



**Management Discussion and Analysis of Financial Condition  
and Results of Operations**

**Fiscal 2011 – Third Quarter  
for the three and nine month periods ended January 31, 2011**

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## Overview

The following management discussion and analysis (MD&A) is a review of the financial condition and results of operations of Critical Outcome Technologies Inc. (“COTI” or the “Company”) for the quarter ended January 31, 2011, and has been prepared with all information available up to and including March 30, 2011. This MD&A is intended to assist in understanding the dynamics of the Company’s business and the key factors underlying its financial results. This analysis should be read in conjunction with the audited financial statements and notes thereto for the year ended April 30, 2010. *The financial information contained herein has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) unless specifically identified otherwise; however, the information as presented herein represents unaudited disclosure.* All dollar amounts are expressed in Canadian dollars. Quarterly interim reports, the Company’s Annual Information Form (AIF) and additional supplementary information concerning the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## Forward-looking Statements

This MD&A contains certain statements based upon “forward-looking information” concerning the Company’s plans for its operations and other matters within the meaning of applicable Canadian provincial securities laws (“forward-looking statements” or “FLS”). FLS are necessarily based on estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies. All statements that address activities, events or developments that the Company believes, expects or anticipates will or may occur in the future are FLS. FLS are subject to a variety of risks and uncertainties that may cause the actual events or results of the Company to differ materially from those discussed in the FLS, and even if such actual events or results are realized or substantially realized, there can be no assurance that they will have the expected consequences to, or effects on, the Company.

Any statements that express or involve discussion with respect to predictions, expectations, beliefs, plans, projections, objectives, or assumptions of future events or performance (often, but not always, using words or phrases such as “expects” or “does not expect”, “is expected”, “anticipates” or “does not anticipate”, “plans”, “estimates” or “intends”, or stating that certain actions, events or results “may”, “could”, “would”, “might” or “will” be taken, occur or be achieved) are not statements of historical fact and may be FLS. The major FLS included in this MD&A are set out in Table 1.

*Table 1: Forward-looking Statements*

MD&A Section Heading	Nature of Forward-Looking Information Disclosed
Our Business	<ul style="list-style-type: none"> <li>• Plans to license or co-develop molecules</li> <li>• Plans for future research and development activities which could lead to a Phase 1 clinical trial</li> <li>• Plans for future application of the CHEMSAS® technology</li> <li>• The Company’s commercialization strategy for collaborations</li> </ul>
Liquidity and Capital	<ul style="list-style-type: none"> <li>• Expectations of future long term contractual commitments</li> </ul>

<b>MD&amp;A Section Heading</b>	<b>Nature of Forward-Looking Information Disclosed</b>
Resources	<ul style="list-style-type: none"> <li>• Sufficiency of cash resources to carry out operations for the remainder of the fiscal year</li> </ul>
Operational Progress and Outlook	<ul style="list-style-type: none"> <li>• The potential for future licensing and collaboration opportunities with near term emphasis on COTI-2</li> <li>• The requirement to put certain projects on hold until funding is obtained</li> <li>• The expectation for AML and HIV programs to move ahead once necessary funding is obtained</li> </ul>
Industry and Economic Factors Affecting Performance	<ul style="list-style-type: none"> <li>• The expected continuation of losses until a revenue transaction is secured</li> <li>• Plans to negotiate future licensing agreements</li> <li>• Plans to raise additional financing through different venues and mechanisms available to the Company</li> </ul>
Changes in Accounting Policies Including Initial Adoption	<ul style="list-style-type: none"> <li>• The progression of the IFRS transition plan and project completion estimates</li> <li>• The unlikely adoption of new accounting standards issued by the Accounting Standards Board as the Company is not anticipating any future business combinations</li> </ul>

The basis for the FLS is management's current expectations, estimates, projections and assumptions. By their nature, they are not guarantees of future performance as they involve significant risks and uncertainties.

The main assumptions used by management to develop the forward-looking information include the following:

- An ability to obtain sufficient financing to support working capital requirements and fund further research and development initiatives over the long term
- An ability to further develop the CHEMSAS® technology for internal and collaborative purposes
- A continuation of favourable preclinical test results from the COTI-2 program and an ability to meet the requirements for regulatory approval
- Obtaining patent protection for the Company's compounds and other intellectual property
- An ability to attract and retain skilled and experienced personnel and to maintain relationships with third party clinical research organizations

Management of COTI considers the assumptions on which the FLS are based to be reasonable. However, management cautions the reader that because of the many risk factors as set out in the Company's AIF, including those specifically described below which are of particular importance to the assumptions above, actual results could differ materially from those expressed or implied in the FLS. These assumptions may prove to be wrong, and as such, undue reliance should not be placed on FLS.

The main risk factors that will influence the Company's ability to realize on its FLS include:

- The ability to raise sufficient financing for continuing operations and development
- The ability to establish customer relationships leading to licensing agreements for the Company's compounds
- The ability to generate customer demand for outputs from the CHEMSAS® technology
- Continued favorable preclinical test results
- The ability to meet regulatory requirements to commercialize compounds
- The ability to obtain patent protection for the Company's compounds
- The ability to raise sufficient financing to maintain its workforce

The forward-looking information is provided as of the date of this MD&A and the Company will not undertake any obligation to publicly update or revise any forward-looking information, whether because of new information, future events, or otherwise, except as required by securities laws.

## **The Company**

COTI is a London, Ontario based company resulting from the amalgamation on October 13, 2006 of Aviator Petroleum Corp. (Aviator), a public company listed on the TSX Venture Exchange (TSXV), and Critical Outcome Technologies Inc., a private company under the provisions of the *Business Corporations Act* (Ontario). The amalgamation constituted the qualifying transaction for Aviator pursuant to the policies of the TSXV. The amalgamated company adopted the name Critical Outcome Technologies Inc. and its common shares were listed and posted for trading on the TSXV under the symbol COT on October 30, 2006.

On November 27, 2007, the Company completed an acquisition of all the outstanding common shares in the capital of 3015402 Ontario Inc. (formerly 6441513 Canada Inc.) operating as DDP Therapeutics (DDP), in which the Company had, up to the date of the acquisition, a 10% ownership interest. DDP was formed in early 2005 to develop a library of small cell lung cancer molecules discovered by the Company using its drug discovery technology.

On May 1, 2008, the Company amalgamated with this wholly owned subsidiary under the laws of the Province of Ontario.

## **Our Business**

COTI is a biotechnology company focused on applying its proprietary computer-based technology, CHEMSAS®, to identify, profile, optimize and select potential new drug candidates at the discovery stage of preclinical drug development and thereby reduce the timeline and cost of getting new drug therapies to market.

The Company is developing focused portfolios of novel, proprietary and optimized small molecules as potential drug candidates for specific therapeutic targets in diseases that have high morbidity and mortality rates and currently have either poor or no effective therapies. COTI has concentrated on developing drug candidates for the treatment of various cancers, human immunodeficiency virus (HIV), multiple sclerosis and Alzheimer's disease. Cancer types

specifically targeted include small cell lung, adult myelogenous leukemia (AML), ovarian, endometrial, pancreatic, brain, breast and colon.

Although the Company intends to license its targeted molecules following synthesis and completion of confirmatory preclinical tests, the Company may also choose to take particularly promising individual molecules forward through various preclinical tests to Phase 1 clinical trials. In this regard, COTI is currently focused on preparing for an investigational new drug (IND) clinical trial submission based on the positive preclinical results achieved for COTI-2, its lead cancer molecule, against a number of cancer indications. Current testing initiatives and planning target an IND filing in calendar 2012. These compounds would then be available for licensing or co-development as Phase 1 ready compounds.

The Company also seeks to leverage CHEMSAS<sup>®</sup> to identify targeted lead candidates of commercial interest to pharmaceutical and biotechnology organizations on a collaborative basis. The Company's preferred commercialization strategy for collaborations involves an upfront fee and a shared risk/reward revenue model delivered through a series of milestone payments based on preclinical and clinical test results. This service offering provides prospective customers with an efficient and effective approach for generating discovery stage compounds while enhancing value to COTI and its shareholders from the underlying CHEMSAS<sup>®</sup> technology. This collaboration approach has resulted in two engagements with multinational pharmaceutical companies in the past few years with one for an HIV program remaining active.

## **Financial Review of Operations**

### *Revenues*

There were no operating revenues in the quarter ended January 31, 2011 (Q3-F'11) or for the nine months ended January 31, 2011 (YTD-F'11). Similarly, there were no operating revenues in the quarter ended January 31, 2010 (Q3-F'10) or for the nine months ended January 31, 2010 (YTD-F'10). The Company continued to pursue a licensing agreement for its lead preclinical oncology compound, COTI-2, during Q3-F'11 with several interested parties but without reaching agreement on contractual terms.

The Company earned \$2,185 in interest income on its cash and cash equivalents in Q3-F'11, compared to \$2,746 earned on cash, cash equivalents and short-term investments in Q3-F'10. This decrease of \$561 primarily reflects the lower average balances held by the Company (Q3-F'11 - \$819,637; Q3-F'10 - \$1,898,121).

### *Operating Expenses*

Operating expenses decreased from \$775,963 in Q3-F'10 to \$644,962 for Q3-F'11, a decrease of \$131,001. Operating expenses decreased from \$2,882,254 for YTD-F'10 to \$1,707,289 for YTD-F'11, a decrease of \$1,174,965. Three major expense items, as set out in Table 2, accounted for \$122,483 of the comparable quarterly change or 93.5% of the total decrease. Table 3 indicates these same expense items accounted for \$1,138,862 of the YTD-F'11 change or 96.9% of the total decrease compared to YTD-F'10.

**Table 2: Major Expense Items – Comparative Quarters Ended January 31**

Expense	Q3-F'11	Q3-F'10	Change
Research and product development	\$ 125,454	\$ 233,476	\$ (108,022)
Stock-based compensation	79,878	52,895	26,983
General and administration	245,349	286,793	(41,444)
	450,681	573,164	(122,483)
Other expenses	194,281	202,799	(8,518)
<b>Total</b>	<b>\$ 644,962</b>	<b>\$ 775,963</b>	<b>\$ (131,001)</b>

**Table 3: Major Expense Items – Comparative YTD Ended January 31**

Expense	YTD-F'11	YTD-F'10	Change
Research and product development	\$ 456,535	\$ 951,372	\$ (494,837)
Stock-based compensation	(24,912)	396,489	(421,401)
General and administration	711,595	934,219	(222,624)
	1,143,218	2,282,080	(1,138,862)
Other expenses	564,071	600,174	(36,103)
<b>Total</b>	<b>\$ 1,707,289</b>	<b>\$ 2,882,254</b>	<b>\$ (1,174,965)</b>

Research and product development (R&D) activity was scaled down between Q1-F'11 and Q3-F'11 as a strategic decision to reduce the Company's cash usage and thereby lengthen the Company's operational timeline while seeking additional financing. Tables 4 and 5 provide a breakdown of R&D costs for the three and nine month periods ended Q3-F'11 and Q3-F'10 by major expense type.

**Table 4: R&D Expenses – Comparative Quarters Ended January 31**

	Q3-F'11	Q3-F'10	Change
R&D testing, consulting and materials	\$ 20,592	\$ 68,555	\$ (47,963)
Synthesis	9,534	58,617	(49,083)
	30,126	127,172	(97,046)
Labour including benefits	87,062	104,281	(17,219)
Other	8,266	2,023	6,243
<b>Total</b>	<b>\$ 125,454</b>	<b>\$ 233,476</b>	<b>\$ (108,022)</b>

*Table 5: R&D Expenses – Comparative YTD Ended January 31*

	YTD-F'11	YTD-F'10	Change
R&D testing, consulting and materials	\$ 91,280	\$ 304,054	\$ (212,774)
Synthesis	68,679	316,637	(247,958)
	159,959	620,691	(460,732)
Labour including benefits	279,228	319,918	(40,690)
Other	17,348	10,763	6,585
<b>Total</b>	<b>\$ 456,535</b>	<b>\$ 951,372</b>	<b>\$ (494,837)</b>

For Q3-F'11, R&D testing, consulting and materials decreased \$47,963 due to reductions in R&D activity. Consistent with Q3-F'10, the majority of this cost focused on the Company's lead oncology compound, COTI-2, with spending on COTI-2 of \$20,592 or 100.00% in Q3-F'11 and \$58,459 or 85.27% in Q3-F'10. For YTD-F'11, R&D testing, consulting and materials decreased \$212,774. Again, the majority of this cost focused on COTI-2 with spending of \$89,487 or 98.04% in YTD-F'11 and \$255,699 or 84.10% in YTD-F'10.

For Q3-F'11, synthesis costs decreased \$49,083 compared to Q3-F'10. In Q3-F'10, \$6,689 or 11.41% of synthesis expenditures focused on COTI-2, compared to \$2,514 or 26.37% in Q3-F'11. For YTD-F'11, synthesis costs decreased \$247,958 compared to YTD-F'10. In YTD-F'10, \$56,994 or 18.00% of synthesis expenditures focused on COTI-2, compared to \$61,857 or 90.07% in YTD-F'11. Unlike Q3-F'11 and YTD-F'11, the majority of synthesis cost expenditures in Q3-F'10 and YTD-F'10 focused on the Company's collaboration projects.

R&D labour costs decreased in Q3-F'11 and YTD-F'11 compared to Q3-F'10 and YTD-F'10. This decrease relates to the allocation of the Chief Scientific Officer's (CSO) salary costs based on time commitments in his various roles following assumption of the additional role of Chief Executive Officer (CEO) in June 2010. Salary costs of \$19,539 were allocated to general and administration expense (G&A) in Q3-F'11 and \$40,913 on a year to date basis, to recognize the non-R&D related activity. There were no changes in R&D staff levels during the comparable periods.

Tables 6 and 7 provide a breakdown of the components of stock-based compensation expense for the three and nine month periods ended January 31, 2011 and 2010 respectively.

*Table 6: Stock-Based Compensation Expense – Comparative Quarters Ended January 31*

	Q3-F'11	Q3-F'10	Change
Compensation recognized on new option grants	\$ 74,827	\$ 8,564	\$ 66,263
Compensation recognized on existing options	5,051	44,331	(39,280)
	\$ 79,878	\$ 52,895	\$ 26,983

*Table 7: Stock-Based Compensation Expense – Comparative YTD Ended January 31*

	YTD-F'11	YTD-F'10	Change
Compensation recognized on new option grants	\$ 77,308	\$ 284,954	\$ (207,646)
Compensation recognized on existing options	56,773	111,535	(54,762)
Compensation adjusted on re-measured options	(48,484)	-	(48,484)
Compensation adjusted on cancelled options	(110,509)	-	(110,509)
	\$ (24,912)	\$ 396,489	\$ (421,401)

The stock-based compensation expense for Q3-F'11 primarily resulted from the recognition of stock-based compensation expense for the October 28, 2010 option grant to members of the Board of Directors vesting over time.

The stock-based compensation recovery for YTD-F'11 primarily resulted from the recovery of \$110,509 in previously recognized stock-based compensation expense on 300,000 unvested options cancelled upon the resignation of its previous CEO in Q1-F'11, and on the re-measurement of stock options issued to consultants in prior periods recognized in Q2-F'11. Options granted to the Board of Directors in the prior year were assigned a larger fair value using the Black-Scholes option pricing model and they vested immediately upon grant, hence the stock-based compensation expense was fully recognized in Q2-F'10.

Tables 8 and 9 provide a breakdown of G&A by major expense type for the comparable three and nine month fiscal periods ended January 31 respectively. The decrease in G&A of \$41,444 for Q3-F'11 compared to Q3-F'10, and \$222,624 for YTD-F'11 compared to YTD-F'10, related primarily to decreased salaries and benefits, professional fees, travel expenses and director compensation offset by an increase in patent cost write-down's.

*Table 8: G&A – Comparative Quarters Ended January 31*

	Q3-F'11	Q3-F'10	Change
Salaries and benefits	\$ 93,921	\$ 140,459	\$ (46,538)
Corporate governance	9,639	29,732	(20,093)
Promotion and travel	6,231	8,335	(2,104)
Patent loss on abandonment	34,406	-	34,406
Professional fees - other	70,373	72,157	(1,784)
	214,570	250,683	(36,113)
Other	30,779	36,110	(5,331)
Total	\$ 245,349	\$ 286,793	\$ (41,444)

**Table 9: G&A – Comparative YTD Ended January 31**

	YTD-F'11	YTD-F'10	Change
Salaries and benefits	\$ 292,376	\$ 415,928	\$ (123,552)
Corporate governance	71,022	127,014	(55,992)
Promotion and travel	15,832	63,824	(47,992)
Professional fees - financing efforts	-	31,950	(31,950)
Patent loss on abandonment	37,423	11,931	25,492
Professional fees - other	205,045	184,175	20,870
	621,698	834,822	(213,124)
Other	89,897	99,397	(9,500)
<b>Total</b>	<b>\$ 711,595</b>	<b>\$ 934,219</b>	<b>\$ (222,624)</b>

The salaries and benefits figures for Q3-F'10 and YTD-F'10 reflect staff levels that included a dedicated CEO. The comparable Q3-F'11 and YTD-F'11 salaries and benefits were lower following the former CEO's resignation effective June 30, 2010. This decrease in CEO salary was partially offset by a year to date salary allocation of \$40,913 recognizing the G&A activity of the former President and CSO who was also appointed CEO effective July 1, 2010.

The Company incurred professional fees and travel costs in its efforts to facilitate a non-brokered private placement in Q1-F'10 and Q2-F'10 as reflected in the YTD-F'10 expense for Professional fees - financing efforts. A decision was made to withdraw the placement in August 2009 due to unfavourable market conditions and consequently \$31,950 relating to the financing effort was expensed. No similar activities occurred in fiscal 2011.

Corporate governance costs decreased in Q3-F'11 and YTD-F'11 primarily due to; fewer meetings of the Board of Directors and its committees, two fewer members on the Board, and a decrease in the cash meeting fees paid effective May 1, 2010, which coincided with the beginning of fiscal 2011.

Other professional fees increased primarily due to consulting contracts initiated in the last quarter of fiscal 2010 that were still in place at Q3-F'11. These consulting arrangements contributed \$34,500 to professional fee costs in Q3-F'11, or \$108,201 on a year to date basis, with comparable expense of \$11,700 and \$13,325 in Q3-F'10 and YTD-F'10 respectively. This increase in consulting costs was partially offset by a decrease in human resource consulting costs of \$2,160 from Q3-F'10 and \$33,390 from YTD-F'10, intellectual property consulting costs of \$5,392 from Q3-F'10 and \$10,992 from YTD-F'10, and legal consulting costs of \$7,268 from Q3-F'10 and \$9,425 from YTD-F'10.

During the quarter, the Company abandoned patent efforts on two series of HIV compounds and on one series of MS compounds which resulted in a write-off of these expenses for \$34,406. This was in addition to an expense of \$3,017 on an abandoned jurisdictional patent filing for COTI-2 in Q2-F'11, resulting in a total of \$37,423 in patent write-offs for YTD-F'11. No patent impairment was recognized in Q3-F'10, however an impairment of \$11,931 was recognized in YTD-F'10.

**Financial Results Summary by Quarter**

Table 10 summarizes the financial results of COTI by quarter for the past two fiscal years and the three most recent quarters.

*Table 10: Summary of Quarterly Financial Results*

FYE 2011	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	9 Months YTD
Revenue	\$ -	\$ -	\$ -	\$ -	\$ -
Loss before other income	(552,204)	(510,123)	(644,962)	-	(1,707,289)
Other income	2,932	124,952	2,185	-	130,069
Loss	(549,272)	(385,171)	(642,777)	-	(1,577,220)
Loss per common share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ -	\$ (0.03)

FYE 2010	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	Full Year
Revenue	\$ -	\$ -	\$ -	\$ -	\$ -
Loss before other income	(986,899)	(1,119,391)	(775,963)	(833,037)	(3,715,290)
Other income	7,810	142,713	2,746	1,711	154,980
Loss	(979,089)	(976,678)	(773,217)	(831,326)	(3,560,310)
Loss per common share	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.08)

FYE 2009	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	Full Year
Revenue	\$ -	\$ 5,982	\$ 13,204	\$ 29,972	\$ 49,158
Loss before other income	(898,304)	(759,908)	(1,036,831)	(1,400,319)	(4,095,362)
Other income	39,533	34,906	38,530	63,374	176,343
Loss	(858,771)	(725,002)	(998,301)	(1,336,945)	(3,919,019)
Loss per common share	\$ (0.02)	\$ (0.01)	\$ (0.02)	\$ (0.03)	\$ (0.08)

The decreasing quarterly loss trend in fiscal 2011 compared to fiscal 2010 reflects the Company's decision to reduce R&D and discretionary spending in moderating the Company's use of cash. The majority of the variation by quarter across the years, and year over year, is explained by three expense categories as set out in Table 11.

*Table 11: Selected Quarterly Expense Categories*

FYE 2011	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	9 Months YTD
General and administration	\$ 239,404	\$ 226,842	\$ 245,349	\$ -	\$ 711,595
Research and product development	196,312	134,769	125,454	-	456,535
Stock-based compensation	(69,317)	(35,473)	79,878	-	(24,912)
Total of expense categories	\$ 366,399	\$ 326,138	\$ 450,681	\$ -	1,143,218
Total expense for the quarter	\$ 552,204	\$ 510,123	\$ 644,962	\$ -	1,707,289
Expense categories as a % of total expense	66.4%	63.9%	69.9%	0.0%	67.0%

FYE 2010	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	Full Year
General and administration	\$ 329,615	\$ 317,812	\$ 286,793	\$ 312,262	\$ 1,246,482
Research and product development	425,860	292,037	233,476	165,637	1,117,010
Stock-based compensation	33,602	309,992	52,895	174,243	570,732
Total of expense categories	\$ 789,077	\$ 919,841	\$ 573,164	\$ 652,142	\$ 2,934,224
Total expense for the quarter	\$ 986,899	\$ 1,119,391	\$ 775,963	\$ 833,037	\$ 3,715,290
Expense categories as a % of total expense	80.0%	82.2%	73.9%	78.3%	79.0%

FYE 2009	Q1 31-Jul	Q2 31-Oct	Q3 31-Jan	Q4 30-Apr	Full Year
General and administration	\$ 258,814	\$ 194,314	\$ 283,366	\$ 296,097	\$ 1,032,591
Research and product development	201,895	348,786	485,113	422,758	1,458,552
Stock-based compensation	232,621	24,056	86,922	498,603	842,202
Total of expense categories	\$ 693,330	\$ 567,156	\$ 855,401	\$ 1,217,458	\$ 3,333,345
Total expense for the quarter	\$ 898,304	\$ 765,890	\$ 1,050,035	\$ 1,430,291	\$ 4,144,520
Expense categories as a % of total expense	77.2%	74.1%	81.5%	85.1%	80.4%

The variability in the first two quarters of FYE 2011 is largely due to the impact of the recovery of \$158,993 in previously recognized stock-based compensation costs, of which \$110,509 was recognized in Q1-F'11 on the cancellation of options upon the resignation of the former CEO and \$48,484 was recognized in Q2-F'11 on the re-measurement of consultant options. The remaining variability from prior years can be explained by the large decreases in quarterly R&D spending as the balance of the remaining expense categories remained relatively consistent.

### Liquidity and Capital Resources

At the end of Q3-F'11, the Company had cash and cash equivalents of \$609,552 compared to \$1,945,376 of cash and cash equivalents at FYE 2010 reflecting a decrease of \$1,335,824. The decreased cash position at Q3-F'11 from FYE 2010 was due primarily to cash utilized to fund operations in the period as operating activities used \$1,324,044. The average monthly cash usage rate was \$148,425 on a year to date basis, compared to \$230,700 during YTD-F'10. The drop in average monthly cash usage reflects management's cash conservation efforts in lengthening the operational runway while management pursued additional funding from a license agreement and new financing.

The investing activities of \$15,624 in Q3-F'11 relate solely to expenditures on intangible assets, primarily on patents of \$9,891.

The Company's working capital at Q3-F'11 was \$496,888 compared to \$1,705,078 at FYE 2010. Current assets decreased to \$693,265 at Q3-F'11 from \$2,050,087 at FYE 2010 for a decrease of \$1,356,822, primarily due to the decrease in cash and cash equivalents. Current liabilities decreased \$148,632 to \$196,377 at Q3-F'11 from \$345,009 at FYE 2010 because of reduced trade payables related to R&D testing expenditures and reduced professional fee, director fee and salary accruals.

Subsequent to quarter end, on March 25, 2011, the Company completed the first tranche of a private placement and issued 8,152,500 units for gross proceeds of \$1,304,400. Each unit consisted of one common share and one common share purchase warrant with each whole warrant exercisable into one additional common share at a price of \$0.30 until September 24,

2012. Cash costs of the private placement amounted to approximately \$76,680. A total of 385,500 agent warrants exercisable into one additional common share at a price of \$0.30 until September 24, 2012 were issued. The Company expects to complete the second tranche of the private placement in April 2011. This funding strengthens the Company’s cash position and improves its liquidity. The funds raised in this placement will be used to conduct additional testing of COTI-2 to enhance its attractiveness to potential licensees, to conduct development of the Company’s acute myelogenous leukemia (AML) program and for general working capital purposes.

The Company’s exposure to fluctuations in the recoverability of its financial assets is limited as cash not required for current purposes is held in interest bearing cash accounts. Miscellaneous receivables are of high credit quality. The short periods to maturity of these instruments and their capacity for prompt liquidation result in future settlement amounts which are consistent with carrying values. Given the nature of the Company’s financial liabilities, there is also limited risk that future settlement amounts will differ from carrying values. The Company does not have any derivative financial instruments, nor does it engage in hedging transactions, as risk exposure is limited.

The Company’s long-term contractual obligations are summarized in Table 12.

*Table 12: Contractual Obligations*

Obligation	Total	31-Jan-2011	
		2011	2012
Premises rent <sup>(1)</sup>	\$ 9,345	\$ 9,345	\$ -
Research and development contracts	38,860	38,860	-
Consulting services	15,250	15,250	-
<b>Total contractual obligations</b>	<b>\$ 63,455</b>	<b>\$ 63,455</b>	<b>\$ -</b>

<sup>(1)</sup> During fiscal 2009 the Company was assessed additional property taxes of \$6,400, which the Company is contesting. The premises lease agreement expired on May 31, 2009 and has been extended on a month to month basis with a 90 day notice period.

Based upon the balance of cash and cash equivalents subsequent to the closing of the private placement, the Company expects to have sufficient cash resources to carry out its operations to the end of fiscal 2012 at planned operating levels.

**Off-Balance Sheet Arrangements**

The Company has not historically utilized, nor is it currently utilizing any off-balance sheet instruments.

**Foreign Exchange Exposure**

During Q3-F’11, the Company recorded a foreign exchange loss of \$330 compared to a loss of \$4,693 in Q3-F’10. The loss recorded in Q3-F’11 reflects \$96 in unrealized gains resulting from holding foreign currency balances at the quarter end, compared to \$483 in unrealized losses at

Q3-F'10. The foreign currency exposure in Q3-F'11 was immaterial and unchanged from FYE 2010.

### Related Party Transactions

There were no related party transactions of a material amount during Q3-F'11. All transactions were incurred and recorded at the exchange amounts agreed by the parties.

### Outstanding Share Information

Outstanding share information as at the close of business March 30, 2011 is set out in Table 13.

*Table 13: Outstanding Share Information*

	Outstanding	Expiry Date
<b>Common shares</b>		
Authorized - unlimited		
Issued	58,023,715	
Fully diluted <sup>(1)</sup>	72,409,000	
Weighted average outstanding <sup>(2)</sup>	50,008,544	
<b>Common share warrants</b>		
\$0.40 agent warrants	105,607	Oct 27/11
\$0.40 agent warrants	643	Nov 27/11
\$0.30 agent warrants	385,500	Sep 24/12
\$0.55 warrants	1,519,070	Oct 27/11
\$0.55 warrants	56,430	Nov 27/11
\$0.30 warrants	8,152,500	Sep 24/12
	10,219,750	
<b>Common share stock options</b>		
\$0.01 - \$0.50	2,066,018	Sep 9/14 - Oct 27/15
\$0.51 - \$1.00	1,749,517	Jan 11/12 - Mar 14/15
\$1.01 - \$1.50	250,000	Mar 25/12 - Jul 15/13
\$1.51 - \$2.00	100,000	Oct 8/12
	4,165,535	

<sup>(1)</sup> Assumes conversion of all outstanding common share stock options and warrants.

<sup>(2)</sup> Weighted average shares outstanding calculated from May 1, 2010 to March 30, 2011.

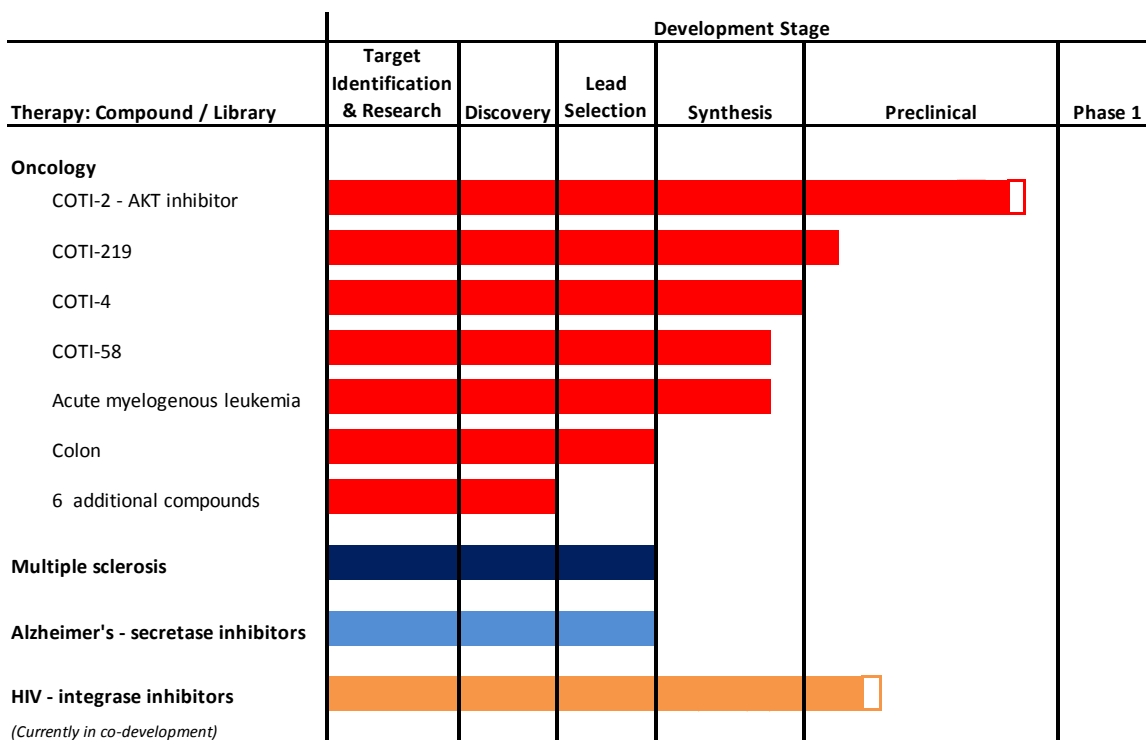
### Operational Progress and Outlook

The Company continued to make progress in developing its drug candidate pipeline during Q3-F'11. Figure 1 highlights the development status of specific compounds and libraries to the date of this report. A clear box indicates the progress made in the quarter for a particular library or compound.

The Company has a number of drug compounds and programs whose further development has been put on hold because of limited near term financial resources. These include oncology

compounds COTI-4, COTI-219 and the colorectal cancer portfolio, the multiple sclerosis program, the HIV program and the Alzheimer’s disease project. The Company is exploring a variety of ways to realize value on these compounds or further their development through co-development projects.

Figure 1: COTI Product Development Pipeline at March 30, 2011



**COTI-2**

During the quarter, the Company continued development of COTI-2 by carrying out additional experiments and laboratory work in preparation for an IND clinical trial submission.

On November 15, 2010, the Company announced its attendance at BIO Europe, taking place in Munich, Germany, and on January 10, 2011, the Company announced its attendance at Biotech Showcase, taking place in San Francisco, California. The objective of attending these meetings was to present detailed scientific information on COTI-2 to prospective licensing partners that included pharmaceutical, biotechnology and investment organizations. Feedback received at these meetings was favourable and management continues to pursue licensing opportunities for COTI-2.

**Acute Myelogenous Leukemia**

The Company continued the development of its acute myelogenous leukemia compounds as part of its project being co-funded by the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP), as announced on June 29, 2010. The Company recognized \$3,204 in government assistance in Q3-F’11 and \$13,162 YTD-F’11 related to

optimizing the compounds in computer simulations in preparation for synthesis. The compounds are now ready for synthesis once sufficient funds are available to finance this activity.

#### Collaborations and Co-Development Projects

##### HIV-1 Integrase Co-development

There was no progress made on this project in Q3-F'11. Subsequent to the quarter end, the Company made a submission to a new initiative of the NRC-IRAP called the Canadian HIV Technology Development Program, which is part of a wider Canadian HIV Vaccine Initiative under a collaboration between the Government of Canada and the Bill and Melinda Gates Foundation. This program initiative was announced on January 25, 2011. The project submission seeks financial support to move its research forward on compounds that are characterized by a different binding mode than current integrase treatments and with activity against Isentress® (raltegravir, the only integrase treatment on the market) mutant strains. Whether project approval and funding will be obtained is unknown but the Company hopes that such funding will assist in gaining sufficient funds to finance further development in fiscal 2012.

#### **Industry and Economic Factors Affecting Performance**

The biotechnology industry is regarded as high risk given the uncertain nature of developing drug candidates and limited access to capital. On the other hand, success in this industry can be highly rewarding. COTI operates in the discovery and preclinical stage of the drug development cycle. The realization of COTI's long-term potential is dependent upon the successful development and commercialization of molecules discovered using the Company's drug discovery technology either for its own account or in collaboration agreements for others, and in utilizing the technology to provide profiling and screening services on a fee for service basis. The major industry and economic risk factors affecting realization of this potential in Q3-F'11 remain substantially unchanged from the analysis discussed at length in the Company's AIF and the risks discussed in the Q1-F'11 and Q2-F'11 quarterly MD&A.

The three risk categories having the greatest affect on the Company during the quarter were:

1. the lack of product revenues;
2. securing adequate licensing agreements; and
3. financing requirements.

#### Lack of Product Revenues

COTI has not recorded any revenues from the sale or license of any drug compounds or compound libraries during its first four full years as a public company consistent with the most recent quarter of this period, Q3-F'11. COTI has an accumulated deficit since its inception through to January 31, 2011 of \$13,320,528. This deficit is expected to increase in the near term as COTI continues its product development efforts, develops relationships with prospective customers, and strives to obtain licensing and collaboration agreements. Operating losses are expected to be incurred until upfront licensing, milestone and royalty payments are sufficient to

generate revenues to fund its continuing operations. COTI is unable to predict with any certainty when it will become profitable, or the extent of any future losses or profits.

#### Securing Adequate Licensing Agreements

The Company's ability to commercialize its products successfully will depend first, on meeting the scientific due diligence requirements of prospective customers and second, on its ability to negotiate satisfactory licensing terms with pharmaceutical and biotechnology organizations for preclinical compounds. While continued positive test results during this fiscal year, including the most recent efforts on developing an oral formulation of COTI-2, generate positive feedback from potential licensees, efforts have not translated into a contractual agreement. Licensing discussions during Q3-F'11 continued to find an increasing interest for earlier stage deals, as the focus on late stage compounds during the past three years has diminished the availability of good compounds in the mid to late stages of clinical development held by companies looking to license. This is reflected in an increasing number of early stage deals in many therapeutic areas during calendar 2010. Industry media coverage continues to highlight the productivity challenges of pharmaceutical industry R&D spending in generating new compounds (The Financial Times, Feb 9/11, Drugs: Supply Running Low) but there is no certainty that licensing deals can be successfully negotiated for COTI's preclinical compounds.

#### Financing Requirements

The Company is seeking additional funds to continue to develop its R&D programs and to move its compounds more rapidly through development in calendar 2011 and 2012. The Company intends to raise these funds through public or private equity offerings, convertible debt, and collaborations with other pharmaceutical and biotechnology organizations or from other sources. If adequate funding is not available, COTI may be required to delay, reduce, or eliminate one or more of its R&D programs or obtain funds through corporate partners or others who may require it to relinquish significant rights to product candidates or obtain funds on less favourable terms than COTI would otherwise accept. COTI's success in obtaining future capital requirements will depend on many factors, such as establishing and maintaining investment industry relationships, collaborative partnering relationships and the general economic conditions and availability of capital in the equity markets for biotechnology companies.

During Q3-F'11, the Company continued to explore various financing options and was able to secure estimated net proceeds of \$1,220,470 subsequent to the quarter end on March 25, 2011 with the closing of the first tranche of a private placement. Additional financing is anticipated from this private placement for an amount and on a subsequent closing date not yet determined.

As previously advised, COTI is a Tier 2 issuer on the TSXV and accordingly is not required to file an AIF, however, the Company voluntarily filed an AIF on August 30, 2010 to strengthen its ability to raise public financing. This filing enables the Company to proceed with a short form prospectus offering at a later date should the Company determine this to be an appropriate course of action at that time.

Despite the Company's financing efforts, there can be no assurance additional funding will be available on terms acceptable to COTI.

### **Changes in Accounting Policies including Initial Adoption**

(i) Change in Accounting Policies

The Company did not change any of its accounting policies in Q3-F'11.

(ii) Adopted in Q3-F'11

The Company did not adopt any new accounting standards in Q3-F'11 as no new standards were issued by the CICA that required adoption.

(iii) To be Adopted in Fiscal 2012

The Canadian Institute of Chartered Accountants issued new accounting standards that will apply to the Company for Fiscal 2012 and beyond. These standards are described below.

a) International financial reporting standards (IFRS):

The development phase of the Company's IFRS transition plan as previously reported remains ongoing. In Q3-F'11, the Company made significant progress in the finalization of its component evaluations (CEs), with approximately 11 of the remaining 22 CE's approaching the final stages of completion with approval by the Audit Committee anticipated in the next quarter.

There have been no changes to the Company's prior guidance on the CEs expected to have the most significant impact on the financial statements upon transition.

The Company estimates that at January 31, 2011 it has completed draft CEs for 96% of the accounting standards applicable to the Company. The Company expects to finalize all of the CEs by the end of Q4-F'11. The process of drafting model financial statements compliant with IFRS has commenced and completion is anticipated to coincide with the finalization of the CEs. The implementation phase of the transition plan is expected to commence late in fiscal 2011, enabling the Company to prepare comparative results once it adopts IFRS in fiscal 2012.

b) Business combinations, consolidated financial statements and non-controlling interests:

In December 2008, the Accounting Standards Board (AcSB) issued Section 1582, "Business Combinations" that replaced Section 1581, "Business Combinations". The AcSB also issued Section 1601, "Consolidated Financial Statements" that replaced Section 1600, "Consolidated Financial Statements", and the AcSB amended Section 1602, "Non-controlling interests". These Sections became effective for the Company with interim and annual financial statement reporting beginning on January 1, 2011. The standards are to be applied prospectively to future business combinations; however, entities transitioning to IFRS may choose to adopt these Sections early to minimize the effect of transitional differences with IFRS. If an entity chooses to adopt Section 1582 before the required transition date, Sections 1601 and 1602 must be applied

at the same time. These standards are expected to have no effect on the Company before transition to IFRS as no future business combinations are being considered at present.