PACIFIC THERAPEUTICS LTD.
(A Development Stage Company)
INTERIM FINANCIAL STATEMENTS

Three and nine month periods ended September 30, 2012 and 2011
(Expressed in Canadian Dollars)

Unaudited – Prepared by Management

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 unaudited interim financial statements of Pacific Therapeutics Ltd. ("the Company") have been prepared by and are the responsibility of the Company's management.

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

PACIFIC THERAPEUTICS LTD.
(A Development Stage Company)

Condensed Interim Balance Sheets
Unaudited
(Expressed in Canadian Dollars)

AS AT:	September 30, 2012	December 31, 2011
	$	$
ASSETS		
CURRENT		
Cash and cash equivalents	36,004	6,094
Restricted cash (Note 4)	-	300,000
Harmonized sales tax recoverable	5,379	13,976
Prepaid expenses	146,487	5,119
	187,870	325,189
NON-CURRENT ASSETS		
PROPERTY AND EQUIPMENT (Note 5)	5,000	6,358
INTANGIBLE ASSETS (Note 6)	87,759	90,631
	280,629	422,178
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	302,580	161,771
Convertible note (Note 11)	12,317	-
Derivative liability (Note 11)	12,248	-
Shareholder Demand Loan (Note 9)	56,800	20,300
Shareholder Short Term Loan (Note 9)	195,017	-
	578,962	182,071
NON-CURRENT LIABILITIES		
Irrevocable subscriptions (Note 7)	-	230,481
Due to shareholders' (Note 9)	-	175,935
	-	406,416
SHAREHOLDERS' (DEFICIENCY)		
Share capital (Note 10)	1,996,080	1,765,754
Contributed surplus	199,250	162,052
Deficit accumulated during the development stage	(2,493,663)	(2,094,115)
	(298,333)	(166,309)
	280,629	422,178

Nature and Continuance of Operations (Note 1) **and Commitments** (Note 15)

On behalf of the Board:

"Douglas H. Unwin"	Director	*"Doug Wallis"*	Director
Douglas H. Unwin		Doug Wallis	

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

PACIFIC THERAPEUTICS LTD.
(A Development Stage Company)

Interim Statements of Comprehensive Loss
Unaudited
(Expressed in Canadian Dollars)

	Three months ended 30 Sep 2012	Three months ended 30 Sep 2011	Nine months ended 30 Sep 2012	Nine months ended 30 Sep 2011
	$	$		
Expenses				
Advertising and promotion	19,510	400	24,593	1,499
Amortization of property and equipment	453	453	1,358	1,358
Amortization of intangible assets	957	957	2,872	2,531
Bank charges & interest	204	2,774	470	3,007
Computer	-	-	1,544	-
Insurance	4,244	3,655	12,451	10,973
Investor relations	17,500	-	34,450	-
Office and miscellaneous	235	735	2,498	2,605
Professional fees	13,553	45,568	48,466	81,745
Rent and occupancy costs	6,412	1,963	14,023	10,292
Research and development	33,309	-	37,116	-
Stock-based compensation	20,200	-	31,763	-
Telephone and utilities	87	866	2,073	3,135
Transfer agent	3,479	-	5,125	-
Travel	11,360	-	13,130	-
Wages and benefits	25,000	24,885	76,043	92,659
Total Expense	156,503	82,256	307,975	209,804
Interest (Income)/Expense				
Interest (Income)/Expense	-	8,914	(30)	16,932
ISA interest incurred (Note 7)	-	11,250	3,001	27,375
ISA-accretion of deemed discount (Note 7)	-	-	69,520	-
Shareholder loan accretion of deemed discount (Note 9)	6,853	4,905	19,082	9,722
Class B Series I Preferred Shares accretion of deemed discount	-	7,786	-	21,783
Total Interest (Income)/Expense	6,853	32,855	91,573	75,812
Net Loss and Comprehensive Loss	**(163,356)**	**(115,111)**	**(399,548)**	**(285,616)**
Loss per share Basic and Diluted	**($ 0.01)**	**($ 0.01)**	**($ 0.02)**	**($ 0.02)**
Weighted average number of common shares outstanding	**21,906,862**	**17,281,647**	**21,394,249**	**17,023,052**

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

PACIFIC THERAPEUTICS LTD.
(A Development Stage Company)

Interim Statements of Changes in Shareholders' Equity
Unaudited
(Expressed in Canadian Dollars)

	Number of common shares	Number of Series II Preferred shares	Share capital $	Contributed surplus $	Deficit $	Total $
Balance at December 31, 2010	15,930,451	203,250	1,133,136	136,110	(1,564,297)	(295,051)
Loss for the period	-	-	-	-	(285,616)	(285,616)
Exercise of common share warrants @ $0.10	300,000	-	30,000	-	-	30,000
Common shares issued under Irrevocable Subscription Agreements	750,000	-	112,500	45,610	-	158,110
Repricing of common shares	-	-	41,600	-	-	41,600
Share issue costs	-	-	(21,532)	-	-	(21,532)
Common shares issued for cash @ $0.15	250,000	-	37,500	-	-	37,500
Common shares issued for debt @ $0.15	110,000	-	16,500	-	-	16,500
Discount on shareholder loans	-	-	-	20,078	-	20,078
Balance at September 30, 2011	17,340,451	203,250	1,349,704	201,798	(1,849,913)	(298,411)
Balance at December 31, 2011	20,989,157	-	1,765,754	162,052	(2,094,115)	(166,309)
Exercise of common share warrants @ $0.15	66,666	-	10,000	-	-	10,000
Common shares issued for cash	1,531,003	-	229,651	-	-	229,651
Share issue costs	-	-	(9,325)	-	-	(9,325)
Stock based compensation	-	-	-	37,198	-	37,198
Loss for the period	-	-	-	-	(399,548)	(399,548)
Balance at September 30, 2012	22,586,826	-	1,996,080	199,250	(2,493,663)	(298,333)

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

PACIFIC THERAPEUTICS LTD.
(A Development Stage Company)

Interim Statements of Cash Flow
Unaudited
(Expressed in Canadian Dollars)

	For the nine month period ended 30 Sep 2012 $	For the nine month period ended 30 Sep 2011 $
Cash flows used in operating activities		
Net loss and Comprehensive loss	(399,548)	(285,616)
Adjustments for items not affecting cash		
Amortization of property and equipment	1,358	1,358
Amortization of intangible assets	2,872	2,531
Amortization of deemed discounts on ISA, Class B Series I Preferred Shares and shareholder loans	88,602	26,386
Interest Expense Incurred	-	27,375
Stock based compensation	31,763	-
Changes in non-cash working capital balances		
Harmonized sales tax recoverable	8,597	(4,290)
Prepaid expenses	(141,368)	(7,188)
Security deposit	-	(2,400)
Unearned revenue	-	(2,600)
Shareholder Loan	-	100,854
Accounts payable and accrued liabilities	140,808	27,061
	(266,916)	(116,529)
Cash flows used in investing activities		
Additions to intangible assets	-	(18,308)
	-	(18,308)
Cash flows from financing activities		
Issue of common shares for cash	220,326	37,500
Re-pricing of shares for cash	-	41,600
Exercise of Warrants	10,000	30,000
Promissory Notes	30,000	-
Due to shareholders short term	36,500	-
	296,826	109,100
Increase/(Decrease) in cash and cash equivalents	29,910	(25,737)
Cash and cash equivalents, beginning of period	6,094	30,457
Cash and cash equivalents, end of period	36,004	4,720

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

1. NATURE AND CONTINUANCE OF OPERATIONS

Pacific Therapeutics Ltd. (the “Company" or "PTL") was incorporated under the laws of the Province of British Columbia, Canada on September 12, 2005. The Company is a development stage company focused on developing proprietary drugs to treat certain types of lung disease including fibrosis. On October 14, 2011, the Company became a reporting company in British Columbia and was approved by the Canadian National Stock exchange (“CNSX”) and opened for trading on November 16, 2011.

The Company’s principal place of business is located at Suite 1500 – 409 Granville Street, Vancouver, BC, V6C 1T2.

PTL has financed its cash requirements primarily from share issuances and payments from research collaborators. The Company's ability to realize the carrying value of its assets is dependent on successfully bringing its technologies to market and achieving future profitable operations, the outcome of which cannot be predicted at this time. It will be necessary for the Company to raise additional funds for the continuing development of its technologies.

The financial statements have been prepared on a going concern basis, which contemplates continuity of operations and the realization of assets and settlement of liabilities in the ordinary course of business. The Company is subject to risks and uncertainties common to drug discovery companies, including technological change, potential infringement on intellectual property of and by third parties, new product development, regulatory approval and market acceptance of its products, activities of competitors and its limited operating history. All of these factors create uncertainty in the Company's ability to successfully bring its technologies to market, to achieve future profitable operations and to realize the carrying value of its assets. Given these uncertainties, there is significant doubt as to the Company’s ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of these uncertainties.

2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION

(a) Statement of Compliance

These interim condensed financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, as issued by the International Accounting Standards Board (“IASB”) and using the accounting polices adopted and disclosed in Note 3 of Pacific Therapeutics 2011 Annual Report. These interim condensed financial statements should be read in conjunction with Pacific Therapeutics’ 2011 Annual Report.

These interim financial statements were approved and authorized for issue by the Board of Directors on August 28, 2012.

(b) Basis of Presentation

These financial statements have been prepared on a historical cost basis and are presented in Canadian dollars which is the Company’s functional currency.

(c) Use of Estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting periods. Although these estimates are based on management’s best knowledge of current events and actions, actual results ultimately may differ from those estimates.

3. RECENT ACCOUNTING PRONOUNCEMENTS

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board ("IASB") or International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods beginning after January 1, 2013 or later periods. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements. The new standards are summarized below:

IFRS 9 – Financial Instruments addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaced the models for measuring equity instruments and such instruments are either recognized at fair value through profit and loss or at fair value through other comprehensive income.

IFRS 10 – Consolidated Financial Statements requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 11 – Joint Arrangements, requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures.

IFRS 12 – Disclosure of Interests in Other Entities establishes disclosure requirements for interest in other entities, such as joint arrangements, associates, and special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with and entity's interests in other entities.

IFRS 13 – Fair Value Measurement is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is set out among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

4. RESTRICTED CASH

The Company's restricted cash balance at September 30, 2012 is $Nil (December 31, 2011 - $300,000) The funds consisted of monies held in an escrow account, pursuant to the terms of the Irrevocable Subscription Agreements ("ISAs") with investors (Note 7). The release of the invested funds was governed by the terms of the ISAs (Note 7) and an Escrow Agreement. The agreement included Draw Down Terms that permitted the Company at its sole discretion to draw down the restricted cash to purchase Class A Common shares at the greater of $0.10 per share and the closing market price of the Securities on the day prior to the dissemination of a news release announcing the allotment less the maximum discount prescribed by the Canadian National Stock Exchange. On January 31, 2012, the Company terminated the irrevocable subscription agreements entered into by the Issuer on January 31, 2011 and May 16, 2011, respectively, and the $300,000 of restricted funds held by the Company were returned to the investors.

5. PROPERTY AND EQUIPMENT

Cost

	Computer Equipment	Furniture and Fixtures	Leasehold Improvements	Total
Balance at January 1, 2011	$ 5,876	$ 8,093	$ 8,330	$ 22,299
Additions	-	-	-	-
Disposals	-	-	-	-
Balance at December 31, 2011	$ 5,876	$ 8,093	$ 8,330	$ 22,299
Additions	-	-	-	-
Disposals	-	-	-	-
Balance at September 30, 2012	$ 5,876	$ 8,093	$ 8,330	$ 22,299

Amortization

	Computer Equipment	Furniture and Fixtures	Leasehold Improvements	Total
Balance at January 1, 2011	$ 5,169	$ 4,364	$ 4,598	$ 14,131
Amortization for the year	318	746	746	1,810
Balance at December 31, 2011	$ 5,487	$ 5,110	$ 5,344	$ 15,941
Amortization for the period	239	559	560	1,358
Balance at September 30, 2012	$ 5,726	$ 5,669	$ 5,904	$ 17,299

Carrying amounts

At January 1, 2011	$ 707	$ 3,729	$ 3,732	$ 8,168
At December 31, 2011	$ 389	$ 2,983	$ 2,986	$ 6,358
At September 30, 2012	$ 150	$ 2,424	$ 2,426	$ 5,000

6. INTANGIBLE ASSETS

Cost

	Technology Licenses (i)	Patents (ii)	Total
Balance at January 1, 2011	$ 30,738	$ 46,632	$ 77,370
Additions	11,772	10,808	22,580
Disposals	-	-	-
Balance at December 31, 2011	$ 42,510	$ 57,440	$ 99,950
Additions	-	-	-
Disposals	-	-	-
Balance at September 30, 2012	$ 42,510	$ 57,440	$ 99,950

Amortization

	Technology Licenses (i)	Patents (ii)	Total
Balance at January 1, 2011	$ -	$ 5,830	$ 5,830
Amortization for the year	-	3,489	3,489
Balance at December 31, 2011	$ -	$ 9,319	$ 9,319
Amortization for the period	-	2,872	2,872
Balance at September 30, 2012	$ -	$ 12,191	$ 12,191

Carrying amounts

At January 1, 2011	$ 30,738	$ 40,802	$ 71,540
At December 31, 2011	$ 42,510	$ 48,121	$ 90,631
At September 30, 2012	$ 42,510	$ 45,249	$ 87,759

(i) On April 25, 2007, the Company entered into a license agreement with Dalhousie University (“Dalhousie”). The license covers Pentoxifylline and Functional Derivatives/Metabolites and its applications. The fields of use include pulmonary indications and radiation induced fibrosis. The company has paid license fees to date of $42,510 to secure this license which is to be credited towards future royalties. As part of the agreement the Company must make milestone payments of up to $825,000 to Dalhousie based on patient enrolment, clinical studies, and regulatory approval for sale of the product as well as a $25,000 payment into the patent fund maintained by Dalhousie, details of which are further explained in Note 14, Commitments.

(ii) The Company is currently pursuing a patent application for the compositions and methods of treating fibro proliferative disorders. Costs of this application incurred to date are $57,440. The application is still pending as at September 30, 2012, however due to a finite life of the patent which begins from the date of application; the Company is amortizing these costs over the expected life of the patent.

(iii) In 2011, in accordance with the Company's policy on impairment testing, per Note 2(f), the Company concluded that no impairment in its intangible asset values existed and consequently no impairment loss was recognized in the year.

7. IRREVOCABLE SUBSCRIPTION AGREEMENTS ("ISA")

On January 31, 2012, the Company terminated the ISAs, explained in detail in Note 8 of the annual financial statements. Termination of these agreements eliminated the reservation of the 3,000,000 shares reserved for issue under the agreements thereby improving the Issuer's capital structure. The termination also eliminates the 1% per month interest expense on the money that was in trust and the transaction costs associated with issuing shares associated with the draw downs.

During the nine month period ended September 30, 2012, the Company recorded total interest expense of $72,521 (12 months December 2011 - $81,230) on the ISAs, for the one month period prior to its cancellation on January 31, 2012, inclusive of 1% interest per month recorded on the ISA funds held in escrow of $3,001, and accretion of the amount allocated to bonus shares, i.e., the ("deemed discount") of $69,520.

See ISA continuity schedule below:

	September 30, 2012	December 31, 2011
Balance at beginning of period	$ 230,481	$ Nil
Principal amount of ISA received from investors	-	375,000
Amount allocated to Bonus shares ("Deemed Discount")	-	(112,500)
Net amount allocated to ISA	230,481	262,500
Amount returned to investor on demand	-	(25,000)
Draw down of funds	-	(49,999)
Accretion of deemed discount	69,521	42,980
Termination of ISA	(300,000)	-
Net carrying amount	$ -	$ 230,481

8. INCOME TAXES

As at September 30, 2012, the Company had available for deduction against future taxable income, non-capital losses of approximately $2,148,000. The potential income tax benefit of these losses has been offset by a full valuation allowance. These losses, if unutilized, will expire as follows:

2025	$ 23,000
2026	130,000
2027	451,000
2028	245,000
2029	254,000
2030	283,000
2031	402,000
2032	360,000
	$ 2,148,000

The Company has un-depreciated capital cost of $68,299 [2011 - $68,299] available to be deducted against future taxable income.

9. DUE TO SHAREHOLDERS

Shareholders of the Company as at September 30, 2012 are owed $251,817 of which $56,800 is unsecured and payable on demand and loans of $195,017 is due on January 1, 2013 (December 31, 2011 - $196,235, $20,300 on demand and $175,935 due on January 1, 2013). The loan is carried on the face of the financial statements at amortized cost, using a discount rate of 15%. See continuity schedule below:

	September 30, 2012	December 31, 2011
Principal amount of shareholder loan liability	$ 202,470	$ 202,470
Less discount allocated to contributed surplus	(41,853)	(41,853)
Shareholder loan outstanding (net of discount)	160,617	160,617
Accretion of discount	34,400	15,318
Net carrying amount	$ 195,017	$ 175,935

10. SHARE CAPITAL

Authorized

Unlimited	Class A common shares without par value
1,500,000	Class B Series I preferred shares without par value
1,000,000	Class B Series II preferred shares without par value

Issued

22,586,826	Class A common shares without par value
NIL	Class B Series I preferred shares without par value
NIL	Class B Series II preferred shares without par value

Class A Common Shares

On January 31, 2012 the Company terminated the Irrevocable Subscription Agreements (ISAs) entered into by the Issuer on January 31, 2011 and May 16, 2011. Termination of these agreements eliminated 3,000,000 shares that were reserved under the terms of the agreements.

On January 31, 2012, an officer and director of the Company exercised 66,666 warrants at $0.15, for net proceeds of $10,000, and resulting in 66,666 of total shares being issued.

During the nine months ended September 30, 2012 the Company issued 1,531,003 shares through private placement at $0.15 per share resulting in net proceeds of $229,651. The Company paid issue costs related to the placement of $9,325.

Stock options and share based compensation:

On March 5, 2012, 75,000 previously issued options that vested on March 5, 2012, valued at $5,022. The options were valued using Black-Scholes option pricing model at $5,021.

On March 14, 2012, the Board of Directors passed a resolution granting stock options under the terms of the Company's 2012 Stock Option Plan to purchase a total of 100,000 common shares in the capital stock of the Company at an exercise price of $0.15 per share (being a price greater than or equal to the trading price of the Company's common shares on The Canadian National Stock Exchange (CNSX) on the close of business on the day prior to the day of grant), such options being exercisable for a period of two years from the date of grant with immediate vesting. The options were valued using Black-Scholes option pricing model at $6,542.

On July 3, 2012, the Board of Directors passed a resolution granting stock options under the terms of the Company's 2012 Stock Option Plan to purchase a total of 475,000 common shares in the capital stock of the Company at an exercise price of $0.10 per share (being a price greater than or equal to the trading price of the Company's common shares on The Canadian National Stock Exchange (CNSX) on the close of business on the day prior to the day of grant), such options being exercisable for a period of five years from the date of grant with immediate vesting. The options were valued using Black-Scholes option pricing model at $20,200.

At September 30, 2012, the Company had 1,525,000 (December 31, 2011 - 1,650,000) stock options outstanding, of which 1,525,000 (December 31, 2011 - 1,550,000) are exercisable, at a weighted average exercise price of $0.21 (December 31, 2011 - $0.26) per common share and expiring at various dates from October 14, 2012 to July 3, 2017.

Details of the stock option transactions are summarized as follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Price $
Balance, December 31, 2011	1,650,000	0.26
Expired	(600,000)	0.27
Issued	100,000	0.15
Forfeited	(100,000)	0.15
Issued	475,000	0.10
Balance September 30, 2012	1,525,000	0.21

The Company recognized $31,763 in share based compensation expense for the nine months ended September 30, 2012 compared to $5,864 for the twelve months ended December 31, 2011. Share based compensation expenses are comprised of awards of options granted to employees and non employees of the Company. The Company's Board of Directors has discretion as to the number, vesting period, and expiry dates of options granted. Stock options are granted to both employees and non-employees.

The fair value of share based awards is determined using the Black-Scholes option pricing model. The Black-Scholes option pricing model is based on several subjective assumptions including the expected life of the option and expected future stock price volatility. Changes in these assumptions can materially affect the estimated fair value of the Company's stock options.

The estimated fair value of options granted to the Company's employees and directors is calculated at the grant date and amortized using graded vesting over the vesting period of the options. The fair value of non-employee awards are estimated each reporting period until the final measurement date.

The following table summarizes assumptions used in the Black-Scholes option pricing model for employees and directors for the nine month period ending September 30, 2012 and December 31, 2011.

	Employees and Directors	
	2012	**2011**
Dividend yield	0%	0%
Expected volatility	91%	47%
Risk free interest rate	1.19%	1.4% and 1.8%
Expected life in years	2	1 - 4
Fair value per share	$0.07	$0.05

Warrants

As at September 30, 2012, the following share purchase warrants were outstanding:

	Issued	**Weighted Average Exercise Price ($)**
December 31, 2011	3,830,422	0.16
Expired	(28,200)	0.15
Exercised	(66,666)	0.15
Issued	1,736,502	0.22
September 30, 2012	**5,472,058**	**0.18**

On January 31, 2012, 66,666 warrants were exercised at $0.15 each for gross proceeds of $9,999.90.

On March 1, 2012, 28,200 warrants expired at an original exercise price of $0.15.

On June 20, 2012 the Company issued 789,336, two year warrants with an exercise price of $0.22, of which 56,666 warrants were issued to satisfy part of a finder's fee.

On September 21, 2012 the Company issued 741,666, two year warrants with an exercise price of $0.22, of which 5,500 warrants were issued to satisfy part of a finder's fee.

On September 24, 2012 the Company issued 200,000, two year warrants with an exercise price of $0.22 (Note 11).

11. CONVERTIBLE NOTES

On September 24, 2012 the Company issued a convertible note ("the Note") with a face value of $30,000 plus 200,000 two year $0.22 warrants (Bonus Warrants) for $30,000 in cash. The Note has a term of one year and is repayable by the Issuer at any time. The holder of the Note may convert the whole Note or any portion into Units at any time. Each Unit will consist of 1 common share (the Share Option) and 1 warrant (the Warrant option), each Warrant Option is exercisable to acquire an additional common share for a period of 2 years from the date the warrant was issued. Subject to regulatory approval the conversion price per Unit will be at a 25% discount to the ten day weighted average price of the Issuers shares at the date of conversion. Subject to regulatory approval the exercise price per Warrant Option will be at a 25% premium to the ten day weighted average price of the Issuers shares at the date of conversion. Each Bonus Warrant is exercisable to acquire an additional common share for a period of 2 years from the closing date at a price of $0.22. The Note accrues interest at the rate of 1% per month, payable in quarterly installments.

The fair value of the Bonus Warrants and Option Warrants was determined using the Black-Scholes pricing model. The Black-Scholes pricing model is based on several subjective assumptions including the expected life of the option and expected future stock price volatility. Changes in these assumptions can materially affect the estimated fair value of the Company's stock options. The estimated fair value of the Bonus Warrants was calculated on the grant date as $13,238. The estimated fair value of the Option Warrants was calculated on the grant date as $11,600.

The fair value of the Option Shares was determined using the Geske pricing model. The Geske pricing model is based on several subjective assumptions including the expected life of the option and expected future stock price volatility. Changes in these assumptions can materially affect the estimated fair value of the Company's stock options. The estimated fair value of the Option Shares was calculated on the grant date as $18,232.

Upon initial recognition, the Company allocated the $30,000 proceeds between the components using the relative fair value method as follows:

			Estimated Value		Allocation of Proceeds
Liabilities-Current					
	Convertible Loan	Face value of note	30,000	41%	12,317
	Derivative Liability	Share Option	18,232	25%	7,485
	Derivative Liability	Warrant Option	11,600	16%	4,763
Shareholders-Contributed Surplus					
	Warrant Reverve	Bonus Warrants	13,238	18%	5,435
			73,070	100%	30,000

12. CAPITAL DISCLOSURE

The Company considers its capital under management to be comprised of shareholders' equity and any debt that it may issue. As at September 30, 2012, the Company's shareholders' deficiency was $303,768 (December 31, 2011 - $166,309). The Company's outstanding issued debt includes due to shareholders' long-term of $Nil (December 31, 2011 - $175,935), due to shareholders short-term of $251,817 (2011 - $20,300) and Irrevocable Subscriptions of $Nil (December 31, 2011 - $230,481). The Company's objectives when managing capital are to maintain financial strength and to protect its ability to meet its on-going liabilities, to continue as a going concern, to maintain creditworthiness and to maximize returns for shareholders over the long term. Protecting the ability to pay current and future liabilities includes maintaining capital above minimum regulatory levels, current financial strength rating requirements and internally determined capital guidelines and calculated risk management levels. The Company is not subject to any capital restrictions. There has been no change in the Company's objectives in managing its capital.

13. RELATED PARTY TRANSACTIONS AND BALANCES

Details of the transactions between the Company and its related parties are disclosed below:

(a) Related Party Transactions

		Nine months ended September 30, 2012		2011
Accounting fees paid to a shareholder of the Company	$	15,140	$	21,000
Legal fees incurred from a consultant and director of the Company	$	Nil	$	7,934
Share based payments to employees and directors of the Company	$	Nil	$	5,864
Salaries, directors fees and other benefits	$	62,500	$	115,433

(b) Related Party Balances

		Nine months ended September 30, 2012		2011
Amounts in accounts payable and accrued liabilities owing to a consultant and director of the Company for legal fees	$	14,991	$	14,991
Amount in accounts payable and accrued liabilities owing to a shareholder and director of the Company for unpaid salary and expenses	$	81,632	$	23,306
Amounts in accounts payable and accrued liabilities owing to a shareholder of the Company for accounting fees	$	18,500	$	3,360

14. FINANCIAL INSTRUMENTS AND RISK

Financial Instruments

As at September 30, 2012, the Company's financial instruments consist of cash and cash equivalents, accounts payable and accrued liabilities and amounts due to shareholders. The fair values of cash and cash equivalents and accounts payable and accrued liabilities approximate their carrying values due to their short term maturity.

The Company classifies its cash and cash equivalents as loans and receivables and its accounts payable and accrued liabilities and amounts due to shareholders as other financial liabilities.

Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risks consist principally of cash and cash equivalents. To minimize the credit risk the Company places these instruments with a high credit quality financial institution.

Liquidity Risk

The Company ensures its holding of cash and cash equivalents is sufficient to meet its short-term general and administrative expenditures. All of the Company's financial liabilities are subject to normal trade terms. The Company does not have investments in any asset-backed deposits. The Company's liabilities as at September 30, 2012, are due as follows:

Liabilities Outstanding		
On demand	$	-
0 – 30 days		302,580
31 – 90 days		-
<365 days		281,817
Over 365 days		-
Total	**$**	**584,397**

Foreign Exchange Risk

The Company is not exposed to foreign exchange risk on its financial instruments.

Interest Rate Risk

At September 30, 2012 the Company is not exposed to significant interest rate risk as its interest bearing debt is at fixed rates.

15. COMMITMENTS

The Company's commitments are as follows:

(a) On April 25, 2007, the Company entered into a license agreement with Dalhousie University ("Dalhousie"). The license covers Pentoxifylline and Functional Derivatives/Metabolites and its applications. The fields of use include pulmonary indications and radiation induced fibrosis.

The Company is required to make annual maintenance payments of $7,500 which are credited towards future royalties. In addition the Company must make milestone payments of up to $825,000 to Dalhousie based on patient enrolment, clinical studies, and regulatory approval for sale of the product as well as a $25,000 payment into the patent fund maintained by Dalhousie.

As further consideration under the Assignment Agreement, the Company is required to pay to Dalhousie a royalty on revenue earned from marketing, manufacturing, licensing, sale or distribution of the technology, improvements relating to the technology or products.

Under the terms of the license agreement, the Company was required to a) secure $2,000,000 in capital or debt financing by December 31, 2010, b) complete enrolment of a first patient in a Phase II clinical study and c) expend $200,000 per year in research and development related activities. The Company has received a waiver from Dalhousie for the requirement (a) and (b) above, and requirement (c) was amended to include a requirement that a first human subject be dosed by December 31, 2012 and initiation of a Phase II study by December 12, 2015.

(b) The Company's rental lease agreement terminated on July 31, 2012 and was not renewed.

16. SUBSEQUENT EVENTS

There are no subsequent events for the period from the date of the nine month period ended 30 September 2012 to the date the interim financial statements were available to be issued on 28 November 2012.