

Consolidated Financial Statements

**Quest PharmaTech Inc.**

Six months ended July 31, 2008

(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 six month period ended July 31, 2008 have not been reviewed by the Company's auditors.

**Quest PharmaTech Inc.****CONSOLIDATED BALANCE SHEETS**

(see note 1 – going concern uncertainty)

As at

	July 31, 2008 (Unaudited) \$	January 31, 2008 (Audited) \$
<b>ASSETS</b>		
<b>Current</b>		
Cash	1,269,720	1,305,802
Accounts receivable	64,553	168,893
Prepaid expenses and other assets	65,475	32,240
	<b>1,399,748</b>	1,506,935
Property, plant and equipment <i>[note 4]</i>	240,560	66,665
Assets held for sale <i>[note 5]</i>	—	37,500
	<b>1,640,308</b>	1,611,100
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	133,791	161,265
Convertible debenture <i>[note 6]</i>	487,137	500,000
Current portion of deferred revenue <i>[note 8]</i>	758,000	758,000
	<b>1,378,928</b>	1,419,265
Deferred revenue <i>[note 8]</i>	97,667	101,667
	<b>1,476,595</b>	1,520,932
<b>Shareholders' equity</b>		
Share capital <i>[note 9]</i>	23,998,875	23,998,875
Warrants <i>[note 9]</i>	48,000	144,000
Equity portion of convertible debenture <i>[note 6]</i>	60,000	40,000
Contributed surplus <i>[note 9]</i>	1,535,115	1,439,115
Deficit	(25,478,277)	(25,531,822)
	<b>163,713</b>	90,168
	<b>1,640,308</b>	1,611,100

*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 (LOSS) AND  
DEFICIT**

	For the quarter ended July 31		For the six months ended July 31	
	2008 \$	2007 \$	2008 \$	2007 \$
				(restated - note 16)
<b>REVENUE</b>				
License fees and market distribution rights <i>[notes 7 and 11]</i>	<b>502,000</b>	2,000	<b>1,004,000</b>	170,005
<b>EXPENSES</b>				
General and administrative	<b>224,586</b>	143,837	<b>347,928</b>	315,668
Research and development, net <i>[note 14]</i>	<b>273,532</b>	221,061	<b>575,724</b>	333,091
Amortization	<b>12,177</b>	7,273	<b>17,503</b>	14,545
Bank charges and interest	<b>16,505</b>	26,283	<b>30,228</b>	57,258
	<b>526,800</b>	398,454	<b>971,383</b>	720,562
<b>Income (loss) before the undernoted</b>	<b>(24,800)</b>	(396,454)	<b>32,617</b>	(550,557)
<b>Other income (expenses):</b>				
Interest income	<b>4,905</b>	4,590	<b>12,369</b>	6,455
Foreign exchange gain (loss)	<b>2,381</b>	(9,669)	<b>3,559</b>	(4,066)
	<b>7,286</b>	(5,079)	<b>15,928</b>	2,389
<b>Income (loss) from continuing operations</b>	<b>(17,514)</b>	(401,533)	<b>48,545</b>	(548,168)
Income (loss) from discontinued operations <i>[note 5]</i>	<b>(3,750)</b>	—	<b>5,000</b>	9,262
<b>Net and comprehensive income (loss) for the period</b>	<b>(21,264)</b>	(401,533)	<b>53,545</b>	(538,906)
Deficit, beginning of period	<b>(25,457,013)</b>	(24,350,749)	<b>(25,531,822)</b>	(24,213,376)
<b>Deficit, end of period</b>	<b>(25,478,277)</b>	(24,752,282)	<b>(24,478,277)</b>	(24,752,282)
<b>Basic and diluted earnings (loss) per share</b>				
Continuing operations	<b>(\$0.00)</b>	(\$0.01)	<b>\$0.00</b>	(\$0.01)
Discontinued operations	<b>(\$0.00)</b>	\$0.00	<b>\$0.00</b>	\$0.00
	<b>(\$0.00)</b>	(\$0.01)	<b>\$0.00</b>	(\$0.01)

*See accompanying notes*

**Quest PharmaTech Inc.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

	For the quarter ended July 31		For the six months ended July 31	
	2008	2007	2008	2007
	\$	\$	\$	\$
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>				
Net income (loss) for the period	(21,264)	(401,533)	53,545	(538,906)
(Income) loss from discontinued operations	3,750	—	(5,000)	(9,262)
	(17,514)	(401,533)	48,545	(548,168)
Items that do not involve cash:				
Interest accreted on convertible debenture	5,000	3,212	7,137	6,424
Amortization	12,177	7,273	17,503	14,545
Deferred revenue recognized in the period	(502,000)	(2,000)	(1,004,000)	(4,000)
Cash received on deferred licenses [note 7]	1,000,000	—	1,000,000	—
Changes in non-cash working capital items relating to continuing operating activities [note 13]	(88,407)	117,970	43,630	(450,574)
	409,256	(275,078)	112,815	(981,773)
<b>CASH PROVIDED BY FINANCING ACTIVITIES</b>				
Private placement of units/common shares	—	1,160,000	—	2,120,000
Repayment of demand notes	—	(50,000)	—	(50,000)
Deposit on share subscription	—	—	—	(183,000)
Repayment of convertible debenture	—	(200,000)	—	(200,000)
	—	910,000	—	1,687,000
<b>CASH USED IN INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment	(182,704)	—	(191,397)	—
	(182,704)	—	(191,397)	—
<b>Cash provided by (used in) continuing operations</b>	<b>226,552</b>	<b>634,922</b>	<b>(78,582)</b>	<b>705,227</b>
<b>Cash (used in) provided by discontinued operations</b>				
Operating activities	—	—	—	4,262
Investing activities	(3,750)	—	42,500	5,000
	(3,750)	—	42,500	9,262
<b>Increase (decrease) in cash and cash equivalents</b>	<b>222,802</b>	<b>634,922</b>	<b>(36,082)</b>	<b>714,489</b>
Cash and cash equivalents, beginning of period	1,046,918	202,589	1,305,802	123,022
<b>Cash and cash equivalents, end of period</b>	<b>1,269,720</b>	<b>837,511</b>	<b>1,269,720</b>	<b>837,511</b>
Cash consists of:				
<b>Cash</b>	<b>269,720</b>	<b>837,511</b>	<b>269,720</b>	<b>837,511</b>
<b>Cash equivalents</b>	<b>1,000,000</b>	<b>—</b>	<b>1,000,000</b>	<b>—</b>
	<b>1,269,720</b>	<b>837,511</b>	<b>1,269,720</b>	<b>837,511</b>

See accompanying notes

## **Quest PharmaTech Inc.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**For the six months ended July 31, 2008**

## **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, 2008. These unaudited interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements for the year ended January 31, 2008.

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 3. INTANGIBLE ASSETS

	<u>at July 31, 2008</u>		<u>at January 31, 2008</u>	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	\$	\$	\$	\$
Hypocrellin based technology and licenses	<b>2,476,822</b>	<b>2,476,822</b>	2,476,822	2,476,822
Net book value		—		—

#### 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].

#### 4. PROPERTY, PLANT AND EQUIPMENT

	<u>at July 31, 2008</u>		<u>at January 31, 2008</u>	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	\$	\$	\$	\$
Computer hardware and software	<b>80,808</b>	<b>67,511</b>	79,670	65,316
Furniture and fixtures	<b>12,114</b>	<b>10,421</b>	12,114	10,122
Office equipment	<b>31,494</b>	<b>28,759</b>	31,494	28,278
Manufacturing and R&D equipment	<b>496,475</b>	<b>273,640</b>	306,217	259,114
	<b>620,891</b>	<b>380,331</b>	429,495	362,830
Net book value		<b>240,560</b>		66,665

During the three and six month periods ended July 31, 2008, amortization of property, plant and equipment related to continuing operations was \$12,177 and \$17,503, respectively (for the three and six month periods ended July 31, 2007 – \$7,273 and \$14,545, respectively).

## **Quest PharmaTech Inc.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**For the six months ended July 31, 2008**

## **5. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE**

During 2006, the Company announced that it had approved initiatives to divest of certain non-core technologies and operations as a part of a plan to focus on core technologies and refinancing the Company. Accordingly, the results of operations of these non-core technologies and operations have been segregated and presented separately as discontinued operations in the consolidated financial statements.

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 will receive cash of \$50,000, certain share consideration and certain future royalties upon the successful commercialization of Bionex related products. During the six month period ended July 31, 2008, the Company recorded a gain on sale of \$5,000 based on the cash consideration of the transaction.

During the six month period ended July 31, 2007, the Company recorded a disposal gain of \$5,000 in connection with ACP-HIP and also recognized \$4,262 as a recovery of a bad debt in connection with Accu-MAb. These events resulted in income of \$9,262 from discontinued operations for the six month period ended July 31, 2007.

## **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, 2008, the maturity date has been extended to March 22, 2009. 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 99.5% and an average risk-free interest rate of 2.18%. The equity component was calculated to be \$60,000. The liability component is being accreted to the face value of the debenture over its term and the accretion charge is being accounted for as interest expense. At July 31, 2008, the liability component was calculated to be \$487,137.

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 6. CONVERTIBLE DEBENTURE (CONTINUED)

During the three and six month periods ended July 31, 2008, the Company incurred \$16,250 and \$29,637, respectively (2007 - \$23,912 and \$49,624, respectively) in interest under this convertible debenture, of which \$5,000 and \$7,137, respectively (2007 - \$3,212 and \$6,424, respectively) 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, \$1,000,000 in June, 2008, with an additional \$1,000,000 to be received in December, 2008. 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 and \$1,000,000, respectively, of the license fee during the three and six month periods ended July 31, 2008.

#### 8. DEFERRED REVENUE

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

	Jul 31, 2008	Jan 31, 2008
	\$	\$
<hr/>		
<b>Current portion:</b>		
License fees	750,000	750,000
Market distribution rights	8,000	8,000
	<hr/> 758,000	<hr/> 758,000
<hr/>		
<b>Long term portion:</b>		
Market distribution rights	97,667	101,776
	<hr/>	<hr/>

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 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 \$
<b>Common shares</b>		
At January 31, 2008	68,197,580	23,998,875
At July 31, 2008	68,197,580	23,998,875

The following options to purchase common shares were outstanding as at July 31, 2008.

Exercise price	Options outstanding	Weighted average remaining life	Options exercisable	Options non-exercisable
\$0.25	3,218,000	2.54 years	3,168,000	50,000
\$0.31	166,000	1.47 years	166,000	—
\$0.52	200,000	0.67 years	200,000	—
\$0.64	50,000	0.60 years	50,000	—
\$0.67	50,000	0.36 years	50,000	—
\$1.00	250,000	1.55 years	250,000	—
	3,934,000	2.29 years	3,884,000	50,000

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 9. SHARE CAPITAL (CONTINUED)

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 \$
<b>Balance January 31, 2008</b>	<b>4,800,000</b>	0.20	3,902,000	0.32
Granted	—	—	—	—
Exercised	—	—	—	—
Expired	—	—	(18,000)	0.27
<b>Balance April 30, 2008</b>	<b>4,800,000</b>	0.20	3,884,000	0.32
Granted	—	—	50,000	0.25
Exercised	—	—	—	—
Expired	—	—	—	—
<b>Balance July 31, 2008</b>	<b>4,800,000</b>	0.20	3,934,000	0.32

#### Warrants

During the three month period ended April 30, 2007, the Company issued 4,800,000 share purchase warrants exercisable at \$0.20 per common share. These warrants expire on September 19, 2008 and have an estimated fair value of \$48,000 using the Black-Scholes pricing model assuming an expected life to September 19, 2008, a dividend yield of 0%, average expected volatility of 79.7% and an average risk free interest rate of 2.18%.

#### Stock options

For the three month period ended July 31, 2008, the Company granted 50,000 stock options to an employee under the Company's Stock Option Plan. These options vest in November, 2008.

#### Escrowed shares

As at July 31, 2008, the Company's transfer agent held 905,366 (As at July 31, 2007 – 1,508,944) 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.

**Quest PharmaTech Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**For the six months ended July 31, 2008**

**9. SHARE CAPITAL (CONTINUED)**

**Contributed surplus**

	<b>2008</b>	<b>2007</b>
	\$	\$
<b>Contributed surplus, January 31</b>	<b>1,439,115</b>	1,240,115
Stock-based compensation expense	—	—
Change in equity component of convertible debenture	—	—
Expiration or revaluation of warrants	<b>96,000</b>	—
<b>Contributed surplus, July 31</b>	<b>1,535,115</b>	1,240,115

**Capital Disclosures – Managing Capital**

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. 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 by issuing new shares, selling assets or licensing its technologies to third parties to fund operations and reduce Company debt.

**10. STOCK-BASED COMPENSATION**

For the three and six month periods ended July 31, 2008 and 2007, no stock based compensation was recognized by the Company.

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 11. 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 July 31,		Six months ended July 31,	
	2008	2007	<u>2008</u>	<u>2007</u>
			\$	\$
Canada	—	—	—	—
United States	—	—	—	166,005
Other	<b>502,000</b>	2,000	<b>1,004,000</b>	4,000
	<b>502,000</b>	2,000	<b>1,004,000</b>	170,005

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

#### 12. RELATED PARTY TRANSACTIONS

During the three and six month periods ended July 31, 2008, there were no related party transactions.

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

	<u>3 Months Ended</u>		<u>6 Months Ended</u>	
	July 31 / 08	July 31 / 07	July 31/ 08	July 31/ 07
	\$	\$	\$	\$
Accounts receivable	(7,905)	181,661	<b>104,340</b>	3,716
Prepaid expenses and other assets	<b>37,890</b>	2,052	<b>(33,235)</b>	5,718
Accounts payable and accrued liabilities	<b>(118,392)</b>	(65,743)	<b>(27,474)</b>	(460,008)
	<b>(88,407)</b>	117,970	<b>43,631</b>	(450,574)

## Quest PharmaTech Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended July 31, 2008

#### 14. GOVERNMENT ASSISTANCE

In April, 2008, the Company obtained government assistance in the form of an IRAP grant to cover salaries and contractor fees related to the development of the Company's sonodynamic therapy for the treatment of peritoneal cancer. During the three and six month periods ended July 31, 2008, the Company recognized \$25,692 of funding as a reduction of research and development expenses.

	<u>3 Months Ended</u>		<u>6 Months Ended</u>	
	July 31 / 08	July 31 / 07	July 31/ 08	July 31/ 07
	\$	\$	\$	\$
Gross R & D expenses	299,224	221,061	601,416	358,431
Less government assistance	(25,692)	—	(25,692)	(25,340)
<b>R &amp; D expenses, net</b>	<b>273,532</b>	<b>221,061</b>	<b>575,724</b>	<b>333,091</b>

#### 15. FINANCIAL INSTRUMENTS

##### a) Fair value

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and the convertible debenture. The fair value of financial instruments represents the amounts that would have been received from or paid to counterparties, calculated at the reporting date, to settle these instruments. Transaction costs on financial instruments are expensed when incurred. Purchases and sales of financial assets are accounted for at trade dates. Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and the convertible debenture are assets and liabilities that have short periods to maturity and the carrying values contained in the consolidated balance sheets approximate their estimated fair value. 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) 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. The Company does not currently use derivative instruments to reduce its exposure to foreign currency risk.

##### c) Credit risk

Financial instruments that subject the Company to credit risk consist primarily of accounts receivable. At July 31, 2008 approximately 46% of accounts receivable were due from one organization.

**Quest PharmaTech Inc.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**For the six months ended July 31, 2008**

### **16. PRIOR PERIOD RESTATEMENT**

The 2007 opening deficit figure on the consolidated statements of operations, comprehensive income (loss) and deficit has been restated to reflect an overstatement of the balance as at January 31, 2007. The impact of the restatement was to reduce the deficit at the beginning of the period by \$47,627.

### **17. COMPARATIVE FIGURES**

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