,848)
Net loss	(10,235)	(58,033)
Deficit at end of year	$ (386,116)	$ (375,881)

The accompanying notes are an integral part of these consolidated financial statements.

THE WESTAIM CORPORATION
Consolidated Cash Flow Statements

(thousands of Canadian dollars)	Year Ended December 31 2008	Year Ended December 31 2007
Operating activities		
Loss from continuing operations	$ (1,735)	$ (2,830)
Items not affecting cash		
Depreciation and amortization	1,937	2,093
Change in fair value of third party asset-backed commercial paper	1,706	4,048
Loss on sale of third party asset-backed commercial paper	-	1,067
Dilution gain	(6,000)	(4,525)
Stock-based compensation expense	1,027	2,469
Write-down of capital assets	215	1,203
Gain on sale of capital assets	-	(8,722)
Gain on sale of investments	(534)	(2,648)
(Gain) loss on issuance and repurchase of shares of subsidiary	(96)	134
Non-controlling interest	(804)	(1,293)
Accounts receivable	9,057	(7,190)
Inventories	838	4,128
Other	(90)	(98)
Accounts payable and accrued liabilities	270	1,131
Cash provided from (used in) continuing operations	5,791	(11,033)
Cash used in discontinued operations	(5,712)	(19,739)
Cash provided from (used in) operating activities	79	(30,772)
Investing activities		
Capital expenditures	(1,243)	(2,376)
Intangible assets	(39)	(72)
Proceeds on sale of subsidiary (note 4)	1,816	-
Proceeds on sale of discontinued operations (note 3)	8,165	24
Proceeds on sale of capital assets (note 8)	65	14,437
Intangible assets - discontinued operations	-	(480)
Maturity of short-term investments	-	46,904
Purchase of short-term investments	-	(29,453)
Purchase of short-term investments reclassified to investments	-	(14,400)
Reclassification of cash equivalents to investments	-	(2,650)
Proceeds on sale of investments (note 4)	-	1,582
Proceeds on sale of third party asset-backed commercial paper (note 7)	-	5,968
Cash provided from investing activities	8,764	19,484
Financing activities		
Issuance of common shares of subsidiary (note 4)	1,000	14
Repurchase of common shares by subsidiary (note 5)	(63)	-
Issuance of convertible debentures of subsidiary (note 4)	3,500	-
Issuance of common shares (note 13)	-	27
Net cash outflow on deconsolidation of former subsidiary (note 4)	-	(2,306)
Cash provided from (used in) financing activities	4,437	(2,265)
Effect of exchange rate changes on cash and cash equivalents	2,495	(489)
Net increase (decrease) in cash and cash equivalents	15,775	(14,042)
Cash and cash equivalents at beginning of year	30,993	45,035
Cash and cash equivalents at end of year	$ 46,768	$ 30,993
Cash and cash equivalents is comprised of:		
Cash	4,332	12,537
Cash equivalents	42,436	18,456
	46,768	30,993
Supplemental disclosure of cash flow information:		
Non-cash capital asset additions included in accounts payable and accrued liabilities	$ 5	$ 452

The accompanying notes are an integral part of these consolidated financial statements.

1 BASIS OF PRESENTATION

The Westaim Corporation (the "Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporations Act (Alberta).

These consolidated financial statements include the accounts of the Company and its subsidiaries, iFire Technology Ltd. ("iFire") and Nucryst Pharmaceuticals Corp. ("Nucryst").

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and were prepared using GAAP applicable to a going concern which contemplate that the Company will continue in operation for the foreseeable future and will be able to realize assets and settle liabilities in the normal course of business as they come due. Management believes that the Company has sufficient cash resources to meet its obligations beyond the next twelve months from December 31, 2008 and that there are no material uncertainties relating to expected future events that may cast significant doubt on whether the Company can continue as a going concern.

All amounts are expressed in thousands of Canadian dollars except share and per share data unless otherwise noted.

2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

a) Principles of consolidation

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. Entities which are not controlled but over which the Company has the ability to exercise significant influence, are accounted for using the equity method. Investments in other entities are accounted for using the cost method. Variable interest entities ("VIEs") are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are consolidated by the Company when it is determined that it will, as the primary beneficiary, absorb the majority of the VIEs' expected losses and/or expected residual returns. The Company currently does not have any VIEs. Intercompany balances and transactions are eliminated upon consolidation.

b) Use of estimates

GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the year. Significant estimates include the provision for site restoration, inventory valuation, fair value of stock-based compensation, fair value of financial instruments including asset-backed commercial paper, valuation allowance against future income taxes, useful lives of capital assets and intangible assets, uncertain tax positions and the fair value of assets held for sale. Actual results could differ materially from those estimates.

c) Translation of foreign currencies

Transactions in foreign currencies are translated into Canadian dollars at rates of exchange at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. The resulting gains and losses are included in the consolidated statement of operations.

Foreign operations are considered financially and operationally self-sustaining and are translated into Canadian dollars using the current rate method of translation. Under this method, assets and liabilities are translated at the year-end exchange rates. Unrealized gains and losses arising from translating net investments in foreign operations into Canadian dollars are included in shareholders' equity as a component of accumulated other comprehensive income.

d) Revenue recognition

Specific revenue recognition policies for the Company's operating segment are as follows:

Nucryst – Revenue from direct sales to third parties is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable, and collection is reasonably assured. The Company's revenues earned under license agreements consist primarily of product revenue, royalties and payments upon the achievement of specific milestones. For products manufactured under license, revenue is recorded at the date of shipment. Royalty revenue is earned based on a percentage of sales revenue earned by the licensee on its sales to third parties. Revenue relating to the achievement of milestones under licensing agreements is recognized when the milestone event has occurred. Manufacturing cost rebates paid annually are

2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

recorded as a reduction to revenue evenly throughout the year. Nucryst may also derive revenue from research activities and this revenue is recognized as services are performed (note 20).

e) Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities at the date of acquisition of 90 days or less and are recorded at fair value as they are classified as held-for-trading financial assets (note 16). Cash and cash equivalents at December 31, 2008 is comprised of cash of $4,332 (2007 - $12,537) and cash equivalents of $42,436 (2007 - $18,456).

f) Short-term investments

Short-term investments consist of money-market instruments with maturities of less than one year and are classified as held-for-trading financial assets (note 16). As at December 31, 2008 and 2007, the Company did not hold any short-term investments.

g) Long-term investments

Long-term investments are reported at fair value and are classified as held-for-trading or available-for-sale financial assets (note 16).

h) Inventory valuation

Finished product, raw materials, and materials in process are valued at the lower of average cost and net realizable value.

i) Research and development costs

Research costs are expensed as incurred and significant project development costs are capitalized in accordance with GAAP once the Company has determined that commercialization criteria concerning the product or process have been met. Amortization of these costs over their estimated useful life commences with the successful commercial production or use of the product or process. On an ongoing basis, management reviews the unamortized balance to ensure that the deferred development costs continue to satisfy the criteria for deferral and amortization.

As at December 31, 2008 and 2007, no development costs have been capitalized.

j) Capital assets

Land, buildings, machinery and equipment, and computer hardware and software are stated at cost. Depreciation is calculated using a straight-line method based on the estimated useful lives of the particular assets which are 20 years for buildings, and 2 to 10 years for machinery and equipment, and computer hardware and software. Leasehold improvements are depreciated using the straight-line method over the lesser of the term of the lease or the estimated useful life of the assets.

The Company evaluates the carrying value of capital assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable, and recognizes an impairment charge when it is probable that estimated future non-discounted cash flows of the underlying assets will be less than the carrying value of the assets. Measurement of an impairment loss related to capital assets that management intends to hold and use is based on the fair value of the assets, whereas assets to be disposed of are reported at the lower of the carrying amount or fair value less estimated costs to sell.

k) Site restoration costs

The total estimated costs of site restoration relating to tangible, long-lived assets have been accrued. Site restoration costs have been estimated, taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and the possible uses of the site. The estimated amount of future restoration costs is reviewed regularly based on available information. Where the forecasted net restoration costs exceed existing provisions, an additional expense is recognized in the period.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in these consolidated financial statements as the amount of recovery cannot be reasonably determined. Any future recoveries will be recorded when received.

2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

l) Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values.

Valuation allowances are established when necessary to reduce future tax assets to the amount that, in the opinion of management, is more likely than not to be realized. Future income tax assets and liabilities are determined based on the substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

m) Stock-based compensation plans

The Company and certain of its subsidiaries have stock-based compensation plans, which are described in note 13. Compensation expense for stock options is accounted for using the fair value method. Compensation expense for awards that call for settlement in cash or other assets is measured on an ongoing basis as the amount by which the quoted market price exceeds the exercise price at each measurement date. Any obligations related to increases in the value of Deferred Share Units ("DSUs"), Restricted Share Units ("RSUs") and Stock Appreciation Rights ("SARs") are accrued when a change in value occurs with an offset to the consolidated statement of operations.

Any consideration paid by option holders for the purchase of stock is credited to capital stock. If plan entitlements are repurchased from the holder, the consideration paid is charged to deficit.

n) Earnings per share

Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the average number of shares outstanding during the period plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method.

o) Employee future benefits

All employee future benefits are accounted for on an accrual basis. Until December 31, 2007, the Company maintained defined contribution pension plans for its employees which were funded in an amount of $706 during the year ended December 31, 2007. These plans were wound up effective December 31, 2007 and, effective January 1, 2008, Nucryst's Canadian employees participated in a group registered retirement savings plan. In 2008, Nucryst contributed $458 to this plan. In 2008, the Company's head office and iFire employees were provided with additional compensation of 4% of base salary in lieu of employer pension contributions.

p) Discontinued operations

Long-lived assets to be disposed of by sale are classified as held for sale in the period in which a formal plan of disposal has been approved, the assets are available for immediate sale and are actively being marketed, and if it is expected that the sale will occur within one year. Long-lived assets to be abandoned are classified as held and used until they are disposed of.

Long-lived assets classified as held for sale are carried at the lower of their carrying amount and fair value net of estimated disposition costs. Losses are recognized immediately where carrying value exceeds fair value and gains are recognized at the time of sale.

The results of discontinued operations are reported separately, including gains or losses related to the disposal of related long-lived assets held for sale or disposal. Future costs associated with an exit or disposal activity are recognized in the period in which the liability is incurred.

q) Intangible assets

The Company's definite life intangible assets consist of the prosecution and application costs of patents and trademarks and are amortized on a straight-line basis over their estimated useful lives to a maximum of 10 years. The cost of maintaining patents and trademarks are expensed as incurred. The Company evaluates the carrying value of definite life intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Any impairment in the carrying value, which is based on the fair value of the intangible assets, is charged to expense in the period that impairment has been determined.

Indefinite life intangible assets are recorded at fair value. On a regular basis, the Company reviews the carrying value of these assets for impairment. As at December 31, 2008 and 2007, the Company had no indefinite life intangible assets.

(thousands of Canadian dollars except per share data)

2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

r) Accumulated other comprehensive loss

Comprehensive loss is comprised of net loss and other comprehensive loss.

Certain gains and losses arising from changes in fair value are temporarily recorded outside the consolidated statement of operations in accumulated other comprehensive income as a separate component of shareholders' equity.

Comprehensive loss is comprised of the Company's net loss and other comprehensive income (loss). Other comprehensive income (loss) may include any unrealized gains and losses on available-for-sale securities, foreign currency translation gains and losses on the net investment in self-sustaining foreign operations and changes in the fair market value of derivative instruments designated as cash flow hedges, all net of income taxes. At December 31, 2008, the balance of accumulated other comprehensive income of $1,120 (December 31, 2007 – loss of $1,779) is comprised solely of foreign currency translation adjustments on the Company's net investment in its self-sustaining foreign operations.

s) Financial instruments

All financial assets and liabilities accounted for using one of five available accounting models, being held-to-maturity, available-for-sale, held-for-trading, loans and receivables and other liabilities. All financial instruments classified as available-for-sale, held-for-trading, and derivative financial instruments meeting certain recognition criteria, are carried at fair value. Changes in the fair value of financial instruments designated as held-for-trading and recognized derivative financial instruments are charged or credited to the statement of operations for the current period, while changes in the fair value of financial instruments designated as available-for-sale are charged or credited to other comprehensive income and charged or credited to the statement of operations when the instrument is sold. All other financial assets and liabilities are accounted for at amortized cost depending upon the nature of the instrument. Financial assets and liabilities designated as held-to-maturity are initially recognized at their fair values, with any resulting premium or discount from the fair value being amortized to income or expense using the effective interest method. After their initial fair value measurement, they are measured at amortized cost using the effective interest method. Transaction costs related to the acquisition of financial instruments held-for-trading are expensed as incurred. Transaction costs with respect to instruments not classified as held-for-trading are recognized as an adjustment to the cost of the underlying instruments, when they are recognized, and amortized using the effective interest method.

The following is a summary of the accounting model the Company has elected to apply to each of its significant categories of financial instruments:

Cash and cash equivalents	held-for-trading
Short-term investments	held-for-trading
Long-term investments	available for sale
Long-term investments - asset-backed commercial paper	held-for-trading
Accounts receivable	loans and receivables
Accounts payable and accrued liabilities	other liabilities
Long-term debt	other liabilities

Derivative instruments are recorded at fair value unless exempted from derivative treatment as normal purchases and sales. All changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case, changes in fair value are recorded in other comprehensive income (loss).

t) Recently adopted and pending accounting pronouncements

Effective January 1, 2008, the Company adopted two new CICA standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" which replaced Section 3861 "Financial Instruments – Disclosure and Presentation". The new Disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new presentation standard carries forward the former presentation requirements. The Company determined that the implementation of these new standards did not have any impact on the Company's financial position or results of operations. The disclosures related to these sections are reported in note 16 of these consolidated financial statements.

2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

Effective January 1, 2008, the Company adopted CICA Section 3031 "Inventories". This Section relates to the accounting for inventories and revises and enhances the requirements for assigning costs to inventories. The Company determined that the implementation of this Section did not have a material impact on its consolidated financial statements. The value of inventory expensed for the year ended December 31, 2008 amounted to $13,664 (2007 – $15,856) of which $12,603 (2007 – $14,963) was included in manufacturing costs and $1,061 (2007 – $893) was included in depreciation expense.

In November 2006, the CICA issued new Handbook Section 1535 "Capital Disclosures", effective for annual and interim periods beginning on or after October 1, 2007. This Section establishes standards for disclosing information about an entity's capital and how it is managed in order that a user of the financial statements may evaluate the entity's objectives, policies and processes for managing capital. The Company's capital disclosures are reported in note 17 of these consolidated financial statements.

Future Accounting Pronouncements

In 2006, Canada's Accounting Standards Board ("AcSB") ratified a strategic plan that will result in GAAP, as used by public entities, being converged with International Financial Reporting Standards ("IFRS") over a transitional period. In February 2008, the AcSB confirmed January 1, 2011 as the date that Canadian public entities will be required to start reporting under IFRS. Companies will be required to provide qualitative disclosure on the key elements and timing of their transition plan to IFRS no later than their 2008 annual Management Discussion and Analysis. Qualitative disclosure of the impact of the transition is required in companies' 2009 interim and annual Management Discussion and Analysis. Comparative financial information for 2010 will be required when companies begin reporting 2011 results under IFRS. During 2009 the Company will prepare its detailed IFRS conversion plan. This plan will be aimed at identifying the differences between IFRS and the Company's current accounting policies, assessing the impact on the Company's financial reporting and, when necessary, analyzing alternative policies that could be adopted. The nature and extent of this project may be impacted by changes in the strategic direction of the Company.

In February 2008, the CICA issued new Handbook Section 3064 "Goodwill and Intangible Assets", replacing Handbook Section 3062 "Goodwill and Other Intangible Assets" and Handbook Section 3450 "Research and Development Costs". The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Handbook Section 3062. The Company has determined that the adoption of this new section will not have a material impact on its consolidated financial statements.

3 DISCONTINUED OPERATIONS

In November 2007, the Company announced that it was seeking a buyer for the business and assets of iFire. Accordingly, the results from the operations of this business have been accounted for on a discontinued basis and the related assets and liabilities are classified as held for sale. In accordance with CICA Handbook Section 3475 ("Section 3475"), no depreciation or amortization has been recorded from the date of this announcement on iFire's long-lived assets consisting of capital assets and intangible assets. Also, in accordance with Section 3475, the Company estimated the fair value of these assets at December 31, 2007 less costs to sell, assuming that iFire would be sold as a going concern. This valuation resulted in a write-down of iFire's capital assets of $22,100 in the fourth quarter of 2007.

In the first quarter of 2008, the Company estimated the value that would be realized by selling the individual assets of iFire including buildings, equipment, and intellectual property. As a result, a write-down of $6,086 of capital assets held for sale and $1,000 of intangible assets held for sale was recorded in that period.

In the fourth quarter of 2008, iFire sold its equipment for net proceeds after fees, costs, taxes and termination amounts of $8,165 and reported a gain on the sale of these assets of $5,268. Also, in the fourth quarter, iFire entered into an agreement to sell its intellectual property and other intangible assets. This sale was subject to several conditions, including iFire obtaining certain consents and approvals. The net proceeds to be realized on the sale of the intellectual property and other intangible assets are less than the book value of the intangible assets available for sale and as a result these assets were written down by $279 in the fourth quarter of 2008. The sale of intellectual property and other intangible assets was completed in January 2009 for net proceeds of approximately $1,113. No material gain or loss is expected to be reported on this transaction. The Company's manufacturing building used by iFire in Toronto, Ontario remains for sale and has a book value of $1,048.

(thousands of Canadian dollars except per share data)

3 DISCONTINUED OPERATIONS (continued)

Results of discontinued operations - iFire:

	Year ended	
	Dec. 31, 2008	Dec. 31, 2007
Loss related to discontinued operations	$ (6,403)	$ (33,103)
Write-down of discontinued operations to fair value	(7,365)	(22,100)
Gain on sale of capital assets held for sale	5,268	–
Loss from discontinued operations net of income taxes	$ (8,500)	$ (55,203)

All remaining iFire restructuring costs relating to employee severances have been accrued as at December 31, 2008 and are expected to be paid in the first quarter of 2009 (note 21).

The loss from discontinued operations is after deduction of depreciation and amortization of $nil for the year ended December 31, 2008 (2007 – $13,588). Current income tax expense included in loss from discontinued operations for the year ended December 31, 2008 amounted to $240 (2007 – $22).

Loss per common share from discontinued operations was $0.09 for the year ended December 31, 2008 (2007 – $0.59).

Amounts included in the consolidated balance sheets relating to the iFire discontinued operations are as follows:

	December 31, 2008	December 31, 2007
Current assets held for sale	$ 2,436	$ 590
Accounts payable and accrued liabilities held for sale	(2,885)	(1,443)
Capital assets held for sale	1,103	10,086
Intangible assets held for sale	–	2,392

4 DILUTION GAIN AND GAIN ON SALE OF INVESTMENTS

a) In January 2008, a wholly owned subsidiary of the Company issued common shares to a non-related Canadian company for proceeds of $1,000 representing 40% of the issued share capital of the subsidiary and also issued $3,500 of convertible debentures to non-related third parties. The debentures had no recourse to the Company and were convertible into common non-voting shares of the subsidiary representing 58.3% of the issued share capital on a fully diluted basis. As a result of these transactions, the Company's interest in this subsidiary was reduced to 60%. In March 2008, the debentures were converted and the Company's economic interest in the subsidiary was reduced to approximately 25% and the Company's consolidated non-capital losses, unclaimed scientific research and development expenditures and research and development tax credits were reduced by approximately $85,000, $17,000 and $19,000 respectively. Also, in March 2008, the Company sold its remaining interest in this subsidiary for proceeds of $1,500. As a result of these transactions, the Company is reporting a dilution gain in 2008 of $6,000.

b) In the first quarter of 2007, a subsidiary issued 11,954,000 common shares for proceeds of $5,977 to private investors which reduced the Company's voting interest in the subsidiary to 22.1%. As a result of this dilution in ownership, the net assets of the subsidiary were no longer consolidated and in the first quarter of 2007, the Company recorded a dilution gain of $4,525 resulting from a reduction in cash of $2,306, a reduction in long-term debt of $8,000 and an increase in net working capital of $115. The Company also recorded a deferred gain of $1,284 in the first quarter of 2007 representing a deficiency in the investment. This investment was classified as an available-for-sale security. As a result of this dilution event in the first quarter of 2007, the Company's consolidated non-capital losses, unclaimed scientific research and development expenditures, and research and development tax credits, were reduced by approximately $16,000, $76,000 and $18,000 respectively.

   In the third quarter of 2007, the convertible debentures of the subsidiary were converted to common shares which further reduced the Company's economic interest in the subsidiary to 14.6%.

   In the fourth quarter of 2007, the Company sold 87% of its investment in this former subsidiary for proceeds of $1,582. As a result, the Company realized a gain on the sale of this investment of $2,648 including the pro-rata recognition of the deferred gain in an amount of $1,066. The Company recorded a deferred gain of $218 as at December 31, 2007 which was realized in the second quarter of 2008 when the Company sold its remaining interest in this investment for proceeds of $316 and recorded a gain on the sale of this investment of $534.

5 NON-CONTROLLING INTEREST

The Company's ownership in Nucryst was 74.7% at December 31, 2008 (December 31, 2007 – 74.5%).

(thousands of Canadian dollars except per share data)

5 NON-CONTROLLING INTEREST (continued)

The Company consolidates the financial statements of Nucryst with the non-controlling interest being reported separately in the consolidated statement of operations and consolidated balance sheet. The non-controlling interest for the year ended December 31, 2008 amounted to $804 (2007 – $1,293). The Company recorded a loss on the issuance of shares of Nucryst of $49 for the year ended December 31, 2008 (2007 – $134). These shares were issued by Nucryst in relation to its stock-based compensation plans. In addition, in 2008 the Company reported a gain of $145 as the result of the repurchase by Nucryst of 65,100 of its common shares.

6 INVENTORIES

	December 31, 2008	December 31, 2007
Raw materials	$ 2,726	$ 2,759
Materials in process	387	1,378
Finished product	422	236
	$ 3,535	$ 4,373

7 INVESTMENT IN CANADIAN THIRD PARTY ASSET-BACKED COMMERCIAL PAPER

In the third quarter of 2007, global financial markets experienced an unprecedented credit and liquidity crisis.
Dominion Bond Rating Service ("DBRS") placed Canadian third party asset-backed commercial paper ("ABCP") "Under Review with Developing Implications" following an announcement in August 2007 that a consortium representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement regarding ABCP (the "Montreal Proposal"). Under this proposal, the affected ABCP would be converted into term floating rate notes.

On September 6, 2007, a Pan Canadian Committee (the "Committee") was formed to oversee the proposed restructuring process of the ABCP and on December 23, 2007, the Committee approved an agreement in principle to restructure the ABCP issued by 20 trusts covered by the Montreal Proposal, which includes the investments held by the Company. On March 17, 2008, a court order was obtained through which the restructuring of the ABCP would occur under the protection of the Companies Creditors Arrangement Act ("CCAA"). The restructuring was voted upon and approved on April 25, 2008 on the basis of all ABCP investments being a single class for the purpose of voting and on June 25, 2008 a court order sanctioning the restructuring of the ABCP was made pursuant to the CCAA. On August 18, 2008, the Court of Appeal for Ontario upheld the sanction order and on September 19, 2008, the Supreme Court of Canada denied leave to appeal the Court of Appeal for Ontario's decision. Subsequent to this dismissal, the Committee announced that the process of tendering existing ABCP securities in exchange for new restructured notes had begun.

Under the restructuring plan, all of the ABCP are being exchanged for longer dated notes that match the maturity of the underlying reference assets in the proposed structure. The restructuring also pools certain series of ABCP which are supported in whole or in part by underlying synthetic assets. Under this arrangement, there are three distinct restructuring solutions for (1) Traditional-ABCP which is supported solely by traditional securitized assets, (2) Synthetic-ABCP which is supported by synthetic assets, or a combination of synthetic and traditional securitized assets, and (3) Ineligible-ABCP supported primarily by U.S. sub-prime mortgage assets.

At September 30, 2007, the Company held ABCP with a book value of $14,069 which reflected a face value of $17,050 and a reduction in fair value of $2,981 recorded in the third quarter of 2007. In the fourth quarter of 2007, the Company sold 50% of its holdings in ABCP with a face value of $8,525 and a book value of $7,035 for proceeds of $5,968. This sale resulted in a loss on the sale of the ABCP of $1,067.

On March 20, 2008, the Committee issued an Information Statement containing details about the proposed restructuring. Based on this and other public information it was estimated that, of the $8,525 of ABCP which the Company held at December 31, 2008 and December 31, 2007:

- $600 is represented by traditional securitized assets and the Company will, on restructuring, receive replacement Traditional Asset Tracking long-term floating rate notes.
- $7,725 is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term floating rate notes. The Company expected to receive replacement notes with par values as follows:
    - Class A-1: $5,673
    - Class A-2: $1,553
    - Class B and C: $499

(thousands of Canadian dollars except per share data)

7 INVESTMENT IN CANADIAN THIRD PARTY ASSET-BACKED COMMERCIAL PAPER (continued)

- $200 is represented by assets that have an exposure to U.S. mortgages and sub-prime mortgages. On restructuring, the Company will receive Ineligible Asset Tracking long-term floating rate notes.

The Company has classified its ABCP as long-term investments held-for-trading. The ABCP in which the Company has invested has not traded in an active market since mid-August 2007 and there are currently no market quotations available. The Company has estimated the fair value of its investments in ABCP considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. In accordance with CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement", when the market for a financial instrument is not active, the fair value should be estimated using an appropriate valuation technique. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the Committee and the risks associated with the long-term floating rate notes. The Company has used a probability-weighted discounted cash flow approach to value its ABCP investments at December 31, 2008 and December 31, 2007 which considered expected interest rates, fixed/floating interest rate swaps, credit spreads, estimated restructuring fees and estimated renegotiated maturity dates. The assumptions used in this model include: average risk free interest rate of 2.5%; weighted average discount rate of 11.3%; and average maturity of long-term notes of 8.1 years.

The Company was required to use management estimates when calculating this fair value. Interest and discount rates vary by each of the different replacement long-term floating rate notes to be issued as they have different credit ratings and risks. Interest and discount rates also vary by the different probable cash flow scenarios that have been modeled. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. An increase in the estimated discount rates of 1 percent would reduce the estimated fair value of the Company's investment in ABCP by approximately $279. Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets. As a result of this valuation, the Company has determined the estimated fair value of the investment in ABCP to be $4,262 at December 31, 2008.

This represents a reduction in the estimated fair value of $1,706 from December 31, 2007 primarily as a result of worsening credit markets. The total reduction in the fair value of ABCP amounts to $4,263 at December 31, 2008, of which $2,557 was recorded in 2007. The decrease in fair value in 2008 was primarily due to the deterioration in the credit market, reductions in the DBRS credit ratings and increases in liquidity premiums resulting in higher discount rates.

Based on management's assumptions, the fair value of the Company's holdings of ABCP could range from $3,888 to $4,435. Continuing uncertainties regarding the value of the assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a change in the fair value of the Company's investment in the ABCP which would impact the Company's results from operations. The Company has sufficient other cash resources and credit facilities (note 11) to satisfy its financial obligations as they come due over the next twelve months.

On January 21, 2009, the Committee announced the successful implementation of the restructuring plan and that interest payments in respect of interest accrued since the original liquidity disruption in August 2007 to August 31, 2008 (net of restructuring costs) would be made in two installments based on the ABCP note type. Upon the restructuring, the Company received replacement notes ("New Notes") as follows which reflect the descriptions reported above. The reduction in face value from $8,525 to $8,374 is primarily related to realized losses on certain underlying investments and restructuring costs incurred in the restructuring process.

Notes	Maturity Date	Interest Rate (2)	Face Amount
MAV II Class A-1	July 15, 2056 (1)	BA – 0.5%	$ 5,673
MAV II Class A-2	July 15, 2056 (1)	BA – 0.5%	1,387
MAV II Class B	July 15, 2056 (1)	BA – 0.5%	252
MAV II Class C	July 15, 2056 (1)	BA + 20%	226
MAV III Various	December 13, 2027 to July 15, 2056	not finalized (3)	792
Other	–	–	44
			$ 8,374

(1) Maturity date reflects legal maturity date. Latest maturity date of underlying assets is December 20, 2016.
(2) BA rate is Canadian dollars Bankers Acceptance interest rate with a maturity of 90 days.
(3) Interest rates for MAV III notes have not been finalized.

(thousands of Canadian dollars except per share data)

7 INVESTMENT IN CANADIAN THIRD PARTY ASSET-BACKED COMMERCIAL PAPER (continued)

The MAV II Class A-1 and MAV II Class A-2 notes were assigned an investment grade rating of "A" by the DBRS in January 2009. The MAV II Class B and MAV II Class C notes and MAV III notes have not been rated by the DBRS. Accounting for the exchange of the notes will include settlement of the original notes and recognition of the New Notes. The New Notes will be measured at fair value on initial recognition. The New Notes will be classified as held-for-trading under the Company's Financial Instruments policy which will require them to be fair valued at each period end with changes in fair value included in the consolidated statement of operations in the period in which they arise. Until an active market develops for the New Notes, the fair value will be determined using a discounted cash flow approach based on the maximum use of inputs observed from market conditions on subsequent reporting dates. The fair values may change materially in subsequent periods. As part of the note exchange, the Company received a payment of $213 which was its share of the accumulated interest in the conduit trusts from August 2007 to August 2008. This interest as well as estimated unpaid interest to December 31, 2008 has been included in the Company's fair value calculation at December 31, 2008.

8 CAPITAL ASSETS

December 31, 2008	Cost	Accumulated Depreciation	Net Book Value
Machinery and equipment	$ 13,640	$ 4,052	$ 9,588
Leasehold improvements	2,146	621	1,525
Construction in progress	367	–	367
Computer hardware and software	471	465	6
	$ 16,624	$ 5,138	$ 11,486

December 31, 2007	Cost	Accumulated Depreciation	Net Book Value
Machinery and equipment	$ 9,422	$ 3,481	$ 5,941
Leasehold improvements	2,909	1,508	1,401
Construction in progress	5,064	–	5,064
Computer hardware and software	1,344	1,169	175
	$ 18,739	$ 6,158	$ 12,581

Capital assets excludes capital assets held for sale (note 3).

Depreciation on capital assets for the year ended December 31, 2008 was $1,742 (2007 – $1,869).

In the fourth quarter of 2008, Nucryst's research facility in Wakefield, Massachusetts was closed and, as a result, obsolete assets were written down by $215 net of sale proceeds of $65. In 2007, certain capital assets previously used by Nucryst for the production of wound care dressings and NPI 32101 powder were replaced by newer, more efficient and economical equipment. Consequently, in 2007 Nucryst recorded a write-down of the obsolete equipment of $1,203.

At December 31, 2008, capital assets include construction in progress in the amount of $367 (2007 – $5,064) that is not currently subject to depreciation.

In 2007, the Company sold its real estate holdings in Fort Saskatchewan, Alberta for net proceeds of $14,362 and recorded a gain on the sale of these capital assets of $8,647.

9 INTANGIBLE ASSETS

	December 31, 2008	December 31, 2007
Patents and trademarks	$ 2,651	$ 2,611
Less accumulated amortization	2,008	1,812
	$ 643	$ 799

Intangible assets excludes intangible assets held for sale (note 3).

Amortization of intangible assets was $195 for the year ended December 31, 2008 (2007 – $224).

(thousands of Canadian dollars except per share data)

10 INCOME TAXES

The following is a reconciliation of income taxes, calculated at the statutory income tax rate, to the income tax provision included in the consolidated statement of operations.

	Year ended	
	Dec. 31, 2008	Dec. 31, 2007
Loss from continuing operations before income taxes	$ (1,724)	$ (2,686)
Statutory income tax rate	29.50%	32.12%
Expected income tax recovery	(509)	(863)
Losses and temporary differences		
– valuation allowance	2,290	2,456
Tax effect of items not subject to tax		
– dilution gain (note 4)	(1,770)	(1,453)
Capital taxes	–	4
Income tax expense	$ 11	$ 144

Income taxes are recognized for future income tax consequences attributed to estimated differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases.

The net future income tax asset is comprised of:

	December 31, 2008	December 31, 2007
Future income tax assets:		
Tax benefit of loss carry-forwards and tax credits	$ 58,120	$ 104,430
Provisions and reserves	3,704	3,912
Capital, intangible and other assets	3,446	1,198
Less valuation allowance	(64,595)	(109,216)
	675	324
Future income tax liabilities:		
Capital, intangible and other assets	(675)	(324)
	(675)	(324)
Future income tax assets, net	$ –	$ –

The future income tax asset valuation allowance is in respect of tax loss carry-forwards and tax credits primarily relating to subsidiaries involved in technology development.

The Company has consolidated non-capital losses for income tax purposes of approximately $123,317 (2007 – $185,422) and unclaimed scientific research and experimental development expenditures of approximately $17,809 (2007 – $41,493) which can be used to offset taxable income, if any, in future periods. The Company also has consolidated capital losses of approximately $45,929 (2007 – $43,382) as well as research and development tax credits of approximately $11,528 (2007 – $34,963). The non-capital losses and research and development tax credits will expire at various times to the end of 2028. The tax losses carry-forward and tax credits described above include those related to iFire which is reported as a discontinued operation (note 3). As a result of the sale of the intangible assets held for sale subsequent to year end, the Company's consolidated non-capital losses will decrease by $1,881 and consolidated capital losses will increase by $1,603. Cash taxes relating to continuing operations paid during the year amounted to $161 (2007 – $17).

Nucryst's share of the above consolidated tax losses and credits comprises approximately $40,405 in non-capital losses, approximately $11,626 in unclaimed scientific research and development expenditures, approximately $2,107 in capital losses and approximately $5,348 in research and development tax credits. In 2005, the Canada Revenue Agency ("CRA") commenced an examination of Nucryst's Canadian income tax returns for 2001 and 2002. In December 2007, the CRA proposed certain transfer pricing adjustments for those years. These proposed adjustments, if processed, will not result in any cash tax liability for the Company. In the third quarter of 2008, Nucryst received a report from the CRA which provided additional information with respect to the proposed adjustments. Nucryst has been working with the CRA to resolve the audit matters under review and has made a further submission of information to the CRA in this regard. Resolution of the audit matters under review may apply to taxation years beyond 2002. Any reassessments to be issued by the CRA, on an aggregate basis, could result in a material effect on the Company's consolidated financial statements, although at this time, the potential impact cannot be reasonably estimated by Nucryst.

(thousands of Canadian dollars except per share data)

11 LONG-TERM DEBT

In the first quarter of 2008, the Company completed a credit agreement with a major Canadian financial institution. Under the terms of the revolving credit line, the Company may borrow up to $6,300 for 364 days. Borrowings will be secured by ABCP of equivalent value held by the Company. Interest rates on the credit line increase during the term from banker acceptance rate to banker acceptance rate plus 2%. The Company has not drawn on this facility as at December 31, 2008. In January 2009 this agreement was extended until March 31, 2009. The Company has signed a credit offer for a $4,725 three year replacement credit facility which is expected to be available by March 31, 2009.

12 PROVISION FOR SITE RESTORATION

The provision for site restoration amounted to $6,580 at December 31, 2008 and 2007, with no changes reported in 2008 or 2007.

The provision relates primarily to site restoration associated with soil and groundwater reclamation and remediation, based on periodic independent estimates of these costs. The Company conducts an annual review of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements, and determined that no adjustment to the provision was required at December 31, 2008.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in the consolidated financial statements as the amount of recovery cannot be determined. Any future recoveries will be recorded when received.

13 CAPITAL STOCK

a) Share Capital

The Company's authorized share capital consists of an unlimited number of common shares, Preferred A shares and Preferred B shares. Changes in the Company's common shares outstanding during 2008 and 2007 are as follows:

	2008		2007	
Common Shares	Number	Stated Capital	Number	Stated Capital
Balance at beginning of year	94,135,535	$ 426,262	93,978,758	$ 426,122
Employee share purchase plan	–	–	54,531	39
RSUs exercised	79,097	18	102,246	101
Balance at end of year	94,214,632	$ 426,280	94,135,535	$ 426,262

In 2008, 79,097 (2007 – 102,246) shares were issued as settlement for 79,097 (2007 – 102,246) fully vested RSUs.

During 2007, 54,531 common shares were issued with respect to the Company's employee share purchase plan at a weighted average price of $0.49. The value of these rights to acquire common shares of $13 was reclassified from contributed surplus to share capital. The employee share purchase plan was subsequently cancelled.

No options were exercised in 2008 or 2007.

b) Stock-based compensation plans

Employee and Director stock option plan – The Company maintains an Employee and Director Stock Option Plan under which the Company may grant options for 10,955,445 shares of common stock of the Company at an exercise price equal to the market price of the Company's stock at the date of grant. Options awarded are exercisable for a period of 10 years and vest as to one third of the grant on each of the first, second and third anniversaries after the date of the grant. The Company maintains a Directors and Officers Share Purchase Program under the provisions of the Stock Option Plan. Under the Share Purchase Program, Directors and designated officers may be granted one option for each common share purchased to a cumulative 50,000 options. Options, equal to the net purchases of common shares by the optionee during the calendar year, vest at the end of the calendar year in which the purchases were made. Any options issued under this program which do not vest at the end of the year are cancelled.

(thousands of Canadian dollars except per share data)

13 CAPITAL STOCK (continued)

A summary of the status of the Company's stock option plan as at December 31, 2008 and 2007, and changes during the years ending on those dates is presented below:

	2008		2007	
Stock Options	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding at beginning of year	4,448,598	$ 6.15	4,431,900	$ 7.08
Granted	10,000	$ 0.28	762,200	$ 0.85
Cancelled	(3,333)	$ 1.76	(428,667)	$ 5.84
Expired	(356,668)	$ 6.95	(316,835)	$ 6.85
Outstanding at end of year	4,098,597	$ 6.07	4,448,598	$ 6.15

The following table summarizes information about stock options outstanding as at December 31, 2008:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding Dec.31, 2008	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable Dec.31, 2008	Weighted Average Exercise Price
$0.22–$0.93	307,200	8.9	$ 0.25	147,200	$ 0.24
$0.94–$1.40	390,000	5.2	1.23	146,667	1.23
$1.41–$2.10	496,200	2.9	1.77	463,700	1.78
$2.11–$3.20	130,800	5.1	2.84	130,800	2.84
$3.21–$4.80	701,000	3.5	3.72	701,000	3.72
$4.81–$7.20	995,000	1.8	6.37	903,333	6.39
$7.21–$10.81	170,000	0.1	7.53	170,000	7.53
$10.82–$16.20	908,397	1.1	14.13	908,397	14.13
Total	4,098,597	3.0	$ 6.07	3,571,097	$ 6.70

For the year ended December 31, 2008, corporate costs, research and development costs, and general and administrative expenses include additional compensation expense relating to stock options totaling $987 (2007 – $2,310) with an offsetting increase to contributed surplus. Discontinued operations include compensation recovery relating to stock options totaling $18 (2007 – expense $31) with an offsetting increase to contributed surplus. Also included in general and administrative expenses for the year ended December 31, 2007 is compensation expense of $80 related to the direct award of restricted common shares by Nucryst with a corresponding increase in non-controlling interest in the Company's consolidated balance sheet. There were no direct awards of restricted common shares by Nucryst in 2008.

The fair value of each option grant by the Company is estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 3.75% (2007 – 3.93%), an average life of 7.0 years and a volatility of 64.19% (2007 – 63.57%). The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

Deferred share unit plan – The Company maintains DSUs for the non-executive Directors of the Company. DSUs are issued at the market value of the Company's shares at the date of grant, vest upon death or retirement of the non-executive Director and are payable in cash. Directors may elect to receive additional DSUs in lieu of fees, which are issued at 90% of the market value of the Company's shares at the date of grant. Compensation expense relating to DSUs during the year amounted to $426 (2007 – recovery $523) and as at December 31, 2008, a liability of $687 (2007 – $261) has been accrued with respect to issued DSUs. No DSUs were exercised in 2008. In 2007, 196,118 DSUs were exercised and settled with a cash payment of $190.

Restricted share unit plan – The Company maintains a Restricted Share Unit Plan for the Executive Officers of the Company. These units vest over three years and are payable when fully vested in a combination of common shares and cash at the weighted average trading price at the date of exercise. The liability with respect to these units is accrued over the vesting period. Compensation recovery with respect to RSUs during the year amounted to $4 (2007 – $68) and the corresponding accrued liability as at December 31, 2008 was $25 (2007 – $65).

In 2008, 158,194 (2007 – 449,659) RSUs with a value of $36 (2007 – $413) were settled with the issuance of 79,097 (2007 – 102,246) common shares and cash payments of $18 (2007 – $312).

(thousands of Canadian dollars except per share data)

13 CAPITAL STOCK (continued)

For the year ended December 31, 2008, corporate costs include compensation expense totaling $422 (2007 – recovery $591) relating to DSUs and RSUs.

Subsidiary stock-based compensation plans – The Company's subsidiaries, Nucryst and iFire, maintain equity incentive plans for certain directors and employees, under which stock options have been granted representing 8.7% and 0.5% of the outstanding shares of the respective subsidiaries. These plans are accounted for using the fair value method with the related compensation expense is recorded in the consolidated statement of operations. Subsidiary stock options generally vest evenly over a three-year period and expire after 10 years from the date of grant. The exercise prices of stock options granted are not less than the fair value of the subsidiary's stock at the time of the grant. No subsidiary options were exercised in 2008. In 2007, 4,540 Nucryst options were exercised at a weighted average price of $3.08.

Nucryst Directors and certain Executives have been granted RSUs. These units are issued at the market value of a Nucryst share at the date of grant, vest over two to three years and are payable in common shares of Nucryst. Net changes in the value of these RSUs is recognized as compensation expense over the vesting period with an offset to contributed surplus. General and administrative expenses included compensation expense relating to Nucryst RSUs for the year ended December 31, 2008 of $40 (2007 – $79). Nucryst RSUs with a value of $60 were exercised for Nucryst shares which reduced contributed surplus by $60 (2007 – $17).

14 GUARANTEES

The Company has agreements to indemnify its Officers and Directors for certain events or occurrences while the Officer or Director is or was serving at the Company's request in such capacity. The maximum potential amount of future payments is unlimited. However, the Company maintains Director and Officer liability insurance coverage that limits its exposure and enables the Company to recover a portion of any future amounts paid.

In addition, the Company has provided indemnifications to third parties with respect to future site restoration costs to be incurred on properties previously owned by the Company. These estimated costs have been included in the provision for site restoration (note 12).

15 COMMITMENTS AND CONTINGENCIES

Commitments

The Company is committed to capital expenditures of $41 (2007 – $41) and to future annual payments under operating leases for facility and office space and equipment as follows:

2009	2010	2011	2012	2013
$ 1,713	$ 1,724	$ 1,738	$ 1,283	$ 922

In addition, the Company has contractual obligations to make manufacturing cost rebate payments of U.S. $4,500 in 2009 (note 20) and other contractual commitments of $276 in 2009.

Contingencies

The Company and its subsidiaries are party to legal proceedings in the ordinary course of their businesses. Management does not expect the outcome of any of these proceedings to have a material effect on the Company's financial position or operating results.

16 FINANCIAL INSTRUMENTS

Fair value of financial instruments and financial risk management

a) Financial instruments

The carrying value of the Company’s interest in financial instruments approximates their fair value. The estimated fair value approximates the amount for which the financial instruments could currently be exchanged in an arm’s length transaction between willing parties who are under no compulsion to act. Certain financial instruments lack an available trading market and, therefore, fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instrument.

(thousands of Canadian dollars except per share data)

16 FINANCIAL INSTRUMENTS (continued)

The Company has classified its financial instruments as follows:

	December 31, 2008	December 31, 2007
Financial assets:		
Cash and cash equivalents, measured at fair value (held-for-trading)	$ 46,768	$ 30,993
Accounts receivable, measured at amortized cost (loans and receivables)	$ 6,272	$ 14,931
Long-term investments - ABCP - measured at fair value (held-for-trading)	$ 4,262	$ 5,968
Financial liabilities:		
Accounts payable and accrued liabilities, measured at amortized cost (other liabilities)	$ 6,956	$ 7,018

The carrying value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximates fair value due to their short-term nature.

There is no active market for ABCP and the Company has estimated the fair value of its investment in ABCP considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments (note 7).

The Company is required to identify and measure embedded derivatives that require separation from the related host contract and measure those embedded derivatives at fair value. Subsequent changes in fair value of embedded derivatives are recognized in the statement of operations in the period the change occurs. The Company did not have any embedded derivatives in 2008 or 2007.

b) Financial risk management

The Company has exposure to credit risk, liquidity risk and market risk. The Company's Board of Directors has the overall responsibility for the oversight of these risks and reviews the Company's policies on an ongoing basis to ensure that these risks are appropriately managed.

i) Credit risk

Credit risk is the risk of financial loss to the Company if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents, and accounts receivable. The carrying amount of the financial assets represents the maximum credit exposure.

The Company manages credit risk for its cash and cash equivalents by maintaining bank accounts with major Canadian and U.S. banks and investing only in highly rated Canadian Government securities or Canadian and U.S. financial institutions with debt securities that are traded on active markets and are capable of prompt liquidation. The Company also has investments in ABCP discussed in note 7.

The Company has a concentration of credit risk through its reliance on one customer for Nucryst's wound care products. This risk is limited due to the long-term contractual relationship with this customer. The Company has not experienced any losses related to uncollectible accounts and therefore does not carry an allowance for doubtful accounts. Trade accounts receivable past due more than 60 days represented 9.8% of total receivables at December 31, 2008 (11.0% at December 31, 2007).

ii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk by continuously monitoring forecasts and actual cash flows and has secured a line of credit with a major Canadian bank (note 11).

iii) Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates, and equity prices will affect the Company's income or the value of its financial instruments.

The Company is subject to interest rate risk on its cash and cash equivalents. The Company does not believe that the results of operations or cash flows would be affected to any significant degree by a sudden change in market

(thousands of Canadian dollars except per share data)

16 FINANCIAL INSTRUMENTS (continued)

interest rates relative to interest rates on the investments, owing to the relative short-term nature of the investments. For the year ended December 31, 2008, a 100 basis points decrease in interest rates on investments, excluding ABCP (note 7) would have reduced earnings before income taxes by approximately $293. Conversely, a 100 basis points increase in interest rates would have increased earnings before income taxes by a similar amount.

Financial instruments potentially exposing the Company to foreign exchange risk consist principally of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The Company manages foreign exchange risk by holding U.S. dollar cash receipts in U.S. cash on hand to support U.S. forecasted cash outflows. The Company believes that the results of operations and cash flows would be affected by a sudden change in foreign exchange rates, but that this change would not impair or enhance the Company's ability to pay its U.S.-denominated obligations. For the year ended December 31, 2008, a 10% increase in the U.S. dollar to the Canadian dollar exchange rate would have increased earnings before income taxes by approximately $1,908. Conversely, a 10% decrease in the U.S. dollar to Canadian dollar exchange rate would have reduced earnings by a similar amount.

The Company does not trade in equity instruments of other corporations.

17 CAPITAL DISCLOSURES

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern;
- to ensure that the Company's business plans are developed so that research and development costs do not overextend the Company's financial resources; and
- to maintain flexibility in order to preserve the Company's ability to meet financial obligations with a long term view of maximizing shareholder value.

On an ongoing basis, the Company reviews and assesses its capital structure.

The Company defines its capital as follows:

- shareholders' equity; and
- long-term debt.

The Company's capital at December 31, 2008 and December 31, 2007 is as follows:

	December 31, 2008	December 31, 2007
Shareholders' equity	$ 50,002	$ 56,371
Long-term debt	–	–
Net capital	$ 50,002	$ 56,371

The Company's strategy has been to develop the independent technical operating, and marketing capabilities of its investments through the early years of product introduction and commercialization with the objective of taking these technologies public through initial public offerings. In December 2005, Nucryst completed an initial public offering of its common shares.

The Company has no debt and is not subject to any regulatory or financial covenants and has maintained a policy of not paying dividends in order to retain its cash reserves to finance capital projects and business growth.

In order to preserve capital, the Company significantly reduced operations at iFire and its corporate offices throughout 2007 and 2008. In the fourth quarter of 2007, the Company announced its intention to seek a buyer for the iFire business or assets. The majority of these assets were sold in the fourth quarter of 2008 and the first quarter of 2009.

At December 31, 2008, the Company had consolidated cash and cash equivalents of $46,768, including $28,819 of Nucryst cash and cash equivalents which is not accessible by the Company to fund its own or iFire operations. The Company also has ABCP with an estimated fair value of $4,262 as well as a line of credit of $6,300 that is currently not utilized (note 11).

18 EARNINGS PER COMMON SHARE

In calculating earnings per share under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculation as the assumed exercise of the Company's stock options does not result in an adjustment

(thousands of Canadian dollars except per share data)

18 EARNINGS PER COMMON SHARE (continued)

to income. The reconciliation of the denominator in calculating diluted earnings per share is as follows:

	Year ended	
	Dec. 31, 2008	Dec. 31, 2007
Weighted average number of common shares outstanding – basic and diluted earnings per share	94,207,494	94,069,547

The impact of all dilutive securities on earnings per common share was anti-dilutive for the years ended December 31, 2008 and 2007.

Options to purchase 4,098,597 common shares were outstanding at December 31, 2008 (2007 – 4,448,598). Of these options outstanding in 2008, 3,841,397 (2007 – 4,151,398) were excluded in the calculation of diluted earnings per common share because the exercise price of the options was greater than the weighted average market value of the common shares in the year.

19 SEGMENTED INFORMATION

The Company had two operating segments, Nucryst and iFire, which have been determined based on the nature of the products produced. In November 2007, the Company announced its intention to sell iFire and, as a result, the iFire segment is reported as a discontinued operation (note 3).

The Nucryst segment researches, develops and commercializes wound care products and pharmaceutical products based on noble metal nanocrystalline technology.

The accounting policies of the reportable segments are the same as those described in note 2. Included in other non-cash assets of $5,669 at December 31, 2008 (2007 – $6,403) are assets that cannot be allocated to a particular segment. Non-cash assets excludes assets held for sale.

Year ended December 31, 2008	Revenue	Operating Loss	Depreciation and Amortization	Capital Expenditures	Non-cash Assets Dec.31, 2008
Nucryst	$ 22,397	$ (6,391)	$ 1,937	$ 1,243	$ 22,370
Other	–	(5,068)	–	–	4,600
	$ 22,397	$ (11,459)	$ 1,937	$ 1,243	$ 26,970

Year ended December 31, 2007	Revenue	Operating Loss	Depreciation and Amortization	Capital Expenditures	Non-cash Assets Dec.31, 2007
Nucryst	$ 31,830	$ (635)	$ 1,760	$ 2,083	$ 32,923
Other	–	(10,805)	333	293	6,403
	$ 31,830	$ (11,440)	$ 2,093	$ 2,376	$ 39,326

All of Nucryst's revenues are earned through a long-term exclusive licensing agreement with an international wound care company, Smith & Nephew plc ("Smith & Nephew"), which expires in 2026. Nucryst exports manufactured products to this company for their resale in international markets.

20 AGREEMENTS WITH SMITH & NEPHEW

On September 30, 2007, Nucryst and Smith & Nephew signed amended agreements for the sale to Smith & Nephew of Acticoat™ wound care dressings manufactured by Nucryst. The new agreements amended the criteria for the achievement of sales milestones that resulted in a U.S. $5,000 sales milestone being earned by Nucryst in the third quarter of 2007. The cost recovery structure was also amended such that the parties will annually come to an agreement on the direct costs and fixed overhead costs for manufacturing these products. Nucryst will receive the amount of fixed overhead cost incurred during the year regardless of volume of product sold to Smith & Nephew. The cost to manufacture Acticoat™ products was previously fully reimbursed to Nucryst. Under the amended agreements, Nucryst is obligated to provide Smith & Nephew with a manufacturing cost rebate of U.S. $4,500 in the fourth quarter of the years 2007, 2008 and 2009. The manufacturing cost rebate is recorded as a reduction to wound care product revenue evenly over the course of the year. After 2009, the parties have agreed to renegotiate the product pricing provisions of the agreements.

20 AGREEMENTS WITH SMITH & NEPHEW (continued)

Wound care product revenue for the year ended December 31, 2008 was reduced by $4,802 (2007 - $4,565) with respect to the 2008 manufacturing cost rebate.

No milestone revenue was earned in 2008. Milestone revenue in 2007 was $10,143.

21 OPERATIONAL RESTRUCTURING

In 2007, the Company announced an operational restructuring in which staffing levels at iFire and at the Company's corporate offices were reduced. These initiatives continued in 2008 and all expected remaining severance costs have been accrued as at December 31, 2008.

Operational restructuring costs relating to employee severance amounted to $3,303 for the year ended December 31, 2008 (2007 – $8,798) of which $2,844 (2007 – $3,904) is included in discontinued operations and $459 (2007 – $4,894) is included in corporate costs in the consolidated statement of operations. Included in accounts payable and accrued liabilities at December 31, 2008 are accrued severances and transition costs of $1,765 (December 31, 2007 – $2,430) relating to the operational restructuring. Accounts payable and accrued liabilities held for sale include accrued severance costs of $895 at December 31, 2008 (December 31, 2007 – $284).

22 SUBSEQUENT EVENT

On January 21, 2009, Nucryst mailed to its shareholders an information circular and proxy materials for a Special Meeting of its shareholders held on February 12, 2009. At that meeting, the shareholders approved a special resolution to reduce stated capital of the common shares of Nucryst for the purpose of distributing U.S. $0.80 cash per common share to the shareholders of Nucryst. Nucryst will distribute approximately U.S. $14,700 to shareholders on February 25, 2009. This will reduce the Company’s consolidated cash position by approximately $4,600 representing the amount to be paid to Nucryst minority shareholders.

SHAREHOLDER INFORMATION

BOARD OF DIRECTORS

Ian W. Delaney 3

Non-executive Chairman of the Board
The Westaim Corporation

Chairman and Chief Executive Officer, Sherritt International Corporation

Neil Carragher 2, 3,

Chairman of the Board, NUCRYST Pharmaceuticals Corp.

Chairman, The Corporate Partnership Ltd.

Dr. Roger G.H. Downer 2, 3

President Emeritus of the University of Limerick

G. A. (Drew) Fitch

President and Chief Executive Officer
The Westaim Corporation

Frank W. King 1, 3

President of Metropolitan Investment Corporation

J. Cameron MacDonald

President and Chief Executive Officer,
Goodwood Inc.

Daniel P. Owen 1, 3,

Chairman and Chief Executive Officer, Molin Holdings Limited

Peter J. Puccetti

Chairman and Chief Investment Officer, Goodwood Inc.

Bruce V. Walter 1, 2, 3

Chairman and Chief Executive Officer of
Four Mile Investments Inc.

Numbers indicate the individual's committee membership:

1 Member of the Audit Committee

2 Member of the Human Resources and Compensation Committee

3 Member of the Corporate Governance Committee

The Westaim Corporation Annual General Meeting of Shareholders Tuesday May 12, 2009 10:00 a.m.

InterContinental Hotel, Toronto Centre, Ontario Room
225 Front Street West, Toronto, Ontario

CORPORATE INFORMATION

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President and
Chief Executive Officer
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STOCK INFORMATION

Traded on The Toronto Stock Exchange
under the symbol **WED**

Shares issued and outstanding
at December 31, 2008 were 94,214,632

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