



CellStop Systems Inc.

February 28, 2011 and 2010

Interim Unaudited Consolidated Financial Statements

(Stated in Canadian Dollars)

- ◆ Interim Consolidated Balance Sheets
- ◆ Interim Consolidated Statements of Deficit
- ◆ Interim Consolidated Statements of Operations and Comprehensive Loss
- ◆ Interim Consolidated Statements of Cash Flows
- ◆ Notes to the Interim Consolidated Financial Statements

CELLSTOP SYSTEMS INC.


Suite 302
1620 West 8th Avenue
Vancouver, British Columbia
V6J 1V4
Canada
Tel. (604) 639-4457
Fax. (604) 639-4458

NOTICE TO READER OF THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The financial statements of CellStop Systems Inc. and the accompanying interim consolidated balance sheet as at February 28, 2011, and the interim consolidated statements of earnings, retained earnings and cash flows for the six and three month period then ended are the responsibility of the Company's management. The Consolidated Financial Statements (Unaudited) have been prepared in accordance with Canadian generally accepted accounting principles and where appropriate include management's best estimates and judgments. Management has reviewed the financial information presented throughout this report and has ensured it is consistent with the Consolidated Financial Statements (Unaudited).

The Company's independent auditor, Watson, Dauphinee & Masuch has not performed a review of these interim financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements on behalf of the shareholders by the independent external auditors of the Company.

/s/ M. Gahagan
M. Gahagan
Chief Executive Officer



H. W. Bromley
Chief Financial Officer

CELLSTOP SYSTEMS INC.

Interim Consolidated Balance Sheets

As at February 28, 2011 and August 31, 2010

	February 28, 2011 \$ (Unaudited)	August 31, 2010 \$ (Audited)
ASSETS		
CURRENT		
Cash	434,265	1,018
HST/GST recoverable	1,204	2,142
	<u>435,469</u>	<u>3,160</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	53,413	64,957
Loan payable (Note 3)	-	89,534
	<u>53,413</u>	<u>154,491</u>
EQUITY		
Share capital (Note 6(b))	7,792,497	7,201,210
Contributed surplus	184,286	184,286
Accumulated other comprehensive income (Note 2(g))	194,768	194,768
Deficit	(7,789,495)	(7,731,595)
	<u>382,056</u>	<u>(151,331)</u>
	<u>435,469</u>	<u>3,160</u>

Nature and continuance of operations (Note 1)

Commitments (Note 7)

Approved on behalf of the Board:

/s/ M. Gahagan
M. Gahagan, Director

/s/ G. Tuskey
G. Tuskey, Director

CELLSTOP SYSTEMS INC.

Interim Consolidated Statements of Deficit

For the Period Ended February 28, 2011 and August 31, 2010

	February 28, 2011	August 31, 2010
	\$	\$
DEFICIT, BEGINNING OF THE PERIOD	(7,731,595)	(7,609,253)
Net loss for the period	<u>(57,900)</u>	<u>(122,342)</u>
DEFICIT, END OF THE PERIOD	<u>(7,789,495)</u>	<u>(7,731,595)</u>

CELLSTOP SYSTEMS INC.

Interim Consolidated Statements of Operations and Comprehensive Loss For the Period Ended February 28, 2011 and 2010

	February 28, 2011 6 Months \$ (Unaudited)	February 28, 2010 6 Months \$ (Unaudited)	February 28, 2011 3 Months \$ (Unaudited)	February 28, 2010 3 Months \$ (Unaudited)
EXPENSES				
Administration and management fees	15,000	15,000	7,500	7,500
Auditing and legal	6,866	12,543	4,000	7,314
Consulting fees (Note 5)	12,000	12,000	6,000	6,000
Filing and transfer agent fees	8,416	9,531	1,979	5,705
Interest and financing fee (Note 3)	14,904	-	-	-
Office	1,669	1,468	560	786
	58,855	50,542	20,039	27,305
LOSS BEFORE OTHER ITEMS	(58,855)	(50,542)	(20,039)	(27,305)
OTHER ITEMS				
Settlement of legal claim (Note 4)	-	(1,160)	-	(577)
Interest Income	955	-	955	-
	955	(1,160)	955	(577)
NET LOSS FOR THE PERIOD	(57,900)	(51,702)	(19,084)	(27,882)
WEIGHTED AVERAGE NUMBER OF POST-CONSOLIDATION COMMON SHARES OUTSTANDING (Note 6(b)(ii))	23,474,401	18,291,516	25,058,195	18,291,516
BASIC AND DILUTED LOSS PER POST-CONSOLIDATION COMMON SHARE	(0.00)	(0.00)	(0.00)	(0.00)

CELLSTOP SYSTEMS INC.

Interim Consolidated Statements of Cash Flows

For the Six and Three Months ended February 28, 2011 and 2010

	February 28, 2011 6 Months \$ (Unaudited)	February 28, 2010 6 Months \$ (Unaudited)	February 28, 2011 3 Months \$ (Unaudited)	February 28, 2010 3 Months \$ (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES				
Net loss for the period	(57,900)	(51,702)	(19,084)	(27,882)
Changes in non-cash working capital accounts:				
Change in HST/GST recoverable	938	(909)	3,158	(1,013)
Change in accounts payable and accrued liabilities	(14,723)	1,765	2,808	(3,546)
Change in loan payable – accrued interest payable	13,644	-	-	-
	(58,041)	(50,846)	(13,118)	(32,441)
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from private placement	500,000	-	-	-
Share issuance costs	(8,713)	-	-	-
	491,287	-	-	-
INCREASE (DECREASE) IN CASH FOR THE PERIOD	433,247	(50,846)	(13,118)	(32,441)
CASH, BEGINNING OF PERIOD	1,018	74,777	447,383	56,372
CASH, END OF PERIOD	434,265	23,931	434,265	23,931
SUPPLEMENTARY CASH FLOW INFORMATION				
Interest paid	4,438	-	-	-
Income taxes paid	-	-	-	-

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 1 – NATURE AND CONTINUANCE OF OPERATIONS

CellStop Systems Inc. (the “Company”) was incorporated on April 29, 1982 under the laws of the Province of British Columbia. The Company currently has no active operations and is analyzing project opportunities.

The address of the Company’s registered office is Suite 302, 1620 West 8th Avenue, Vancouver, British Columbia, V6J 1V4, Canada

The Company is a publicly traded company and the Company’s listing on the TSX Venture Exchange (“Exchange”) was transferred to the NEX board of the Exchange effective July 02, 2010 due to the Company’s lack of operations. The NEX board allows the Company’s shares to continue trading while it analyzes project opportunities and resume active business. The Company is subject to restrictions on share issuances and certain types of payments as set out in NEX policies.

The Company was previously in the business of providing wireless telemetry solutions utilizing the GSM network. On September 01, 2007, the Company ceased its operations, being the development and marketing of automotive security using wireless GSM technology, upon the sale of its subsidiary, CellStop International Limited.

These unaudited interim consolidated financial statements have been prepared on the basis of accounting principles applicable to a “going concern” company which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. However, the Company has experienced significant losses from operations to date and has no current source of revenue. As at February 28, 2011, the Company has an accumulated deficit of \$7,789,495 and a working capital surplus of \$382,056.

The Company’s ability to continue as a going concern is dependent upon generating profitable operations, maintaining current financing obligations and obtaining new sources of financing (Note 6). The outcome of these matters cannot be predicted at this time. These financial statements do not reflect any adjustments to the amounts and classification of assets and liabilities, which would be necessary should the Company be unable to continue operations.

The interim unaudited consolidated financial statements were authorized for issue by the Board of Directors on April 26, 2011.

NOTE 2 – BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements are prepared on the historical cost basis using Canadian generally accepted accounting principles (“GAAP”) and with International Financial Reporting Standards (IFRS) using the same accounting policies and methods as those used in the Company’s consolidated financial statements for the year ended August 31, 2010 and are summarized below: These are the Group’s first interim consolidated financial statements prepared in accordance with IFRSs and IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied.

These consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 2 – BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Basis of Consolidation

The unaudited interim consolidated financial statements include the accounts of the Company and its wholly-owned inactive subsidiaries: The Buddy Systems Inc., US incorporated Palm Coast Solutions Inc. (“PCSI”) and Group West Systems (Massachusetts) Ltd. All significant intercompany transactions and balances have been eliminated. As part of its transition to IFRSs, the Company elected to restate only those business combinations that occurred on or after September 1, 2009. In respect of acquisitions prior to September 1, 2009, any goodwill represents the amount recognized under previous Canadian GAAP.

b) Foreign Currency Translation

The Company’s functional and reporting currency is the Canadian dollar.

Monetary assets and liabilities of the Company which are denominated in foreign currencies are translated at the period-end exchange rates. Revenues and expenses are translated at rates of exchange prevailing on the transaction date. All exchange gains or losses are recognized in earnings.

The Company’s inactive foreign subsidiaries are determined to be of an integrated nature and are translated into Canadian dollars using the temporal method. Monetary assets and liabilities of foreign subsidiaries are translated at period-end exchange rates. Non-monetary assets, liabilities, revenues and expenses are translated at the rate of exchange in effect at the transaction date. Exchange gains and losses arising from this translation are recognized in earnings. Prior to September 01, 2008, these foreign operations were translated using the current method for self-sustaining subsidiaries, and the related exchange gains and losses were accumulated and reported in other comprehensive income (Note 2(g)).

c) Use of Estimates

The preparation of financial statements in conformity with GAAP and IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant areas requiring the use of management estimates include the determination of net recoverable amount of assets, the estimated amount of accrued liabilities, and the realization of future income tax assets. Actual results could differ from such estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the note 8 – Income Taxes.

d) Financial Instruments

The Company initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 2 – BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

d) Financial Instruments

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company's financial instruments are classified into one of the following categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale assets or other financial liabilities.

Financial assets and liabilities held-for-trading are measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale financial instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income and reported in shareholders' equity.

The Company classifies cash as held-for-trading which is carried at its fair value; and accounts payable and accrued liabilities and loan payable as other financial liabilities which are carried at their amortized cost.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less.

e) Share Capital

Common shares are classified as equity. The Company records proceeds from share issuances net of commissions and issuance costs. Shares issued for other than cash consideration are valued at the quoted price on the TSX Venture Exchange based on the earlier of: (i) the date the shares are issued, and (ii) the date the agreement to issue the shares is reached.

f) Stock Based Compensation

The Company has a stock option plan for its directors, officers and employees. Under this plan, stock options are not issued at less than their fair market value.

The Company recognizes compensation cost for options and other stock-based awards under the fair value based method. Compensation cost is measured using the Black-Scholes option pricing model at the date of the grant and is expensed over the vesting period of the equity instrument awarded, with the offsetting amounts credited to contributed surplus. Consideration received on the exercise of stock options is recorded as share capital and the related contributed surplus amount is transferred to share capital.

As at February 28, 2011 and August 31, 2010, the Company had no stock options outstanding.

g) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 2 – BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

h) Loss Per Share

Basic loss per share is calculated using the weighted average number of shares issued and outstanding during the period. Diluted loss per share is the same as basic loss per share as the issuance of shares on the exercise of share purchase options and warrants is anti-dilutive.

i) Comprehensive Income

Comprehensive income comprises the Company's net income and other comprehensive income. Other comprehensive income represents changes in shareholders' equity during a period arising from non-shareholder sources, and includes foreign exchange gains and losses arising from the translation of the financial statements of self-sustaining foreign operations.

As at February 28, 2011 and August 31, 2010, the accumulated other comprehensive income of \$194,768 represented the accumulated foreign currency translation gain of the Company's foreign subsidiaries previously classified as self-sustaining operations. Effective September 01, 2008, the Company reclassified these inactive subsidiaries as integrated operations due to their inactivity, and adopted the temporal translation method prospectively to provide more relevant financial information.

h) Income Taxes

The Company accounts for income taxes using the liability method, whereby future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities measured using substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. Income tax assets, including the benefit of income tax losses available for carry forward, are only recognized to the extent that it is more likely than not that the Company will ultimately realize those assets.

j) Comparative Figures

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for the current period. These reclassifications have no effect on the unaudited consolidated net loss for the periods ended February 28, 2011 and August 31, 2010.

k) Adoption of New Accounting Standard

(i) Credit Risk

EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" provides guidance on how to take into account an entity's own credit risk and the credit risk of the counter party in determining the fair value of financial assets and financial liabilities, including derivative instruments. The prospective adoption of this new standard effective September 01, 2009 did not have a material impact on the Company's interim consolidated financial statements.

(ii) International Financial Reporting Standards ("IFRS")

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by IFRS for fiscal years beginning on or after January 01, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. Accordingly, the conversion from Canadian GAAP to IFRS will be applicable to the Company's reporting for the first quarter ending November 30, 2011 for which the current and comparative information will be prepared under IFRS. The Company has begun amending the disclosure of these interim financial statements to be compliant with IFRS and will continue to assess the impact of IFRS on the financial reporting.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 2 – BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

l) Future Accounting Standard Changes

(i) Business Combinations

In January 2009, the Canadian Institute of Chartered Accountants (“CICA”) issued Section 1582 “Business Combinations”, Section 1601, “Consolidations”, and Section 1602 “Non-Controlling Interests”. These sections replace the former Section 1581 “Business Combinations” and Section 1600 “Consolidated Financial Statements”, and establish a new section for accounting for a non-controlling interest in a subsidiary.

Sections 1582 and 1602 will require net assets, non-controlling interests and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. Acquisition costs are not part of the consideration and are to be expensed when incurred. Section 1601 establishes standards for the preparation of consolidated financial statements.

These new sections apply to interim and annual financial statements relating to fiscal years beginning on or after January 01, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. The Company will evaluate the impact of the adoption of these standards on its consolidated financial statements when applicable.

NOTE 3 – LOAN PAYABLE

	February 28, 2011	August 31, 2010
	\$	\$
	(Unaudited)	(Audited)
Loan Payable, Beginning of the Period	-	-
Loan advance received	100,000	100,000
Financing fee on issuance of bonus shares	(20,000)	(20,000)
Interest accrued	-	3,178
Amortization of financing fee	20,000	6,356
Converted in shares	(100,000)	-
	<hr/>	<hr/>
Loan Payable, End of the Period	-	89,534
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>

The loan bears interest at 10% per annum payable quarterly, is unsecured, and matures on May 07, 2011. Pursuant to the loan agreement dated April 28, 2010, the Company issued 400,000 common shares to the lender with a deemed value of \$20,000 in connection to the debt financing. The Company recorded this financing fee as an adjustment to the carrying amount of the loan payable, and amortized the fee over the term of the loan.

During the year ended August 31, 2010, the Company accrued interest of \$3,178 (2009 – \$Nil) and recorded amortization of the financing fee of \$6,356 totaling \$9,534 (2009 – \$Nil).

During the quarter ended November 30, 2010, the Company settled the outstanding principal amount of the loan payable of \$100,000 by issuing common shares and share purchase warrants of the Company (Note 6).

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 4 – SETTLEMENT OF LEGAL CLAIM

On February 18, 2009, the Ontario Superior Court of Justice granted an award of \$58,498 plus interest to a former contractor of the Company. The Company accrued a settlement and interest payable of \$68,073 in the year ended August 31, 2009. In May 2010, the Company paid the full settlement amount including interest totalling \$70,065.

NOTE 5 – RELATED PARTY TRANSACTION

The Company paid \$6,000 (February 28, 2010 – \$6,000) to an officer of the Company for management services provided (Note 7(b)), of which \$2,000 (February 28, 2010 – \$2,000) remained outstanding in accounts payable and accrued liabilities as at February 28, 2011 and 2010.

NOTE 6 – SHARE CAPITAL

a) Authorized Share Capital

Unlimited number of common shares without par value.

b) Issued and Outstanding Share Capital

	Number of Shares	\$
Balance, August 31, 2009 (Pre-Share Consolidation)	73,166,063	7,185,786
Shares issued for loan payable (Note 3)	400,000	19,400
Share consolidation, net of share issuance costs (ii)	(55,174,535)	(3,976)
Balance, August 31, 2010 (Pre-Share Consolidation)	18,391,528	7,201,210
Shares issued for loan payable (Note 3)	1,111,111	100,000
Private Placement	5,555,556	491,287
Balance, February 28, 2011 (Post-Share Consolidation)	25,058,195	7,792,497

- (i) On August 25, 2010, the common shares of the Company was consolidated on a basis of 1 new common shares for 4 old common shares.
- (ii) During the quarter ended November 30, 2010, the Company completed a private placement of 5,555,556 units at \$0.09 per unit for gross proceeds of \$500,000. Each unit is comprised of one common share and one share purchase warrant. Each warrant is exercisable into one additional common share at \$0.12 per share and is valid for one year. These warrants expire on October 13, 2011.
- (iii) During the quarter ended November 30, 2010, the Company issued 1,111,111 units at \$0.09 per unit to settle the outstanding principal amount of the loan payable of \$100,000 (Note 3). Each unit is comprised of one common share and one share purchase warrant. Each warrant is exercisable into one additional common share at \$0.12 per share for a term of one year. These warrants expire on October 13, 2011.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 6 – SHARE CAPITAL (Continued)

c) Share Purchase Warrants

	Number of Warrants	Exercise Price \$
Balance, August 31, 2009 (Pre-Share Consolidation)	10,000,000	0.05
Share consolidation (Note 6(b)(ii))	(7,500,000)	(0.05)
Balance, August 31, 2010 (Pre-Share Consolidation) (i)	2,500,000	0.20
Warrants issued for loan payable (Note 3) (ii)	1,111,111	0.12
Private Placement (iii)	5,555,556	0.12
Balance, February 28, 2011 (Post-Share Consolidation)	9,166,667	0.14

(i) The warrants issued in combination with the private placement for the year ended August 31, 2008 expire on July 27, 2011.

(ii) The warrants issued in combination with the conversion of the loan into shares during the quarter ended November 30, 2010, (Note 3) expire on October 13, 2011.

(iii) The warrants issued in combination with the private placement during the quarter ended November 30, 2010, expire on October 13, 2011.

NOTE 7 – COMMITMENTS

- a) Effective March 01, 2008, the Company entered into a business advisory and administration agreement with an arm's length party for an open term of \$2,500 per month. The Company may terminate the agreement at any time for cause, or on 30-day written notice without cause.

- b) Effective May 01, 2009, the Company entered into a management agreement with an officer of the Company for an open term of \$2,000 per month. The Company may terminate the agreement at any time for cause, or on 30-day written notice without cause.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 8 – INCOME TAXES

a) Future Income Taxes

The tax effects of temporary differences that give rise to future income tax assets as at February 28, 2011 and August 31, 2010 are as follows:

	February 28, 2011 6 Months \$ (Unaudited)	August 31, 2010 12 Months \$ (Audited)
Future income tax assets resulting from:		
Non-capital losses carry-forward	948,407	919,799
Capital losses carry-forward	314,953	314,953
Tax value in excess of net book value	14,132	15,196
Tax deductible share issuance costs	3,668	1,925
	1,281,160	1,251,873
Valuation allowance	(1,281,160)	(1,251,873)
Net future income tax assets	-	-

The Company has Canadian non-capital losses available for carry-forward to offset future taxable income. These losses expire as follows:

Year	\$
2014	287,378
2015	288,924
2026	354,537
2027	249,713
2028	2,179,474
2029	165,743
2030	153,430
2031	114,431
	3,793,630

The Company has Canadian capital losses of \$2,539,137 which can be carried forward indefinitely and may be applied against future capital gains.

Future tax benefits which may arise as a result of these losses have not been recognized in these unaudited interim consolidated financial statements due to the uncertainty of their realization, and accordingly these tax benefits have been offset by a valuation allowance.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 8 – INCOME TAXES (Continued)

b) Provision for Income Taxes

A reconciliation of the combined Canadian federal and provincial income taxes at statutory rates and the Company's effective income tax expense is as follows:

	February 28, 2011 6 Months \$ (Unaudited)	August 31, 2010 12 Months \$ (Audited)
Expected income tax (recovery) expense	(16,985)	(35,888)
Tax deductible costs	(2,324)	(1,907)
Items not deductible for tax	(14,259)	(7,213)
Effect of change in tax rates	4,960	6,650
Unrecognized tax benefits of non-capital losses	28,608	38,358
Income tax expense	-	-

NOTE 9 – FINANCIAL INSTRUMENTS

The Company's financial instruments are exposed to certain financial risks:

a) Fair value

The carrying values of cash, accounts payable and accrued liabilities, and loan payable approximate their respective fair values due to the short-term nature of these instruments.

b) Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet liabilities when due. To the extent that the Company does not believe it has sufficient liquidity to meet obligations, it will consider securing additional equity funding. The ability of the Company to arrange such financing will depend in part upon prevailing capital market conditions as well as the business performance of the Company. There can be no assurance that the Company will be successful in its efforts to arrange additional financing on terms acceptable to the Company.

If additional financing is raised by the issuance of shares from treasury, control of the Company may change and shareholders may suffer dilution. If adequate funds are not available or are not available on acceptable terms, the Company may not be able to take advantage of opportunities or otherwise respond to competitive pressures and remain in business.

c) Foreign Currency Risk

Foreign exchange risk arises because of fluctuations in exchange rates. The Company has no active operations and has minimum cash denominated in United States dollar. The Company has not entered into any forward exchange contracts or other derivative instrument to hedge against foreign exchange risk.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 9 – FINANCIAL INSTRUMENTS (Continued)

d) Credit Risk

Credit risk is the risk of loss associated with a counter party's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to its cash balances. The Company manages its credit risk on bank deposits by holding deposits in high credit quality banking institutions in Canada. Management believes that the credit risk with respect to receivables is remote.

e) Interest Rate Risk

Interest on the Company's loan payable is based on a fixed rate and therefore does not expose the Company to interest rate risk.

f) Operational Risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Company's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Company's operations.

The Company's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Company's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within the Company. This responsibility is supported by the development of overall Company standards for the management of operational risk.

NOTE 10 – CAPITAL MANAGEMENT

The Company manages its common shares as capital, which as at February 28, 2011 was \$7,792,497 (August 31, 2010 – \$7,201,210). The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern in order to pursue project opportunities for the benefit of its shareholders. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company may attempt to issue new shares or debt (Note 6), or adjust the amount of cash. There can be no assurance that the Company will be able to obtain debt or equity capital in the case of operating cash deficits. The Company is not subject to any externally imposed capital requirements. The Company prepares annual expenditure budgets and updates these as required throughout the year which it uses as the primary tool for assessing its capital requirements.

Risk Management

The Company may be exposed to risks of varying degrees of significance that could affect its ability to achieve its strategic objectives. The main objectives of the Company's risk management process are to ensure that risks are properly identified and that the capital base is adequate in relation to those risks. The principal risks to which the Company is exposed are described below.

Capital Risk

The Company manages its capital to ensure that there are adequate capital resources for the Company in order to make further developments or take advantage of unanticipated opportunities.

CELLSTOP SYSTEMS INC.

Notes to the Interim Consolidated Financial Statements

For the Six and Three Months Ended February 28, 2011 and 2010

NOTE 10 – CAPITAL MANAGEMENT (Continued)

Market Risk

The Company is presently analyzing various opportunities to invest its capital. Any potential opportunity will be affected by a market risk.

Key Personnel and Future Staffing Requirements Risk

The Company's success will also be dependent on its ability to identify, recruit, motivate and retain highly qualified executive, management and technical support.