MANAGEMENT'S DISCUSSION AND ANALYSIS

October 6, 2009

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This management discussion and analysis may contain forward-looking statements within the meaning of securities laws. Such statements include, but are not limited to, statements relating to:

- *our ability to obtain the substantial capital required to fund research and operations;*
- *our plans to obtain partners to assist in the further development of our product candidates;*
- *our expectations with respect to existing and future corporate alliances and licensing transactions with third parties, and the receipt and timing of any payments to be made by us or to us in respect of such arrangements;*
- *our expectations regarding future financings;*
- *our plans to conduct clinical trials; and*
- *our expectations regarding the progress and the successful and timely completion of the various stages of our drug discovery, pre-clinical and clinical studies and the regulatory approval process*

the Company's plans, objectives, expectations and intentions and other statements including words such as "anticipate", "contemplate", "continue", "believe", "plan", "estimate", "expect", "intend", "will", "should", "may", and other similar expressions.

Such statements reflect our current views with respect to future events and are subject to risks and uncertainties and are necessarily based upon a number of estimates and assumptions that, while considered reasonable by us are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements, including, among others:

- *our ability to continue to operate as a going concern;*
- *our ability to obtain the substantial capital required to fund research and operations;*
- *our lack of product revenues and history of operating losses;*
- *our early stage of development, particularly the inherent risks and uncertainties associated with (i) developing new drug candidates generally, (ii) demonstrating the safety and efficacy of these drug candidates in clinical studies in humans, and (iii) obtaining regulatory approval to commercialize these drug candidates;*
- *the progress of our clinical trials;*
- *our liability associated with the indemnification of Old Lorus and its directors, officers and employees*
- *our ability to find and enter into agreements with potential partners;*
- *our drug candidates require time-consuming and costly preclinical and clinical testing and regulatory approvals before commercialization;*
- *clinical studies and regulatory approvals of our drug candidates are subject to delays, and may not be completed or granted on expected timetables, if at all, and such delays may increase our costs and could delay our ability to generate revenue;*
- *the regulatory approval process;*
- *our ability to attract and retain key personnel;*
- *our ability to obtain patent protection and protect our intellectual property rights;*
- *our ability to protect our intellectual property rights and to not infringe on the intellectual property rights of others;*
- *our ability to comply with applicable governmental regulations and standards;*
- *development or commercialization of similar products by our competitors, many of which are more established and have greater financial resources than we do;*
- *commercialization limitations imposed by intellectual property rights owned or controlled by third parties;*
- *our business is subject to potential product liability and other claims;*
- *our ability to maintain adequate insurance at acceptable costs;*
- *further equity financing may substantially dilute the interests of our shareholders;*
- *changing market conditions; and*
- *other risks detailed from time-to-time in our ongoing quarterly filings, annual information forms, annual reports and annual filings with Canadian securities regulators and the United States Securities and Exchange Commission, and those which are discussed under the heading "Risk Factors".*

Should one or more of these risks or uncertainties materialize, or should the assumptions set out in the section entitled "Risk Factors" underlying those forward-looking statements prove incorrect, actual results may vary materially from those described herein. These forward-looking statements are made as of the date of this management, discussion and analysis or, in the case of documents incorporated by reference herein, as of the date of such documents, and we do not intend, and do not assume any obligation, to update these forward-looking statements, except as required by law. We cannot assure you that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements. Investors are cautioned that forward-looking statements are not guarantees of future performance and accordingly investors are cautioned not to put undue reliance on forward-looking statements due to the inherent uncertainty therein.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity and debt financing, the proceeds from the exercise of warrants and stock options, and interest income on funds held for future investment. The remaining costs associated with the completion of the LOR-2040 Phase I/II clinical trial program with the US National Cancer Institute ("NCI") will be borne by the NCI. Lorus has, in the past, undertaken additional LOR-2040 trials and acquired additional quantities of LOR-2040 drug to support ongoing trials and undertaken further development of LOR-2040 at its own cost. We will continue the development of our small molecule programs from internal resources.

We have not earned substantial revenues from our drug candidates and are therefore considered to be in the development stage. The continuation of our research and development activities and the commercialization of the targeted therapeutic products are dependent upon our ability to successfully finance and complete our research and development programs through a combination of equity financing and payments from strategic partners. We have no current sources of payments from strategic partners.

During the current quarter, the Company settled its secured convertible debentures and extinguished its liability in the amount of $15.0 million for cash and other consideration.

Management has forecasted that the Company's current level of cash and cash equivalents and short-term investments are not sufficient to execute its current planned expenditures for the next twelve months without further investment. On October 6, 2009, the Company secured a six-month, $1 million, loan from a member of its Board of Directors (See "Subsequent events") and is currently in discussion with several parties with a view to obtaining additional funding. Management believes that with the additional funds received in October 2009, it will complete one or more of these arrangements in sufficient time to continue to execute its planned expenditures without interruption. However, there can be no assurance that the capital will be available as necessary to meet these continuing expenditures, or if the capital is available, that it will be on terms acceptable to the Company. The issuance of common shares by the Company could result in significant dilution in the equity interest of existing shareholders. The Company has implemented a series of strategies to reduce research, development and overhead expenditures and is considering alternatives to delay its research program, amongst other cost savings measures, until sufficient financing is available. There can be no assurance that the Company will be able to obtain sufficient financing to meet future operational needs. As a result, there is a significant doubt as to whether the Company will be able to continue as a going concern and realize its assets and pay its liabilities as they fall due.

These interim consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

The following discussion should be read in conjunction with the audited financial statements for theyear ended May 31, 2009 and the accompanying notes (the "Financial Statements") contained in the Company's annual report. The Financial Statements, and all financial information discussed below, have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are expressed in Canadian dollars unless otherwise noted. All comparative figures presented in these consolidated financial statements include those of those of Old Lorus prior to the Arrangement Date (as defined below) and the Company after the Arrangement Date. References in this Management's Discussion and Analysis to the "Company", "Lorus", "we", "our", "us" and similar expressions, unless otherwise stated, refers to Lorus Therapeutics Inc.

OVERVIEW

Lorus is a life sciences company focused on the discovery, research and development of effective anticancer therapies with a high safety profile. Lorus has worked to establish a diverse anticancer product pipeline, with products in various stages of development ranging from pre-clinical to an advanced Phase II clinical trial. A growing intellectual property portfolio supports our diverse product pipeline. Lorus' pipeline is a combination of internally developed products and products licensed in from other entities at a pre-clinical stage.

We believe that the future of cancer treatment and management lies in drugs that are effective, safe and have minimal side effects, and therefore improve a patient's quality of life. Many of the cancer drugs currently approved for the treatment and management of cancer are toxic with severe side effects, and we therefore believe that a product development plan based on effective and safe drugs could have broad applications in cancer treatment. Lorus' strategy is to continue the development of our product pipeline using several therapeutic approaches. Each therapeutic approach is dependent on different technologies, which we believe mitigates the development risks associated with a single technology platform. We evaluate the merits of each product throughout the clinical trial process and consider commercial viability as appropriate. The most advanced anticancer drugs in our pipeline, each of which flow from different platform technologies, are antisense, small molecules and immunotherapeutics.

Our business model is to take our product candidates through pre-clinical testing and into Phase I and Phase II clinical trials. It is our intention to then partner or co-develop these product candidates after successful completion of Phase I or II clinical trials. Lorus will give careful consideration in the selection of partners that can best advance the drug candidates into a pivotal Phase III clinical trial and, upon successful results, commercialization. Our objective is to receive cash for milestone payments and royalties from such partnerships which will support continued development of our product pipeline. We assess each product candidate and determine the optimal time to work towards partnering out that product candidate.

Our success is dependent upon several factors, including, maintaining sufficient levels of funding through public and/or private financing, establishing the efficacy and safety of our products in clinical trials and securing strategic partnerships.

Our loss from operations (excluding the gain on settlement of the convertible debentures) for the three months ended August 31, 2009 decreased to $1.2 million from $2.7 million during the same period in fiscal 2009. During the three months ended August 31, 2009 the Company recorded a gain on the repurchase of its secured convertible debentures of $11.0 million reflecting the difference between the fair value of the debentures at the repurchase date, net of transaction costs of $221 thousand, and the cash payment amount of $3.3 million resulting in net income for the period of $9.8 million ($0.04 per share). The gain on repurchase of the debentures does not result in income taxes payable as the Company has sufficient capital and non-capital losses to shelter these gains. During the three months ended August 31, 2008 the Company's net loss of $2.2 million included a gain on sale of shares of $450 thousand related to the plan of arrangement and corporate reorganization described below

The decrease in loss from operations for the three months ended August 31, 2009 compared with the same period in the prior year is due primarily to lower research and development costs of $685 thousand resulting from less spending on related activities, and higher expenditures in the prior period for GLP-toxicity studies related too our LOR-2040 and LOR-253 programs; lower general and administrative costs of $261 thousand due to reduced personnel and legal costs; and lower accretion and interest expense related to the convertible debentures as a result of repurchasing the debentures in June 2009. These lower expenditures are partly offset by a decrease in interest income of $71 thousand to $11 thousand in the current quarter as compared to the same period in the prior year is due to lower cash and investment balances as a result of the payment made to repurchase the debentures in June as well as lower prime interest rates.
We utilized cash of $987 thousand in our operating activities in the three months ended August 31, 2009 compared with $2.0 million in the same period in the prior year. The decrease is primarily a result of a reduced net operating loss.

At August 31, 2009, we had cash and cash equivalents and short-term investments of $1.4 million compared to $5.9 million at May 31, 2009. The decrease in cash and cash equivalents is primarily due to the payment made to repurchase the debentures.

As a result of the Company's current cash position, management has implemented a series of strategies to reduce costs and is actively pursuing investment and other opportunities aimed at funding its research and development programs. As part of its cost reduction strategies, management has reduced its research and development costs by limiting activities and reduced its general and administrative costs by limiting expenditures and reducing itspersonnel costs, among other things, and will continue to do so until such time as the Company has sufficient capital to support a full development program.

RESULTS OF OPERATIONS

Revenue

Revenue for the three months ended August 31, 2009 increased to $49 thousand compared with revenue of $3 thousand for the same period in the prior year. This revenue in the current period is related to milestone revenues associated with the license of Virulizin to ZOR Pharmaceuticals LLC ("ZOR") which is recognized over the remaining period of a service contract whereby Lorus has agreed to provide consulting services to ZOR. This agreement remained effective following the convertible debenture repurchase transaction. There remains $57 thousand in deferred revenue at August 31, 2009 that will be recognized during the next fiscal quarter as services are provided or upon expiry of the service agreement term in October 2009.

Research and Development

Research and development expenses totaled $540 thousand in the three months ended August 31, 2009 compared to $1.2 million during the same period in the prior year. The decrease in spending during the current period compared with the prior-year period is due to a reduction in expenditures during the current period in an effort to conserve cash and higher expenditures in the three months ended August 31, 2008 related to completion of GLP-toxicity studies for both our LOR-2040 bladder cancer and LOR-253 small molecule programs.

General and Administrative

General and administrative expenses totaled $533 thousand for the three months ended August 31, 2009 compared to $794 thousand in the same period in the prior year. The decrease in general and administrative costs for the current year is the result of lower personnel and legal costs.

Stock-Based Compensation

Stock-based compensation expense, net of forfeitures, of $105 thousand for the three months ended August 31, 2009 was relatively unchanged from the same period in the prior year.

Depreciation and Amortization

Depreciation and amortization expenses decreased to $21 thousand in the three months ended August 31, 2009 as compared to $43 thousand in the same period in the prior year. The decrease in depreciation and amortization expense is the result of reduced capital asset purchases over the past three fiscal years.

Interest Expense

Interest expense is the interest paid on the $15.0 million convertible debentures at a rate of prime plus 1%. In the current period, interest expense of $27 thousand reflects interest from the beginning of the period to June 19, 2009, the date of repurchase of the debentures. Of this amount, $15 thousand was non-cash interest paid in common shares of the Company and $12 thousand was paid in cash on the closing of the repurchase transaction. In the three months ended August 31, 2008, non-cash interest expense was $217 thousand.

Accretion in Carrying Value of Secured Convertible Debentures

In the three months ended August 31, 2009, accretion expense of $80 thousand reflects accretion on the convertible debentures from the beginning of the period to June 19, 2009 the date of repurchase of the debentures. In the three months ended August 31, 2008, accretion expense was $377 thousand. When the debentures were originally established, the Company allocated the proceeds from each tranche of the debentures to the debt and equity instruments issued on a relative fair value basis resulting in the $15.0 million debentures having an initial cumulative carrying value of $9.8 million as of their dates of issuance. Each reporting period, the Company accretes the carrying value of the convertible debentures such that if they had remained outstanding to maturity, October 6, 2009, the carrying value of the debentures would be the face value of $15.0 million. As a result of the repurchase transaction, the Company will no longer incur further accretion costs on these debentures.

Interest Income

Interest income totaled $11 thousand in the three months ended August 31, 2009 compared to $82 thousand in the same period in the prior year. The decrease in interest income during the current year is due to lower average cash and marketable securities balances and significantly lower interest rates available on investments in comparison with the same period in the prior year.

Net income (loss) for the period

For the reasons discussed above, our net loss from operations (excluding the gain on settlement of the convertible debentures) for the three months ended August 31, 2009 decreased to $1.2 million compared to $2.7 million in the same period in the prior year. This loss was offset by the gain on repurchase of the convertible debentures of $11.0 million resulting in net income of $9.8 million ($0.04 per share). During the same period in the prior year of the Company had a net loss of $2.2 million ($0.01 per share), inclusive of the gain on sale of shares related to the Arrangement of $450 thousand.

PLAN OF ARRANGEMENT AND CORPORATE REORGANIZATION

On July 10, 2007 (the “Arrangement Date”), the Company (or “New Lorus”) completed a plan of arrangement and corporate reorganization with, among others, 4325231 Canada Inc., formerly Lorus Therapeutics Inc. (“Old Lorus”), 6707157 Canada Inc. and Pinnacle International Lands, Inc (the “Arrangement”). As a result of the plan of arrangement and reorganization, among other things, each common share of Old Lorus was exchanged for one common share of the Company and the assets (excluding certain future tax attributes and related valuation allowance) and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it) were transferred, directly or indirectly, to the Company and/or its subsidiaries. The Company continued the business of Old Lorus after the Arrangement Date with the same officers and employees and continued to be governed by the same directors as Old Lorus prior to the Arrangement Date. Therefore, the Company’s operations have been accounted for on a continuity of interest basis and accordingly, the interim consolidated financial statement information included in this MD&A reflect that of the Company as if it had always carried on the business formerly carried on by Old Lorus.

REGULATORY MATTERS

On October 31, 2008 Lorus voluntarily delisted its common shares from trading on the NYSE Alternext US LLC (formerly the American Stock Exchange or AMEX). Lorus is eligible to apply for deregistration from the Securities Exchange Commission one year after delisting from AMEX. We currently intend on maintaining our Securities Exchange Commission registration.

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The selected financial information provided below is derived from the Company’s unaudited quarterly financial statements for each of the last eight quarters.

Research and development expenditures were higher in the previous seven quarters as compared to the most recent quarter. as a result of increased activity related to the LOR-2040 and LOR-253 programs for which development during these periods as compared to the current period. In particular research and development costs were significantly higher during the quarter ended May 31, 2008 as the Company incurred manufacturing costs associated with production of additional quantities of LOR-2040 to support the ongoing Phase II clinical trial in AML.
General and administrative expenses are lower in the most recent two quarters as compared to the prior six quarters reflecting reduced expenditures for personnel and legal costs and the implementation of cost reduction strategies.

The Company recognized a gain on the repurchase of its convertible debentures of shares of $11.0 million in the current quarter. For the quarter ended August 31, 2008 the Company recognized a gain on sale of shares of $450 thousand related to the Arrangement, as discussed above.

(Amounts in 000's except for per common share data)	Aug 31, 2009	May 31, 2009	Feb 28, 2009	Nov. 30, 2008	Aug. 31, 2008	May 31, 2008	Feb. 29, 2008	Nov. 30, 2007
Revenue	$ 49	$ 78	$ 64	$ 39	$ 3	$ 13	$ 3	$ 1
Research and development expense [(1)]	540	701	1,090	741	1,225	1,880	2,265	1,290
General and administrative expense[(1)]	533	516	775	873	794	1,142	820	1,060
Net earnings (loss)	9,760	(1,895)	(2,469)	(2,284)	(2,212)	(3,650)	(3,850)	(2,825)
Basic and diluted[(2)]								
net earnings (loss) per share	$ 0.04	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.01)
Cash used in operating activities	$ (987)	$ (1,394)	$ (1,789)	$ (2,080)	$ (1,950)	$ (2,722)	$ (2,586)	$ (2,537)

(1) Prior quarter amounts have been reclassified to conform to the financial statement presentation subsequent to that date.

(2) During periods of net loss, the calculation of diluted loss per share excludes all common shares potentially issuable upon the exercise of stock options, warrants and the convertible debenture that could dilute basic loss per share, because to do so would be anti-dilutive.

CAPITAL RISK MANAGEMENT

The Company's objectives when managing capital are to:

- Maintain its ability to continue as a going concern in order to provide returns to shareholders and benefits to other stakeholders;
- Maintain a flexible capital structure which optimizes the cost of capital at acceptable risk;
- Ensure sufficient cash resources to fund its research and development activity, to pursue partnership and collaboration opportunities and to maintain ongoing operations.

The capital structure of the Company consists of equity comprised of share capital, warrants, stock options, contributed surplus and deficit. The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issuances, acquiring or disposing of assets, adjusting the amount of cash and short-term investments balances or by undertaking other activities as deemed appropriate under the specific circumstances. In addition, as discussed in Subsequent Events below, in October 2009 the Board of Directors approved a short-term loan in the amount of $1 million to provide working capital while the Company seeks additional capital.

The Company is not subject to externally imposed capital requirements. While the Company's overall strategy with respect to capital risk management remains unchanged from the year ended May 31, 2009, the Company has forecasted that its current capital resources are not sufficient to carry out its research and development plans and operations for the next twelve months and is currently investigating various alternatives to obtain sufficient capital to continue its operations.

Rights Offering

On June 25, 2008, the Company filed a short-form prospectus for a rights offering to its shareholders. Under the rights offering, holders of the Company's common shares as of July 9, 2008 (the "Record Date") received one right for each common share held as of the Record Date. Each four rights entitled the holder thereof to purchase a unit of Lorus ("Unit"). Each Unit consists of one common share of Lorus at $0.13 and a one-half common share purchase warrant to purchase additional common shares of Lorus at $0.18 per common share until August 7, 2010. All unexercised rights expired on August 7, 2008.

Pursuant to the rights offering the Company issued 28,538,889 common shares and 14,269,444 common share purchase warrants in exchange for cash consideration of $3.7 million. The total costs associated with the transaction were $500 thousand. The Company has allocated the net proceeds of $3.2 million received from the issuance of the units to the common shares and the common share purchase warrants based on their relative fair values. The fair value of the common share purchase warrants has been determined based on an option pricing model. Based on relative fair values, $2.8 million of the net proceeds was allocated to the common shares and $417 thousand to the common share purchase warrants

Cash Position

At August 31, 2009, Lorus had cash and cash equivalents and short-term investments totaling $1.4 million compared to $5.9 million at May 31, 2009. The Company invests in highly rated and liquid debt instruments. Investment decisions are made in accordance with an established investment policy administered by senior management and overseen by the board of directors. Working capital (representing primarily cash, cash equivalents, short term investments and other current assets less current liabilities) at August 31, 2009 was $714 thousand.

As discussed above, management has forecasted that the Company's current level of cash, cash equivalents and short-term investments is not be sufficient to execute its current planned expenditures for the next twelve months without further investment. The Company is currently investigating various alternatives to obtain sufficient capital to continue its operations and has implemented a series of strategies to reduce research, development and overhead expenditures until such time as it can obtain additional capital to fund its operations.

If we are able to secure additional financing, we intend to use these resources to fund our existing drug development programs and develop new programs from our portfolio of preclinical research technologies. The amounts actually expended for research and drug development activities and the timing of such expenditures will depend on many factors, including the ability of the Company to raise additional capital, the progress of the Company's research and drug development programs, the results of preclinical and clinical trials, the timing of regulatory submissions and approvals, the impact of any internally developed, licensed or acquired technologies, our ability to find suitable partnership agreements to assist financially with future development, the impact from technological advances, determinations as to the commercial potential of the Company's compounds and the timing and development status of competitive products.

We do not expect to generate positive cash flow from operations in the next several years due to additional research and development costs, including costs related to drug discovery, preclinical testing, clinical trials, manufacturing costs and operating expenses associated with supporting these activities. Negative cash flow will continue until such time, if ever, that we receive regulatory approval to commercialize any of our products under development and/or royalty or milestone revenue from any such products exceeds expenses.

Contractual Obligations and Off-Balance Sheet Financing

At August 31, 2009, we had contractual obligations requiring annual payments as follows:

(Amounts in 000's)	**Less than 1 year**	**1-3 years**	**Total**
Operating leases	$ 150	$ 110	$ 260
Total	**$ 150**	**$ 110**	**$ 260**

In addition, the Company is party to certain licensing agreements that require it to pay a proportion of any fees that it may receive from future revenues or milestone payments. As of August 31, 2009 the Company has not received any amounts related to these licensing agreements and therefore, no amounts are owing. The amount of future fees, if any, is not determinable.

The Company has entered into various consulting agreements that upon execution of a partnership agreement could result in liabilities owing to such consultants. The amounts payable in these agreements are contingent on the amounts receivable by Lorus under such partnership agreements. As of August 31, 2009 no amounts were owed and the amount of future fees payable to the consultants, if any, are not determinable.

As at August 31, 2009, we have not entered into any off-balance sheet arrangements.

Indemnification

Under the Arrangement, Lorus agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring:

(i) prior to, at or after the Effective Time of the Arrangement and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time;

(ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and

(iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

Lorus has recorded a liability of $150 thousand, which management believes is a reasonable estimate of the fair value of the obligation for the indemnifications provided. There have been no claims under this indemnification to date. This amount is included on the balance sheet in Accrued Liabilities at August 31, 2009.

FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

(Amounts in 000's)	**As at August 31, 2009**	As at May 31, 2009
Financial assets		
Cash and cash equivalents, consisting of term deposits, and guaranteed investment certificates, held for trading, measured at fair value	**$ 866**	$ 5,374
Short-term investments, held-for-trading, recorded at fair value	**491**	490
Financial liabilities		
Accounts payable, measured at amortized cost	**360**	299
Accrued liabilities, measured at amortized cost	**1,239**	1,131
Secured convertible debentures, measured at amortized cost	**–**	14,448

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.

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 short-term investments. The carrying amount of the financial assets represents the maximum credit exposure.

The Company manages credit risk for its cash and cash equivalents and short-term investments by maintaining minimum standards of R1 low or A low investments and invests only in highly rated Canadian securities with debt securities that are traded on active markets and are capable of prompt liquidation.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. To the extent that the Company does not believe it has sufficient liquidity to meet its current obligations, the Board considers securing additional funds through equity, debt or partnering transactions. The Company manages its liquidity risk by continuously monitoring forecasts and actual cash flows. Refer to note 1 of the financial statements for further discussion on the Company's ability to continue as a going concern.

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, short-term investments and secured convertible debentures. 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 interest rates relative to interest rates on the investments, owing to the relative short-term nature of the investments. Following the year end, the Company extinguished its secured convertible debentures and does not currently have any interest bearing debt.

Financial instruments potentially exposing the Company to foreign exchange risk consist principally of accounts payable and accrued liabilities. The Company holds minimal amounts of U.S. dollar denominated cash, purchasing on an as needed basis to cover U.S. dollar denominated payments. At August 31, 2009, U.S. dollar denominated accounts payable and accrued liabilities amounted to $51 thousand. Assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in an decrease or increase in net earning, respectively, and other comprehensive income of $5 thousand. The Company does not have any forward exchange contracts to hedge this risk.

The Company does not invest in equity instruments of other corporations. On June 19, 2009, the Company disposed of the shares of Pharma Immune, a wholly owned subsidiary, as part of the consideration in extinguishing its convertible debentures.

OUTLOOK

The Company does not currently have sufficient cash and cash equivalents to execute its operating strategies for the next 12 months. In addition to the funds received in October 2009, management is currently seeking additional investment and believes that it will obtain such investment in sufficient time to continue to execute its planned expenditures without interruption. As a result of the Company's current cash position, management is currently undertaking actions to reduce expenditures while at the same time pursuing investment and other opportunities aimed at funding its research and development programs. As part of its cost reduction strategies, management has reduced its research and development costs by limiting activities and reduced its general and administrative costs by limiting expenditures and reducing its personnel costs, among other things, until such time as the Company has sufficient capital to support a full development program. There can be no assurance that the capital will be available as necessary to meet these continuing expenditures, or if the capital is available, that it will be on terms acceptable to the Company.

Until one of our drug candidates receives regulatory approval and is successfully licensed or commercialized, Lorus will continue to incur operating losses. The magnitude of these operating losses will be largely affected by the timing and scope of future research and development, clinical trials and the Company's ability to raise additional working capital and/or establish effective partnerships to share the costs of development and clinical trials.

SUBSEQUENT EVENT

In October 2009, the Company entered into a loan agreement with a member of its Board of Directors to borrow $1 million.. The loan amount, which was advanced on October 6, 2009, is unsecured, and bears interest at the annual rate of 10%. The principal and interest are due in six months. The funds will be used for general working capital purposes.

RISK FACTORS

Before making an investment decision with respect to our common shares, you should carefully consider the following risk factors, in addition to the other information included or incorporated by reference into this report. The risks set out below are not the only risks we face. If any of the following risks occur, our business, financial condition, prospects or results of operations would likely suffer. In that case, the trading price of our common shares could decline and you may lose all or part of the money you paid to buy our common shares.

Please refer to the MD&A included in our 2009 Annual Report for a complete discussion of risks and uncertainties.

- Our ability to continue as a going concern.
- The cash and cash equivalents on hand are not sufficient to execute our operating strategies for the next twelve months and we may not be able to raise sufficient funds to continue operations.
- We have a history of operating losses. We expect to incur net losses and we may never achieve or maintain profitability.
- We have indemnified Old Lorus and its directors officers and employees in respect of the Arrangement.
- We may be unable to obtain partnerships for one or more of our product candidates which could curtail future development and negatively impact our share price.
- Clinical trials are long, expensive and uncertain processes and Health Canada or the FDA may ultimately not approve any of our product candidates. We may never develop any commercial drugs or other products that generate revenues.
- We may violate one or more of the operational covenants related to our convertible debentures that could result in an event of default and the requirement for early payment of our convertible debentures.
- As a result of intense competition and technological change in the pharmaceutical industry, the marketplace may not accept our products or product candidates, and we may not be able to compete successfully against other companies in our industry and achieve profitability.
- We may be unable to obtain patents to protect our technologies from other companies with competitive products, and patents of other companies could prevent us from manufacturing, developing or marketing our products.
- Our products and product candidates may infringe the intellectual property rights of others, which could increase our costs.
- Our share price has been and may continue to be volatile and an investment in our common shares could suffer a decline in value.
- Future sales of our common shares by us or by our existing shareholders could cause our share price to fall.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Policies and Estimates

Our accounting policies are in accordance with Canadian GAAP including some that require management to make assumptions and estimates that could significantly affect the results of operations and financial position. The significant accounting policies that we believe are the most critical in fully understanding and evaluating the reported financial results are disclosed in the MD&A section of our 2009 annual report. As well, our significant accounting policies are disclosed in Note 3, *Significant Accounting Policies,* of the notes to the financial statements of Lorus provided in our annual report for the year ended May 31, 2009.

Recently Adopted Accounting Recommendations

(a) Goodwill and Intangible Assets

Effective June 1, 2009, the Company adopted Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets ("Section 3062"), and Section 3450, Research and Development Costs which established 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 Section 3062. The adoption of this new section has had no impact on the Company's interim consolidated financial statements.

(b) Financial Instruments

Effective June 1, 2009, the Company adopted the amendments under Section 3862, Financial Instruments - Disclosures ("Section 3862"), to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than the quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data. These disclosures are applicable effective the Company's annual financial statements for the year ended May 31, 2010; therefore, the disclosures required by this new section has had no impact on the Company's current interim consolidated financial statements.

Recent Accounting Recommendations not yet adopted

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards (IFRS) over a transition period expected to end in 2011. The Company has begun to assess the impact of the transition to IFRS on the Company's financial statements but has initiated its process of evaluating the impact of IFRS on it financial reporting but has yet to determine the extent to which it will affect the financial statements when these standards are implemented.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has implemented a system of internal controls that it believes adequately protects the assets of the Company and is appropriate for the nature of its business and the size of its operations. These internal controls include disclosure controls and procedures designed to ensure that information required to be disclosed by the Company is accumulated and communicated as appropriate to allow timely decisions regarding required disclosure.

Internal controls over financial reporting means a process designed by or under the supervision of the Chief Executive Officer and the acting Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The internal controls are not expected to prevent and detect all misstatements due to error or fraud. Management advises that there have been no changes in the Corporation's internal controls over financial reporting during the three months ended August 31, 2009 that have materially affected or are reasonably likely to materially affect the Corporation's internal control over financial reporting.

As at August 31, 2009, the Company's Chief Executive Officer and the acting Chief Financial Officer have certified that these controls and procedures are effective to provide reasonable assurance that material information is made known to them by others in the Company. Management has identified the following two areas of concern, but believes that the Company's limited number of transactions, day-to-day management involvement in operations and reporting and access to third party experts are sufficient compensating controls to limit our risk of material misstatement.

Segregation of Duties

Given our limited staff, certain duties within the accounting and finance department cannot be effectively segregated. We believe that none of the segregation of duty concerns has resulted in a misstatement to the financial statements as we rely on certain compensating controls, including substantive periodic review of the financial statements by the Chief Executive Officer and Audit Committee. This weakness is considered to be a common area of deficiency for many smaller listed companies in Canada. We continue to evaluate whether additional accounting staff should be hired to deal with this weakness.

Complex and Non-Routine Transactions

As required, we record complex and non-routine transactions. These sometimes are extremely technical in nature and require an in-depth understanding of GAAP. Our accounting staff has only a fair and reasonable knowledge of the rules related to GAAP and reporting and the transactions may not be recorded correctly, potentially resulting in material misstatement of our financial statements.

To address this risk, we consult with our third-party expert advisors as needed in connection with the recording and reporting of complex and non-routine transactions. In addition, an annual audit is completed by our auditors, and presented to the Audit Committee for its review and approval. During the audit for the fiscal year ended May 31, 2009, no material misstatements were identified. At a future date, we may consider expanding the technical expertise within our accounting function. In the meantime, we will continue to work closely with our third party advisors.

UPDATED SHARE INFORMATION

As at October 6, 2009, the Company had 257,009,677 common shares issued and outstanding and 14,269,444 common share purchase warrants convertible into an equal number of common shares. In addition, the Company had issued and outstanding 20,655,000 stock options to purchase an equal number of common shares.

ADDITIONAL INFORMATION

Additional information relating to Lorus, including Lorus' 2009 annual information form and other disclosure documents, is available on SEDAR at www.sedar.com. For any information filed prior to July 10, 2007 please access the information on SEDAR for Global Summit Real Estate Inc. (Old Lorus).

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4 subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying interim unaudited financial statements of the Corporation for the interim period ending August 31, 2009 have been prepared by and are the responsibility of the Corporation's management.

The Corporation's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Lorus Therapeutics Inc.
Consolidated Balance Sheets - Unaudited

(amounts in 000's) *(Canadian dollars)*		**As at August 31, 2009**		As at May 31, 2009
ASSETS				
Current				
Cash and cash equivalents	**$**	**866**	$	5,374
Short-term investments (note 7)		**491**		490
Prepaid expenses and other assets		**956**		826
		2,313		6,690
Fixed assets		**209**		231
Goodwill		**606**		606
		815		837
	$	**3,128**	$	7,527
LIABILITIES				
Current				
Accounts payable	**$**	**360**	$	299
Accrued liabilities		**1,239**		1,131
Secured convertible debentures (note 8)		**-**		14,448
		1,599		15,878
SHAREHOLDERS' DEFICIENCY				
Share capital (note 5)				
Common shares		**162,255**		162,240
Equity portion of secured convertible debentures (note 5(e))		**-**		3,814
Stock options (note 6)		**3,950**		3,845
Contributed surplus (note 5(e))		**14,558**		10,744
Warrants		**417**		417
Deficit accumulated during development stage		**(179,651)**		(189,411)
		1,529		(8,351)
	$	**3,128**	$	7,527

See accompanying notes to the interim consolidated financial statements (unaudited)
Basis of Presentation Note 1

Lorus Therapeutics Inc.
Consolidated Statements of (Earnings) Loss and Deficit - Unaudited

(amounts in 000's except for per common share data) *(Canadian dollars)*		**Three months ended Aug. 31, 2009**		Three months ended Aug. 31, 2008		Period from inception Sept. 5, 1986 to Aug. 31, 2009
REVENUE (note 9)	**$**	**49**	$	3	$	1,089
EXPENSES						
Research and development		**540**		1,225		124,537
General and administrative		**533**		794		58,408
Stock-based compensation		**105**		91		8,523
Depreciation and amortization of fixed assets		**21**		43		9,752
Cost of sales		**-**		-		105
Operating expenses		**1,199**		2,153		201,325
Interest expense on convertible debentures		**27**		217		3,995
Accretion in carrying value of convertible debentures		**80**		377		4,983
Amortization of deferred financing charges		**-**		-		412
Interest income		**(11)**		(82)		(12,247)
Loss from operations for the period		**(1,246)**		(2,662)		(197,379)
Gain on repurchase of convertible debentures and transfer of assets (note 8)		**11,006**		-		11,006
Gain on sale of shares (note 1)		**-**		450		6,749
Net earnings (loss) and other comprehensive income for the period		**9,760**		(2,212)		(179,624)
Deficit, beginning of period		**(189,411)**		(180,551)		-
Change in accounting policy		**-**		-		(27)
Deficit, end of period	**$**	**(179,651)**	$	(182,763)	$	(179,651)
Basic earnings (loss) per common share	**$**	**0.04**	$	(0.01)		
Diluted earnings (loss) per common share	**$**	**0.04**		n/a		
Weighted average number of common shares outstanding used in the calculation of: (note 5)						
Basic earnings (loss) per common share		**257,010**		228,407		
Diluted earnings (loss) per common share		**261,797**		n/a		

See accompanying notes to the interim consolidated financial statements (unaudited)

Lorus Therapeutics Inc.
Consolidated Statements of Cash Flows - Unaudited

(amounts in 000's) *(Canadian Dollars)*	**Three months ended Aug. 31, 2009**	Three months ended Aug. 31, 2008	Period from inception Sept. 5, 1986 to Aug. 31, 2009
Cash flows from operating activities:			
Net earnings (loss) for the period	**$ 9,760**	$ (2,212)	$ (179,624)
Less: Gain on repurchase of convertible debentures			
and transfer of assets (note 8)	**(11,006)**	-	(11,006)
Gain on sale of shares (note 1)	-	(450)	(6,749)
Items not involving cash:			
Stock-based compensation	**105**	91	8,523
Interest on convertible debentures	**15**	217	3,983
Accretion in carrying value of convertible debentures	**80**	377	4,983
Amortization of deferred financing charges	-	-	412
Depreciation, amortization and write-down of fixed			
assets and acquired patents and licenses	**21**	43	22,313
Other	**(1)**	(7)	444
Change in non-cash operating working capital	**39**	(9)	(415)
Cash used in operating activities	**(987)**	(1,950)	(157,136)
Cash flows from financing activities:			
Issuance of convertible debentures, net of issuance costs	-	-	12,948
Payment on settlement of convertible debentures,			
including transaction costs (note 8)	**(3,521)**	-	(3,521)
Issuance of warrants	-	417	37,153
Proceeds on sale of shares, net of arrangement costs (note 1)	-	600	6,899
Issuance of common shares and warrants,			
net of issuance costs	-	2,790	112,232
Cash (used in) provided by financing activities	**(3,521)**	3,807	165,711
Cash flows from investing activities:			
Maturity (purchase) of marketable securities			
and other investments, net	-	2,696	(500)
Business acquisition, net of cash received	-	-	(539)
Acquired patents and licenses	-	-	(715)
Additions to fixed assets	-	(3)	(6,303)
Proceeds on sale of fixed assets	-	-	348
Cash (used in) provided by investing activities	-	2,693	(7,709)
(Decrease) increase in cash and cash equivalents during the period	**(4,508)**	4,550	866
Cash and cash equivalents, beginning of period	**5,374**	2,652	-
Cash and cash equivalents, end of period	**$ 866**	$ 7,202	$ 866
Supplemental cash flow information			
Interest paid in cash	**$ 12**	$ -	

See accompanying notes to the interim consolidated financial statements (unaudited)

1. *Basis of presentation*

These unaudited interim consolidated financial statements of Lorus Therapeutics Inc., (the “Company” or “Lorus”) have been prepared by the Company in accordance with Canadian generally accepted accounting principles for interim financial statements and do not include all the information required for complete financial statements. The unaudited interim financial statements follow the same accounting policies and methods of application as the audited annual financial statements for the year ended May 31, 2009. These statements should be read in conjunction with the audited consolidated financial statements for the year ended May 31, 2009. These financial statements are prepared based on the assumption that Lorus will continue its operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business which may not be appropriate given the discussion in section (a) “Going concern,” below.

The information presented as at August 31, 2009 and August 31, 2008 reflect, in the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

a) Going concern

The Company has not earned substantial revenue from its drug candidates and is, therefore, considered to be in the development stage. The continuation of the Company's research and development activities is dependent upon the Company's ability to successfully fund its cash requirements through a combination of equity financing, debt and payments from strategic partners. The Company has no current sources of payments from strategic partners.

Management has forecasted that the Company's current level of cash, cash equivalents and short-term investments is not sufficient to execute its current planned expenditures for the next twelve months without further investment. On October 6, 2009, the Company secured a six-month, $1 million, loan from a member of its Board of Directors (See “Subsequent events”) and is currently in discussion with several parties with a view to obtaining additional funding. Management believes that with the additional funds received in October 2009 it will complete one or more of these arrangements in sufficient time to continue to execute its planned expenditures without interruption. However, there can be no assurance that the capital will be available as necessary to meet these continuing expenditures, or if the capital is available, that it will be on terms acceptable to the Company. The issuance of common shares by the Company could result in significant dilution in the equity interest of existing shareholders. The Company has implemented a series of strategies to reduce research, development and overhead expenditures and is considering alternatives to delay its research program, amongst other cost savings measures, until sufficient financing is available. There can be no assurance that the Company will be able to obtain sufficient financing to meet future operational needs. As a result, there is a significant doubt as to whether the Company will be able to continue as a going concern and realize its assets and pay its liabilities as they fall due.

The interim consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenue and expenses and the balance sheet classifications used.

b) Reorganization

On July 10, 2007 (the “Arrangement Date”), the Company (or “New Lorus”) completed a plan of arrangement and corporate reorganization with, among others, 4325231 Canada Inc., formerly Lorus Therapeutics Inc. (“Old Lorus”), 6707157 Canada Inc. and Pinnacle International Lands, Inc (the “Arrangement”). As a result of the plan of arrangement and reorganization, among other things, each common share of Old Lorus was exchanged for one common share of the Company and the assets (excluding certain future tax attributes and related valuation allowance) and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it) were transferred, directly or indirectly, to the Company and/or its subsidiaries. The Company continued the business of Old Lorus after the Arrangement Date with the same officers and employees and continued to be governed by the same directors as Old Lorus prior to the Arrangement Date. Therefore, the Company’s operations have been accounted for on a continuity of interest basis and accordingly, the consolidated financial statement information included in these financial statements reflect that of the Company as if it had always carried on the business formerly carried on by Old Lorus. Following completion of the Arrangement, New Lorus is not related to Old Lorus, which was subsequently renamed Global Summit Real Estate Inc.

Under the Arrangement, the Company has agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring

(i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time;

(ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and

(iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

In connection with the Arrangement, the Company received cash consideration of approximately $8.5 million, before transaction costs. This amount includes $600 thousand related to the indemnification, above, which was received in July 2008. The Company has recorded a liability of $150 thousand, which it believes is a reasonable estimate of the fair value of the obligation for the indemnifications provided. There have been no claims under this indemnification to date. This amount is included on the balance sheet in Accrued Liabilities as at August 31, 2009.

2. *Changes in accounting policy*

During the three month period ended August 31, 2009, the Company adopted the following accounting policies:

(a) Goodwill and Intangible Assets

Effective June 1, 2009, the Company adopted Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets ("Section 3062"), and Section 3450, Research and Development Costs which established 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 Section 3062. The adoption of this new section has had no impact on the Company's interim consolidated financial statements.

(b) Financial Instruments

Effective June 1, 2009, the Company adopted the amendments under Section 3862, Financial Instruments - Disclosures ("Section 3862"), to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than the quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data. These disclosures are applicable effective the Company's annual financial statements for the year ended May 31, 2010; therefore, the disclosures required by this new section have had no impact on the Company's current interim consolidated financial statements.

3. *Capital risk management*

The Company's objectives when managing capital are to:

- Maintain its ability to continue as a going concern in order to provide returns to shareholders and benefits to other stakeholders;
- Maintain a flexible capital structure which optimizes the cost of capital at acceptable risk;
- Ensure sufficient cash resources to fund its research and development activity, to pursue partnership and collaboration opportunities and to maintain ongoing operations.

The capital structure of the Company consists of equity comprised of share capital, share purchase warrants, stock options, contributed surplus and deficit. The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issuances, acquiring or disposing of assets, adjusting the amount of cash and short-term investments balances or by undertaking other activities as deemed appropriate under the specific circumstances. As discussed in "Subsequent events" (note 10), in October 2009 the Board of Directors approved a short-term loan in the amount of $1 million to provide working capital while the Company seeks additional capital.

The Company is not subject to externally imposed capital requirements.

While the Company's overall strategy with respect to capital risk management remains unchanged from the year ended May 31, 2009, the Company has forecasted that its current capital resources are not sufficient to carry out its research and development plans and operations for the next twelve months and continues to investigate various alternatives to obtain sufficient capital to continue its operations (note 1).

4. *Financial instruments*

(a) Financial instruments

The Company has classified its financial instruments as follows:

(amounts in 000's)	**As at August 31, 2009**	As at May 31, 2009
Financial assets		
Cash and cash equivalents, consisting of term deposits, and guaranteed investment certificates, held for trading, measured at fair value	**$ 866**	$ 5,374
Short-term investments, held-for-trading, recorded at fair value	**491**	490
Financial liabilities		
Accounts payable, measured at amortized cost	**360**	299
Accrued liabilities, measured at amortized cost	**1,239**	1,131
Secured convertible debentures, measured at amortized cost	**–**	14,448

(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 short-term investments. The carrying amount of the financial assets represents the maximum credit exposure.

The Company manages credit risk for its cash and cash equivalents and short-term investments by maintaining minimum standards of R1 low or A low investments and Lorus invests only in highly rated Canadian corporations with debt securities that are traded on active markets and are capable of prompt liquidation.

(ii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. To the extent that the Company does not believe it has sufficient liquidity to meet its current obligations, the Board considers securing additional funds through equity, debt or partnering transactions. The Company manages its liquidity risk by continuously monitoring forecasts and actual cash flows. Refer to note 1 for further discussion on the Company's ability to continue as a going concern.

(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.

Financial instruments potentially exposing the Company to foreign exchange risk consist principally of accounts payable and accrued liabilities. The Company holds minimal amounts of U.S. dollar denominated cash, purchasing on an as needed basis to cover U.S. dollar denominated payments. At August 31, 2009 U.S. dollar denominated accounts payable and accrued liabilities amounted to $51 thousand. Assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in an increase or decrease in net loss and comprehensive loss of $5 thousand. The Company does not have any forward exchange contracts to hedge this risk.

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

5. *Share capital*

(a) Continuity of common shares and warrants

	Common Shares			Warrants	
(amounts in 000's)	Number		Amount	Number	Amount
Balance at May 31, 2008	**217,649**	**$**	**158,743**	–	$ –
Interest payments (b)	2,038		217	–	–
Issuance of units (c)	28,539		2,790	14,269	417
Balance at August 31, 2008	**248226**		**161,750**	**14,269**	**417**
Interest payments (b)	2,989		201	–	–
Balance at November 30, 2008	**251,215**		**161,951**	**14,269**	**417**
Interest payments (b)	3,406		160	–	
Balance at February 28, 2009	**254,621**		**162,111**	**14,269**	**417**
Interest payments (b)	2,187		129		
Balance at May 31, 2009	**256,808**		**162,240**	**14,269**	**417**
Interest payments (b)	202		15		
Balance at August 31, 2009	**257,010**	**$**	**162,255**	**14,269**	**417**

(b) Interest payments

Interest payments relate to interest payable on the $15.0 million convertible debentures payable at a rate of prime +1% up to June 19, 2009. Effective that date, the Company repurchased the convertible debentures, see note 8. Common shares issued in payment of interest were issued at an amount equal to the weighted average trading price of such shares for the ten trading days immediately preceding their issue in respect of each interest payment.

(c) Equity issuances

On June 25, 2008, the Company filed a short-form prospectus for a rights offering to its shareholders. Under the rights offering, holders of the Company's common shares as of July 9, 2008 (the "Record Date") received one right for each common share held as of the Record Date. Each four rights entitled the holder thereof to purchase a unit of Lorus ("Unit"). Each Unit consists of one common share of Lorus at $0.13 and a one-half common share purchase warrant to purchase additional common shares of Lorus at $0.18 until August 7, 2010. All unexercised rights expired on August 7, 2008.

Pursuant to the rights offering the Company issued 28,538,889 common shares and 14,269,444 common share purchase warrants in exchange for cash consideration of $3.71 million. The total costs associated with the transaction were approximately $500 thousand. The Company has allocated the net proceeds of $3.2 million received from the issuance of the Units to the common shares and the common share purchase warrants based on their relative fair values. The fair value of the common share purchase warrants has been determined based on an option-pricing model. Based on relative fair values, $2.8 million of the net proceeds was allocated to the common shares and $417 thousand to the common share purchase warrants.

During the three months ended August 31, 2009, nil stock options were exercised (August 31, 2008 – nil)

(d) Earnings/Loss per share

For the three months ended August 31, 2009, the determination of diluted earnings per share includes in the calculation all common shares potentially issuable upon the exercise of stock options and share purchase warrants, using the “treasury stock method.”

Diluted earnings per share, using the treasury stock method, assumes outstanding stock options and share purchase warrants are exercised at the beginning of the period, and the Company’s common shares are purchased at the average market price during the period from the funds derived on the exercise of these outstanding options and share purchase warrants. Stock options and share purchase warrants with a strike price above the average market price for the period were excluded from the calculation of fully diluted earnings per share as to include them would have increased the earnings per share.

For the three months ended August 31, 2008 the Company has excluded from the calculation of diluted loss per share all common shares potentially issuable upon the exercise of stock options, share purchase warrants and the convertible debenture that could dilute basic loss per share, because to do so would be anti-dilutive.

(e) Continuity of contributed surplus

	Three months ended August 31, 2009		Three months ended August 31, 2008	
Balance, Beginning of year	**$**	**10,744**	$	9,181
Equity portion of secured convertible debentures (note 8)		**3,814**		–
Forfeiture of stock options		**–**		–
Balance, end of period	**$**	**14,558**	$	9,181

As a result of repurchasing the convertible debentures, the Company reallocated the equity portion of the debentures to contributed surplus--see note 8.

6. *Stock options*

(a) Stock options outstanding

	Three months ended August 31, 2009			Three months ended August 31, 2008		
	Options (in 000's)		**Weighted average exercise price**	Options (in 000's)		Weighted average exercise price
Outstanding, Beginning of year	**16,873**	**$**	**0.29**	16,438	$	0.45
Granted	**3,872**		**0.07**	4,224		0.12
Exercised	**–**		**–**	–		–
Forfeited	**–**		**–**	(319)		0.22
Outstanding, end of period	**20,655**	**$**	**0.25**	20,343	$	0.39

For the three month ended August 31, 2009 stock compensation expense of $105 thousand (2008 - $91 thousand) was recognized representing the amortization applicable to the current period of the estimated fair value of options granted since June 1, 2002.

(b) Fair value assumptions

The Company granted approximately 3,872,000 stock options during the three-month period ended August 31, 2009.

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of stock options granted during the following periods:

	Three months ended August 31, 2009		Three months ended August 31, 2008	
Risk free interest rate		**0.3%**		3.5%
Expected dividend yield		**0%**		0%
Expected volatility		**178%**		76%
Expected life of options		**5 years**		5 years
Weighted average fair value of options granted in the period	**$**	**0.067**	$	0.14

(c) Continuity of stock options

(amounts in 000's)	**Three months ended August 31, 2009**		Three months ended August 31, 2008	
Balance at beginning of the year	**$**	**3,845**	$	4,961
Stock option expense		**105**		91
Balance, end of period	**$**	**3,950**	$	5,052

7. Short term investments, marketable securities and other investments

As at August 31, 2009							
(amounts in 000's)		**Less than one year maturities**		**Greater than one year maturities**		**Total**	**Yield to Maturity**
Corporate instruments (including guaranteed investment certificates)	**$**	**491**	**$**	**–**	**$**	**491**	**–**

As at May 31, 2009							
(amounts in 000's)		Less than one year maturities		Greater than one year maturities		Total	Yield to Maturity
Corporate instruments (including guaranteed investment certificates)	$	248	$	242	$	490	–

At August 31, 2009, investments with maturities of less than one year are classified as held-to-maturity investments are carried at amortized cost. These investments have maturities varying from one to three months. Certain corporate instruments totaling $491 thousand at August 31, 2009 (May 31, 2009 - $490 thousand) have been designated as “held-for-trading”, and have been classified as short-term investments on the balance sheet. These investments are carried at fair value. The net increase in fair value of these investments for the three months ended August 31, 2009 amounted to $1 thousand and has been included in the statement of loss and deficit.

At August 31, 2009 and May 31, 2009, the carrying values of held-to-maturity investments approximated their quoted market values.

8. Convertible debentures

The terms of the secured convertible debentures are described in note 13 to the Company's annual financial statements for the period ended May 31, 2009. The Company repurchased these debentures, which were originally due on October 6, 2009, on June 19, 2009.

Under the agreement, Lorus purchased all of the convertible debentures from The Erin Mills Investment Corporation (“TEMIC “) for consideration that included a cash payment on close of the transaction of $3.3 million, the assignment of the rights under the license agreement with ZOR Pharmaceuticals Inc, LLC (“ZOR”) certain intellectual property associated with Virulizin and all of Lorus' shares in its wholly owned subsidiary, Pharma Immune, which holds an equity interest in ZOR (the "Consideration"). Under the agreement, Lorus will be entitled to 50% of any royalties received under the ZOR license agreement and 50% of the value of any transaction completed in territories not covered by the ZOR license agreement. Lorus also retains a perpetual royalty free license for the animal use of Virulizin. TEMIC will be fully responsible for all clinical and regulatory costs associated with commercialization of Virulizin in territories not covered by the ZOR license agreement. Lorus will assist TEMIC with certain agreed upon services.

For receipt of this Consideration, TEMIC has released all security interest in the assets of Lorus.

As a result of the transaction, the Company recognized a gain on the repurchase of the debentures of $11.0 million reflecting the difference between the fair value of the debentures at the repurchase date, net of transaction costs of approximately $221 thousand, and the cash payment amount of $3.3 million. In addition, as a result of extinguishing the debentures, $3.8 million, the equity portion of the debentures, was transferred to contributed surplus. The gain on repurchase of the debentures does not result in income taxes payable as the Company has sufficient capital loss and non-capital loss carryforwards to shelter these gains. Capital loss and non-capital loss carryforwards, and the associated valuation allowance have been reduced accordingly.

9. Revenue

For the three months ended August 31, 2009 the Company recognized $47 thousand (US$41 thousand) in revenue related to milestone payments received from ZOR and recorded as deferred revenue in prior periods. This revenue is recognized over the remaining period of a service contract that was not assigned to TEMIC as part of the repurchase of the secured convertible debenture. Under the agreement, the Company has agreed to provide consulting services to ZOR. There remains $57 thousand (US$54 thousand) in deferred revenue that has been recorded in Accrued Liabilities on the balance sheet as at August 31, 2009.

Management anticipates that this revenue will be recognizable during the next fiscal quarter as services are provided or upon expiry of the service agreement term in October 2009.

10. *Subsequent event*

In October 2009, the Company entered into a loan agreement with a member of its Board of Directors to borrow $1 million. The loan amount, which was received on October 6, 2009, is unsecured, evidenced by a promissory note and bears interest at the annual rate of 10%. The principal and interest are due in six months. The funds will be used for general working capital purposes.