Consolidated Financial Statements

# Quest PharmaTech Inc.

Three months ended April 30, 2009

(Unaudited)

**Quest PharmaTech Inc.**

National Instrument 51 – 102
Continuous Disclosure Obligations

# Notice

Pursuant to Part 4.3 (3) of National Instrument 51 – 102, these unaudited interim consolidated financial statements of Quest PharmaTech Inc. for the three month period ended April 30, 2009 have not been reviewed by the Company’s auditors.

**Quest PharmaTech Inc.**

# CONSOLIDATED BALANCE SHEETS
## (see note 1 – going concern uncertainty)

As at

| | April 30, 2009 (Unaudited) $ | January 31, 2009 (Audited) $ |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash | **737,355** | 594,826 |
| Accounts receivable | **27,910** | 54,617 |
| Marketable securities | **27,814** | 53,010 |
| Prepaid expenses | **24,749** | 37,860 |
| | **817,828** | 740,313 |
| Property, plant and equipment *[note 4]* | **220,679** | 238,024 |
| | **1,038,507** | 978,337 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **133,741** | 202,912 |
| Convertible debenture *[note 6]* | **500,000** | 497,137 |
| Current portion of deferred revenue *[note 8]* | **258,000** | 258,000 |
| | **891,741** | 958,049 |
| Deferred revenue *[note 8]* | **91,667** | 93,667 |
| | **983,408** | 1,051,716 |
| **Shareholders' equity** | | |
| Share capital *[note 9]* | **23,998,875** | 23,998,875 |
| Equity portion of convertible debenture *[note 6]* | **60,000** | 60,000 |
| Contributed surplus *[note 9]* | **1,605,115** | 1,603,615 |
| Deficit | **(25,608,891)** | (25,735,869) |
| | **55,099** | (73,379) |
| | **1,038,507** | 978,337 |

*See accompanying notes*

On behalf of the Board:

(signed)
Ragupathy ("Madi") Madiyalakan
Director

(signed)
Ian McConnan
Director

**Quest PharmaTech Inc.**

# CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME AND DEFICIT

Three months ended April 30

| | 2009<br>$ | 2008<br>$ |
|---|---|---|
| **REVENUE** | | |
| License fees and market distribution rights *[notes 7 & 12]* | **502,000** | 502,000 |
| **EXPENSES** | | |
| General and administrative | **198,935** | 123,342 |
| Research and development, net *[note 15]* | **119,316** | 302,192 |
| Amortization | **17,345** | 5,326 |
| Bank charges and interest | **14,416** | 13,723 |
| | **350,012** | 444,583 |
| **Income before the undernoted** | **151,988** | 57,417 |
| **Other income (expenses)** | | |
| Interest income | **1,396** | 7,464 |
| Foreign exchange (loss) gain | **(1,210)** | 1,178 |
| Gain on sale of non-core assets *[note 5]* | — | 8,750 |
| Loss on fair value adjustment of marketable securities | **(25,196)** | — |
| | **(25,010)** | 17,392 |
| **Net and comprehensive income for the period** | **126,978** | 74,809 |
| Deficit, beginning of period | **(25,735,869)** | (25,531,822) |
| **Deficit, end of period** | **(25,608,891)** | (25,457,013) |
| **Basic and diluted income per share** | **$0.00** | $0.00 |

*See accompanying notes*

**Quest PharmaTech Inc.**

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended April 30

| | 2009<br>$ | 2008<br>$ |
|---|---|---|
| **CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | | |
| Net income for the period | **126,978** | 74,809 |
| Items that do not involve cash: | | |
| Interest accreted on convertible debenture *[note 6]* | **2,863** | 2,137 |
| Amortization | **17,345** | 5,326 |
| Stock-based compensation | **1,500** | — |
| Gain on sale of non-core assets | — | (8,750) |
| Loss on fair value adjustment of marketable securities | **25,196** | — |
| Deferred revenue recognized in the period | **(502,000)** | (502,000) |
| Changes in non-cash working capital items relating to operating activities *[note 14]* | **(29,353)** | 132,038 |
| | **142,529** | (296,440) |
| **CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES** | | |
| Purchase of property, plant and equipment | — | (8,694) |
| Proceeds from sale of non-core assets | — | 46,250 |
| | — | 37,556 |
| **Cash provided by (used in) operations** | **142,529** | (258,884) |
| **Increase (decrease) in cash and cash equivalents** | **142,529** | (258,884) |
| Cash and cash equivalents, beginning of period | **594,826** | 1,305,802 |
| **Cash and cash equivalents, end of period** | **737,355** | 1,046,918 |

*See accompanying notes*

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 1. DESCRIPTION OF BUSINESS AND GOING CONCERN UNCERTAINTY

### Description of business

Quest PharmaTech Inc., (the "Company") is incorporated under the Business Corporations Act (Alberta). The Company's principal business activity is the research and development of pharmaceutical products. The Company is publicly traded on the TSX Venture Exchange under the symbol "QPT".

### Going concern uncertainty

The Company's consolidated financial statements have been prepared on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced significant operating losses and cash outflows from operations since its inception.

The Company's ability to continue as a going concern is uncertain and is dependent upon its ability to raise additional capital to successfully complete its research and development programs, commercialize its technologies and conduct clinical trials and receive regulatory approvals for its products. It is not possible at this time to predict the outcome of these matters. The Company's consolidated financial statements do not reflect any adjustments to the classifications and carrying values of assets and liabilities that may be required should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements have been prepared by management in accordance with the accounting policies described in the Company's consolidated financial statements for the year ended January 31, 2009. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended January 31, 2009.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 3. INTANGIBLE ASSETS

| | at April 30, 2009 | | at January 31, 2009 | |
|---|---|---|---|---|
| | **Cost** | **Accumulated amortization** | Cost | Accumulated amortization |
| | $ | $ | $ | $ |
| Hypocrellin based technology and licenses | **2,476,822** | **2,476,822** | 2,476,822 | 2,476,822 |
| CDK technology | **225,000** | **225,000** | 225,000 | 225,000 |
| | **2,701,822** | **2,701,822** | 2,701,822 | 2,701,822 |
| | | — | | — |

**CORE TECHNOLOGY:**

**Hypocrellin based technology and licenses ("SonoLight Technology")**
The Company's subsidiary, Sonolight Pharmaceuticals Corp ("Sonolight"), holds the exclusive worldwide license to develop, commercialize and exploit several proprietary inventions involving a class of sonosensitizers and their use in cancer and non-cancer therapies. Sonolight signed a licensing agreement dated March 6, 2001 with the University of Alberta. The license agreement is for a term of 25 years. The agreement requires royalty payments upon successful sales and marketing of products developed using the technology. The Company has amortized this asset on a straight-line basis over a three-year period that commenced August 1, 2001. This intangible asset is fully amortized. The Company has pledged this technology as collateral in connection with the convertible debenture [note 6].

**NON CORE TECHNOLOGIES - CDK technology (proprietary rights)**
The Company owns the worldwide rights to develop, manufacture and sell the CDK technology, a novel immunomodulator with anti-cancer properties. As consideration for its acquisition of the technology, the Company must issue 400,000 common shares as certain milestones outlined in the technology purchase agreement are met. To date, the Company has issued 200,000 shares under the agreement: 100,000 shares issued in fiscal 2004 and 100,000 shares in fiscal 2003. These shares have been recorded at a value that represents the closing price of the common shares on the date the shares were issued. The Company amortized this asset on a straight-line basis over a three-year period, which commenced on August 1, 2002. This intangible asset is fully amortized. During fiscal 2009, the Company determined that it will not proceed with further development with respect to the CDK technology at this time.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 4. PROPERTY, PLANT AND EQUIPMENT

| | **at April 30, 2009** | | at January 31, 2009 | |
|---|---|---|---|---|
| | **Cost** | **Accumulated amortization** | Cost | Accumulated amortization |
| | $ | $ | $ | $ |
| Computer hardware and software | **74,878** | **66,919** | 74,878 | 66,273 |
| Furniture and fixtures | **12,114** | **10,824** | 12,114 | 10,122 |
| Office equipment | **31,494** | **29,411** | 31,494 | 28,278 |
| Manufacturing and R&D equipment | **454,083** | **244,736** | 441,838 | 228,310 |
| Deposit on manufacturing and R&D equipment | — | — | 12,245 | — |
| | **572,569** | **351,890** | 572,569 | 334,545 |
| Net book value | **220,679** | | 238,024 | |

During the period ended April 30, 2009, amortization of property, plant and equipment was $17,345 (for the period ended April 30, 2008 – $5,326).

## 5. ASSETS HELD FOR SALE

As part of the Company's approved initiatives to divest itself of certain non-core technologies, on December 21, 2007, and amended on April 18, 2008, the Company signed a technology transfer agreement with a third party to sell its interest in the Bionex Technology. Under the terms of the agreement, the Company received cash of $50,000, 1,351,111 common shares of Toba Industries Ltd. (afterwards known as Brand Marvel World Wide Consumer Products Corporation), and future royalties of up to $200,000 upon the successful commercialization of Bionex related products. During the three month period ended April 30, 2008, the Company recorded a gain on sale of $8,750 based on the cash consideration of the transaction.

## 6. CONVERTIBLE DEBENTURE

On March 23, 2005, the Company entered into an agreement to issue a $1,000,000 principal amount 8% convertible debenture with a one-year maturity to two arm's-length parties. The debenture is collateralized by the Company's SonoLight Technology, one of its core technologies *[note 3]*. The debenture was repayable in blended monthly installments of $6,667 with the balance, including accrued interest, due on March 22, 2006. The debenture had a conversion feature whereby it could be converted into common shares of the Company at a price of $0.45 per common share and could be redeemed at any time by the Company. The Company obtained extensions to the maturity date, and as at April 30, 2009, the maturity date has been extended to March 22, 2010. In connection with the extensions, the debenture interest rate was revised from 8% to 9% per annum and the debenture conversion price was amended from $0.45 to $0.25 per common share. During 2008, the Company made principal payments of $500,000 against the convertible debenture.

The Company has used the residual value method to allocate the proceeds of $500,000 between the liability component and the equity component based on a Black-Scholes option pricing model assuming an expected life of one year, dividend yield of 0%, average expected volatility of 238.2% and an average risk-free interest rate of 0.50%. The equity component was calculated to be $60,000. The liability component has been accreted to the face value of the debenture over its term and the accretion charge has been accounted for as interest expense. At April 30, 2009, the liability component was calculated to be $500,000.

During the three month period ended April 30, 2009, the Company incurred $14,113 [2008 - $13,387] in interest under this convertible debenture, of which $2,863 [2008 - $2,137] was in the form of accreted interest.

## 7. LICENSE FEES

On December 14, 2007, the Company signed a license agreement to receive $3,000,000 to develop oncology products based on its SonoLight technology. Under the terms of the agreement, the Company received $1,000,000 on execution of the agreement, $1,500,000 during fiscal 2009 and $500,000 during the three month period ended April 30, 2009. The license agreement requires the Company to pay royalties on all future net revenue from the commercialization of the Company's oncology products. Under the terms of the agreement, the Company is required to use commercially reasonable efforts to initiate a Phase 1 clinical trial for photodynamic therapy treatment of prostate cancer. The Company is recognizing the license fee in relation to the costs incurred with these efforts and has recognized $500,000 of the license fee during the three month period ended April 30, 2009.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 8. DEFERRED REVENUE

The Company has recorded deferred revenue in connection with license fees and market distribution rights received but not earned as follows:

| | Apr 30, 2009<br>$ | Jan 31, 2009<br>$ |
|---|---|---|
| **Current portion:** | | |
| License fees | **250,000** | 250,000 |
| Market distribution rights | **8,000** | 8,000 |
| | **258,000** | 258,000 |
| **Long term portion:** | | |
| Market distribution rights | **91,667** | 93,667 |

## 9. SHARE CAPITAL

**Authorized**

Unlimited number of common shares without nominal or par value
Unlimited number of First Preferred shares
Unlimited number of Second Preferred shares
The First and Second Preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

**Issued:**

| | Number of common shares | Amount<br>$ |
|---|---|---|
| **Common shares** | | |
| **At January 31, 2009** | **68,197,580** | 23,998,875 |
| **At April 30, 2009** | **68,197,580** | 23,998,875 |

At April 30, 2009, the Company holds 22,540 common shares for cancellation.

## 9. SHARE CAPITAL (CONTINUED)

The following options to purchase common shares were outstanding as at April 30, 2009.

| Exercise price | Options outstanding | Weighted average remaining life | Options exercisable | Options non-exercisable |
|---|---|---|---|---|
| $0.15 | 300,000 | 4.75 years | 300,000 | — |
| $0.25 | 3,318,000 | 1.80 years | 3,318,000 | — |
| $0.31 | 166,000 | 0.72 years | 166,000 | — |
| $1.00 | 250,000 | 0.80 years | 250,000 | — |
| | 4,034,000 | 1.91 years | 4,034,000 | — |

The following schedule details the warrants and stock options granted, exercised and expired:

| | Shares issuable on exercise of | | | |
|---|---|---|---|---|
| | Warrants | | Stock options | |
| | Number of shares | Weighted average exercise price $ | Number of shares | Weighted average exercise price $ |
| **Balance January 31, 2009** | — | — | 4,184,000 | 0.31 |
| Granted | — | — | 100,000 | 0.25 |
| Exercised | — | — | — | — |
| Expired | — | — | (250,000) | 0.54 |
| **Balance April 30, 2009** | — | — | 4,034,000 | 0.29 |

**Stock options**

For the three month period ended April 30, 2009, the Company granted 100,000 (2008 – nil) stock options under the Company's Stock Option Plan. These options have an exercise price of $0.25 and were granted to a non-employee (note 11). At April 30, 2009, 2,785,758 options are available for issue.

**Escrowed shares**

As at April 30, 2009, the Company's transfer agent held 301,788 (As at April 30, 2008 – 905,366) common shares pursuant to a time based escrow agreement (prior to October 31, 2004, these shares were subject to a TSX Venture Exchange performance based escrow agreement). These shares will be automatically released over time through to October 30, 2009.

## 9. SHARE CAPITAL (CONTINUED)

**Contributed surplus**

| | **2009** $ | **2008** $ |
|---|---|---|
| Contributed surplus, January 31 | **1,603,615** | 1,439,115 |
| Stock-based compensation expense | **1,500** | — |
| Expiration or revaluation of warrants | — | 96,000 |
| Contributed surplus, April 30 | **1,605,115** | 1,535,115 |

## 10. CAPITAL DISCLOSURES

The Company is a biotechnology company and consistent with other companies in the industry, the Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern so that it can continue with its drug development program and strive to maximize shareholder value. Note 1 provides a discussion surrounding the Company's ability to continue as a going concern. Capital is defined by the Company as shareholders' equity (deficiency) (primarily comprised of share capital, contributed surplus and deficit) and current term debt consisting of a convertible debenture. The Company manages its capital structures and makes adjustments based on the needs of the Company's operations and the requirement for funding to continue with the Company's drug development program. The Company does this through new share or debt issuances, selling assets or licensing its technologies to third parties to fund operations. The Company is not subject to externally imposed capital requirements

## 11. STOCK-BASED COMPENSATION

During the three months ended April 30, 2009, the Company granted a total of 100,000 stock options, as per the Company's Stock Option Plan, to a consultant, at an exercise price of $0.25 per share. 50,000 of these stock options vested during the quarter. The estimated fair value of these vested options ($1,500) was recognized as an expense and credited to contributed surplus for the three month period ended April 30, 2009.

For the three month period ended April 30, 2008, the Company did not grant any stock options.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 12. SEGMENT DISCLOSURES

The Company is managed as one operating segment – biopharmaceutical products. The following table presents information on the Company's operating results.

**Revenues by geographic area**

| | Three months ended April 30, | |
|---|---|---|
| | **2009** | **2008** |
| | **$** | **$** |
| Canada | — | — |
| United States | — | — |
| Other | **502,000** | 502,000 |
| | **502,000** | 502,000 |

Revenues from operations represent license fees and market distribution rights earned during the period.

## 13. RELATED PARTY TRANSACTIONS

During the three month periods ended April 30, 2009 and 2008, there were no related party transactions.

## 14. CHANGES IN NON-CASH WORKING CAPITAL ITEMS RELATING TO CONTINUING OPERATING ACTIVITIES

| | **April 30/ 09** | **April 30/ 08** |
|---|---|---|
| | $ | $ |
| Accounts receivable | **26,707** | 112,245 |
| Prepaid expenses and other assets | **13,111** | (71,125) |
| Accounts payable and accrued liabilities | **(69,171)** | 90,918 |
| | **(29,353)** | 132,038 |

## 15. GOVERNMENT ASSISTANCE

In April, 2008, the Company obtained federal government assistance in the form of an NRC-IRAP grant to cover salaries and contractor fees related to the development of the Company's Sonodynamic therapy for the treatment of peritoneal carcinomatosis and pleural effusion. During the three month period ended April 30, 2009, the Company recognized $32,341 of funding as a reduction of research and development expenses.

During the three month period ended April 30, 2008, the Company did not recognize any government assistance.

| | Apr 30/09<br>$ | Apr 30/08<br>$ |
|---|---|---|
| Gross research and development expenses | **151,657** | 302,192 |
| Less government assistance | **(32,341)** | — |
| **Research and development expenses, net** | **119,316** | 302,192 |

## 16. FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities, and the convertible debenture.

### a) Carrying value and fair value

The carrying values of cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities, and the convertible debenture approximate fair value due to the immediate or short term maturity of these instruments. The fair values of other financial instruments reflect the Company's best estimate based upon estimated interest rates at which the Company believes it could enter into with similar instruments at the consolidated balance sheet dates.

### b) Risks

#### i) Foreign currency risk

The Company has certain assets and liabilities that are denominated in foreign currencies and are exposed to risks from changes in foreign exchange rates and the degree of volatility of these rates. Due to the limited number of transactions that are denominated in foreign currencies, the Company does not consider its exposure to foreign currency risk to be significant and currently does not use derivative instruments to reduce its exposure to foreign currency risk.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**For the three months ended April 30, 2009**

## 16. FINANCIAL INSTRUMENTS (CONTINUED)

### ii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Company's exposure to liquidity risk is dependent on its ability to raise funds to meet its commitments and sustain its operations. The Company controls liquidity risk by managing its working capital and by securing additional funds through equity, debt or partnering transactions (see Capital Disclosures note 10).

### iii) Credit risk

Financial instruments that subject the Company to credit risk consist primarily of cash equivalents and accounts receivable. To minimize its exposure to credit risk for cash equivalents, the Company invests in short term guaranteed investment certificates with its financial banker, a major Canadian bank (approximately $660,000 at April 30, 2009). At April 39, 2009, approximately 36% of accounts receivable were due from one organization.

### iv) Market risk

The Company owns investments in common shares of publicly traded companies that subject the Company to market risk. As market prices change, the Company's income and the value of its marketable securities are affected. The Company expects that its exposure to market risk will be short lived as the investments are viewed as temporary in nature.

### v) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents are comprised of highly liquid investments that earn interest at market rates. Interest on the long term debt is at fixed rates. Consequently, the Company is exposed to fair value changes on long-term debt when the market rate on interest changes. Accounts receivable, accounts payable and accrued liabilities bear no interest.

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company invests excess funds in liquid, fully guaranteed deposits with its financial banker.

## 17. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

## 18. SUBSEQUENT EVENTS

On May 11, 2009, the Company signed an agreement granting 25,000 stock options to a consultant of the Company. The stock options are exercisable at a price of $0.15 per common share and carry an expiry date of May 11, 2012.