Financial Statements of

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Years ended April 30, 2007 and 2006 and cumulative period from April 30, 1999 (inception) to April 30, 2007

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## AUDITORS' REPORT

To the Shareholders of Critical Outcome Technologies Inc.

We have audited the balance sheets of Critical Outcome Technologies Inc. (a development stage company) as at April 30, 2007 and 2006 and the statements of operations and deficit, and cash flows for each of the years then ended and the cumulative period from April 30, 1999 (inception) to April 30, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 2007 and 2006 and the results of its operations and its cash flows for the years then ended and for the period from April 30, 1999 (inception) to April 30, 2007, in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

London, Canada

July 12, 2007

**CRITICAL OUTCOME TECHNOLOGIES INC.**
(a development stage company)
Balance Sheets

April 30, 2007 and 2006

| | | 2007 | | 2006 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 2,417,801 | $ | 170,464 |
| Other receivables | | 76,655 | | 8,842 |
| Prepaid expenses and deposits | | 56,413 | | 5,241 |
| | | 2,550,869 | | 184,547 |
| Equipment (note 2) | | 24,242 | | 33,766 |
| Patents (note 3) | | 134,298 | | 68,727 |
| Trademark (note 4) | | 870 | | 1,740 |
| Investment in DDP Therapeutics (note 5) | | 1 | | 1 |
| | $ | 2,710,280 | $ | 288,781 |
| **Liabilities and Shareholders' Equity (Deficiency)** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | $ | 179,091 | $ | 171,266 |
| Due to shareholders (note 6) | | 118,631 | | 127,194 |
| Notes payable and other advances (note 7) | | 20,000 | | 45,000 |
| Current portion of obligation under capital lease (note 8) | | 20,244 | | 16,128 |
| | | 337,966 | | 359,588 |
| Obligation under capital leases (note 8) | | 21,287 | | 33,525 |
| Shareholders' equity (deficiency): | | | | |
| Share capital and warrants (note 9) | | 4,037,165 | | 576,292 |
| Contributed surplus (note 10) | | 675,469 | | 251,000 |
| Deficit | | (2,361,607) | | (931,624) |
| | | 2,351,027 | | (104,332) |
| Commitments (note 14) | | | | |
| Subsequent events (note 17) | | | | |
| | $ | 2,710,280 | $ | 288,781 |

See accompanying notes to financial statements.

On behalf of the Board:

Mr. John Drake
Chairman & Chief Executive Officer

Dr. Wayne Danter
President and Chief Scientific Officer

## CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)
Statements of Operations and Deficit

| | Years ended April 30, 2007 | 2006 | Cumulative period April 30, 1999 (inception) to April 30, 2007 |
|---|---|---|---|
| Revenue: | | | |
| Contract services | $ 2,500 | $ 30,000 | $ 32,500 |
| Screening services | - | 2,500 | 2,500 |
| | 2,500 | 32,500 | 35,000 |
| Expenses: | | | |
| Stock-based compensation | 424,469 | 251,000 | 675,469 |
| Salaries and benefits | 423,014 | 149,465 | 596,932 |
| Synthesis costs | 247,560 | - | 382,560 |
| Professional fees | 168,038 | 48,335 | 333,357 |
| Marketing | 108,199 | 13,637 | 156,858 |
| Amortization of equipment | 27,747 | 22,542 | 55,864 |
| Office and general | 27,184 | 6,430 | 48,031 |
| Computer expense | 26,447 | 8,180 | 56,171 |
| Reorganization costs | 23,964 | 82,580 | 106,544 |
| Rent | 17,134 | 14,667 | 53,068 |
| Research and product development | 15,840 | 27,000 | 54,628 |
| Corporate governance | 14,749 | - | 14,749 |
| Insurance | 12,692 | - | 12,692 |
| Interest and bank charges | 10,106 | 5,152 | 25,365 |
| Amortization of trademarks | 870 | 870 | 3,480 |
| | 1,548,013 | 629,858 | 2,575,768 |
| Loss before other income (expense) | (1,545,513) | (597,358) | (2,540,768) |
| Other income (expense): | | | |
| Investment tax credit refund | 75,050 | 6,540 | 137,615 |
| Interest | 40,480 | (111) | 41,546 |
| | 115,530 | 6,429 | 179,161 |
| Loss | (1,429,983) | (590,929) | (2,361,607) |
| Deficit accumulated during development stage, beginning of year | (931,624) | (340,695) | - |
| Deficit accumulated during development stage, end of year | $ (2,361,607) | $ (931,624) | $(2,361,607) |
| Basic and diluted loss per common share | $ (0.05) | $ (0.06) | |
| Weighted average number of common shares outstanding | 29,866,634 | 9,611,243 | |

See accompanying notes to financial statements.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)
Statements of Cash Flows

| | Years ended April 30, 2007 | 2006 | Cumulative period April 30, 1999 (inception) to April 30, 2007 |
|---|---|---|---|
| Cash provided by (used in): | | | |
| Operations: | | | |
| Loss | $ (1,429,983) | $ (590,929) | $(2,361,607) |
| Items not involving cash: | | | |
| Stock-based compensation | 424,469 | 251,000 | 675,469 |
| Amortization of equipment | 27,747 | 22,542 | 55,864 |
| Amortization of trademark | 870 | 870 | 3,480 |
| Change in non-cash operating working capital (note 13) | (111,160) | 97,523 | 46,023 |
| | (1,088,057) | (218,994) | (1,580,771) |
| Financing activities: | | | |
| Research advances | - | - | 269,745 |
| Due to shareholders | (8,563) | 80,444 | 118,631 |
| Notes payable and other advances | (25,000) | 25,000 | 20,000 |
| Repayment of obligation under capital lease | (8,122) | (1,541) | (9,663) |
| Issuance of common shares and warrants | 3,460,873 | 306,545 | 3,767,420 |
| | 3,419,188 | 410,448 | 4,166,133 |
| Investing activities: | | | |
| Investment in DDP Therapeutics | - | (1) | (1) |
| Purchase of equipment | (18,223) | - | (28,912) |
| Additions to patents and trademark | (65,571) | (22,809) | (138,648) |
| | (83,794) | (22,810) | (167,561) |
| Increase in cash | 2,247,337 | 168,644 | 2,417,801 |
| Cash and cash equivalents, beginning of year | 170,464 | 1,820 | - |
| Cash and cash equivalents, end of year | $ 2,417,801 | $ 170,464 | $ 2,417,801 |
| Represented by: | | | |
| Cash | $ 317,801 | $ 170,464 | $ 317,801 |
| Cash equivalent | 2,100,000 | - | 2,100,000 |
| | $ 2,417,801 | $ 170,464 | 2,417,801 |
| Supplemental cash flow information: | | | |
| Interest paid | $ 2,351 | $ 288 | $ 2,654 |
| Non-cash transactions: | | | |
| Acquisition of equipment under capital lease | 11,081 | 51,193 | 62,274 |

See accompanying notes to financial statements.

**Description of business:**

COTI is a biopharmaceutical company focused on applying its proprietary computer technology, CHEMSAS®, to identify, profile and optimize commercially viable drug candidates at the earliest stage of pre-clinical drug development and thereby dramatically reduce the timeline and cost of getting new drug therapies to market.

In developing its technology, COTI has focused on novel, proprietary, small molecules used to treat cancer and HIV. This focus has been on cancers with high morbidity and mortality such as acute leukemia in adults, hormone resistant breast cancer, hormone resistant prostate cancer, small cell lung cancer and melanoma which currently have either poor or no effective therapies.

Using CHEMSAS® the Company is developing a pipeline of small highly optimized libraries of 6-10 molecules for specific therapy targets and plans to sell/licence these libraries to interested pharmaceutical partners for human trials and further drug development. Currently, the libraries in various stages of development in the pipeline are targeted at small cell lung cancer, colorectal cancer, HIV integrase inhibitors, chronic and acute leukemia and multiple sclerosis.

In addition to its targeted library pipeline, the Company may also take particularly promising individual molecules forward for development outside of the library development approach. These molecules would follow the same development process and approach as the library molecules through to the end of in vitro and in vivo testing. These compounds will then be available for sale, licensing or co-development with a pharmaceutical partner.

**Amalgamation:**

On October 13, 2006, Critical Outcome Technologies Inc. (Private COTI) amalgamated with Aviator Petroleum Corporation (Aviator), a public company listed on the TSX Venture Exchange (the TSXV) to form a new company with the name Critical Outcome Technologies Inc. (Public COTI) under the provisions of the Business Corporations Act (Ontario).

The amalgamation between Aviator and Private COTI was an arm's length transaction requiring shareholder approval and a majority of minority shareholder approval pursuant to applicable corporate laws. The amalgamation constituted the qualifying transaction of Aviator pursuant to the policies of the TSXV and is the means by which Private COTI has become a public issuer.

**Amalgamation (continued):**

Under the amalgamation agreement, the Aviator common shares were exchanged for 5,635,000 common shares of Public COTI. In addition, the Aviator agent's options outstanding were exchanged for agent's options of Public COTI with the same terms entitling the holder to acquire up to 275,000 Public COTI common shares. The Private COTI common shares were exchanged for 28,967,332 Public COTI common shares with a deemed value of $0.34521 per share. In addition, each outstanding $0.40 warrant, $0.70 warrant, $0.30 agent's warrant and $0.40 agent's warrant was exchanged on a one for one basis for replacement securities of Public COTI with the same terms. The transaction resulted in the shareholders of Private COTI retaining an 83.7% interest in the amalgamated company, with shareholders of Aviator retaining a 16.3% interest. The COTI common shares commenced trading on October 30, 2006 with 34,602,332 shares issued and outstanding on that date (see note 9).

Since the qualifying transaction and amalgamation resulted in Private COTI shareholders acquiring control of the amalgamated company, Private COTI is deemed to be the acquirer for financial reporting purposes. The share exchange is therefore considered to be a reverse takeover. As Aviator was deemed a non-operating public enterprise the transaction has been accounted for as a capital transaction wherein the net monetary assets of Aviator are recorded at their fair market values, net of transaction costs to the extent of cash on hand in Aviator.

The net monetary assets of Aviator upon amalgamation were as follows:

| | | |
|---|---|---|
| Monetary assets | $ | 353,249 |
| Less monetary liabilities | | 18,706 |
| Net monetary assets | | 334,543 |
| Less transactions costs | | 328,298 |
| Amount allocated to share capital (note 9) | $ | 6,245 |

**1. Significant accounting policies:**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Significant accounting policies adopted by the Company are as follows:

(a) Basis of presentation:

The financial statements have been prepared assuming that the Company will continue as a going concern. The Company is a development stage company and is subject to risks common to rapidly growing technology based companies, including a limited operating history, dependence on key personnel, the need to raise capital for successful development, marketing and operations and/or additional financing to meet the Company's liabilities and commitments as they become due. The financial statements do not include adjustments that would be required if the going concern assumption was not appropriate and consequently that the assets are not realized and the liabilities settled in the normal course of operations.

The Company has incurred a loss of $1,429,983 (2006 - $590,929) and negative cash flow from operations of $1,088,057 (2006 - $218,994) for the year ended April 30, 2007. As at April 30, 2007, the Company has an accumulated deficit of $2,361,607 (2006 - $931,624) which results in a shareholders' equity of $2,351,027. As of April 30, 2007 the Company has working capital of $2,212,903.

(b) Equipment:

Equipment is recorded at amortized cost. Amortization is recorded on a straight-line basis over the estimated useful lives of the assets whether purchased directly by the Company or acquired under a capital lease as follows:

| Asset | Useful life |
|---|---|
| Furniture and fixtures | 5 years |
| Computer hardware | 2 - 3 years |
| Computer software | Term of license |

**1. Significant accounting policies (continued):**

(c) Patents:

Capitalized amounts for patents relate to the direct costs incurred in connection with securing patents. The cost of evaluating and investigating patents are accumulated by specific product or molecule and the capitalized costs are amortized over the life of the patent beginning in the year the patent is received. The accumulated cost of a product investigated for patenting which is not subsequently patented is expensed in the year when the decision is made to not pursue the patent.

(d) Trademarks:

The costs of evaluating and investigating trademark registration are accumulated by specific process and where trademark registration is obtained such costs are capitalized and amortized over the lesser of the marketing life of the process or five years beginning in the year after the trademark is received. Where trademark registration is not ultimately obtained accumulated costs are expensed.

(e) Impairment of long-lived assets:

The Company tests long-lived assets or asset groups for recoverability when events or changes in circumstances indicate that their carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of the long-lived asset and its net recoverable value, which is generally determined based on undiscounted cash flows expected to result from the use and eventual disposal of the long-lived asset. If the carrying value of the long-lived asset is not recoverable, an impairment loss is recognized to write down the long-lived asset to its fair value.

(f) Portfolio investments:

Portfolio investments are recorded at cost. Gains and losses on disposal of investments are recognized when realized.

(g) Research and product development:

Research expenditures are expensed as incurred. Development expenditures are deferred when they meet the criteria for capitalization in accordance with Canadian GAAP, and the future benefits could be regarded as being reasonably certain. At April 30, 2007 and 2006 no development costs were deferred.

**1. Significant accounting policies (continued):**

(h) Revenue recognition:

The Company recognizes technical consulting and molecule screening service revenue upon completion of the contracted service.

(i) Investment tax credits:

Investment tax credits ("ITCs") are accrued when qualifying expenditures are made and there is reasonable assurance that the credits will be realized. ITCs relating to research and development expenses are recorded as other income and those relating to capital expenditures are recorded as a reduction of the cost of the asset acquired.

(j) Stock-based compensation and other stock based payments:

The Company accounts for employee stock options using the fair value based method, whereby compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period.

(k) Income taxes:

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and the respective tax bases of the assets and liabilities, measured using substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in income tax rates are recognized as income or loss in the year that the income tax rate change occurs.

The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

**1. Significant accounting policies (continued):**

(l) Use of estimates:

The preparation of these financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying value of equipment and intangibles, valuation of future income taxes and accounting for share capital, warrants and options. Actual results could differ from those estimates.

(m) Basic and diluted loss per share:

Basic and diluted loss per share are determined using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed in a manner consistent with basic earnings per share, except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of options and warrants, if dilutive.

**2. Equipment:**

2007

| | | Cost | | Accumulated amortization | | Net book value |
|---|---|---|---|---|---|---|
| Computer hardware | $ | 61,487 | $ | 39,612 | $ | 21,875 |
| Furniture and fixtures | | 5,856 | | 3,489 | | 2,367 |
| Computer software | | 12,762 | | 12,762 | | - |
| | $ | 80,105 | $ | 55,863 | $ | 24,242 |

2006

| | | Cost | | Accumulated amortization | | Net book value |
|---|---|---|---|---|---|---|
| Computer hardware | $ | 43,628 | $ | 17,553 | $ | 26,075 |
| Furniture and fixtures | | 5,494 | | 2,384 | | 3,110 |
| Computer software | | 12,761 | | 8,180 | | 4,581 |
| | $ | 61,883 | $ | 28,117 | $ | 33,766 |

Included in equipment are assets under capital lease with a cost of $62,274 (2006 - $51,193) and accumulated amortization of $45,803 (2006 - $19,106).

**3. Patents:**

The Company is pursuing patents on certain molecules and their manufacturing process with accumulated costs at April 30, 2007 and 2006 of $134,298 and $68,727 respectively.

## 4. Trademark:

Trademark registration has been obtained for the exclusive use of the name, CHEMSAS®, which describes the Company's proprietary molecular screening technology. Costs incurred are being amortized over five years as management has determined that the trademark does not have an indefinite life. The accumulated costs are as follows:

2007

| | Cost | Accumulated amortization | Net book value |
|---|---|---|---|
| CHEMSAS® - molecular profiling technology | $ 4,350 | $ 3,480 | $ 870 |

2006

| | Cost | Accumulated amortization | Net book value |
|---|---|---|---|
| CHEMSAS® - molecular profiling technology | $ 4,350 | $ 2,610 | $ 1,740 |

## 5. Investment in DDP Therapeutics:

The Company has a 10% ownership interest and certain officer shareholders of COTI have a 50% ownership interest in a company, 6441513 Canada Inc, operating as DDP Therapeutics (DDP), formed in early 2006 to develop a library of small cell lung cancer molecules discovered by the Company using CHEMSAS®.

Under an agreement created April 7, 2006, the Company transferred the library of small cell lung cancer molecules to DDP for $1. COTI is entitled, under the agreement, to receive a payment in the amount of 10% of the aggregate net proceeds raised by DDP in connection with a financing to support (a) the validation of the transferred molecules for purposes of an investigational new drug filing and (b) entering into a strategic agreement with a pharmaceutical company. Net proceeds is defined as the gross amount realized from the financing less the direct costs incurred by DDP in completing the financing.

The Company earned contract services revenue from DDP during the years ended April 30, 2007 and 2006 of $2,500 and $30,000 respectively.

**6. Due to shareholders:**

The amounts advanced by shareholders are unsecured and due on demand. Advances made to the Company prior to March 1, 2005 are non-interest bearing. Those advances made subsequent to that date are supported by promissory notes bearing interest at 7%.

| | 2007 | 2006 |
|---|---|---|
| Non-interest bearing advances | $ 38,098 | $ 45,494 |
| Interest bearing notes | 80,533 | 81,700 |
| | $ 118,631 | $ 127,194 |

Interest expense on the interest bearing notes for the year ended April 30, 2007 was $5,572 (2006 - $2,592).

**7. Notes payable and other advances:**

| | 2007 | 2006 |
|---|---|---|
| Unsecured notes payable bearing interest at bank prime plus 3%, due on demand with 30 days notice | $ 20,000 | $ 20,000 |
| Advance from Aviator Petroleum Corp | - | 25,000 |
| | $ 20,000 | $ 45,000 |

Upon amalgamation, the advance made by Aviator as a non-refundable, unsecured advance pursuant to a signed letter of intent dated February 7, 2006 was applied to the proceeds of the purchase.

**8. Obligation under capital leases:**

| | 2007 | 2006 |
|---|---|---|
| 2007 | $ - | $ 18,480 |
| 2008 | 22,352 | 18,480 |
| 2009 | 20,813 | 16,942 |
| 2010 | 1,290 | - |
| Total minimum lease payments | 44,455 | 53,902 |
| Less amount representing interest | 2,924 | 4,249 |
| | 41,531 | 49,653 |
| Current portion of obligation under capital leases | 20,244 | 16,128 |
| | $ 21,287 | $ 33,525 |

The Company has entered into various capital leases which expire prior to September 2009 for certain computer equipment. The interest rates implicit in the leases range from 5.56% to 10.37%. Included in the obligation under capital leases is $33,525 (2006 - $49,653) owing to a shareholder.

## 9. Share capital and warrants:

The following table summarizes the details of share capital transactions for the years ended April 30, 2007 and 2006:

| | | 2007 | | 2006 | |
|---|---|---|---|---|---|
| | Expiry | Issued | Amount | Issued | Amount |
| Share capital: | | | | | |
| Authorized: | | | | | |
| Unlimited preference shares | | | | | |
| Unlimited common shares | | | | | |
| Issued: | | | | | |
| Common shares | | 37,507,052 | $ 3,598,977 | 22,373,332 | $ 551,792 |
| Common share purchase warrants: | | | | | |
| $0.30 agent warrants | April 18/08 | - | - | 40,000 | 2,500 |
| $0.40 warrants | April 18/08 | 533,332 | 13,830 | 733,332 | 22,000 |
| $0.40 agent warrants | Oct 12/08 | 378,930 | 52,921 | - | - |
| $0.60 warrants | July 15/08 | 1,000,000 | 151,990 | - | - |
| $0.70 warrants | April 12/08 to Oct 18/08 | 3,545,950 | 219,447 | - | - |
| | | 5,458,212 | 438,188 | 773,332 | 24,500 |
| | | | $ 4,037,165 | | $ 576,292 |

**9. Share capital and warrants (continued):**

| | Shares | Amount |
|---|---|---|
| Shares issued for cash, April 30, 1999 and balance April 30, 2005 | 200 | $ 2 |
| Shares issued for molecular mining technology | 110 | 1 |
| Shares issued to repay research advances | 150 | 269,745 |
| Shares issued for additional financing | 56 | 100,000 |
| Shares issued for stock dividend | 8,764 | - |
| Shares issued for exercise of warrants | 720 | 40 |
| Shares issued for exchange on share conversion | (10,000) | - |
| Shares issued on share conversion | 10,000,000 | - |
| Stock options exercised | 439,001 | 4 |
| Shares exchanged on amalgamation | (10,439,001) | - |
| Shares issued on amalgamation | 21,640,000 | - |
| Shares issued on private placement | 733,332 | 182,000 |
| Balance April 30, 2006 | 22,373,332 | 551,792 |
| Shares issued on private placement | 6,594,000 | 1,858,010 |
| Shares issued on amalgamation | 5,635,000 | 6,245 |
| Shares issued on private placement | 2,000,000 | 832,243 |
| Shares issued on $0.10 agent stock options | 263,500 | 22,988 |
| Shares issued on $0.40 warrants | 240,000 | 101,352 |
| Shares issued on $0.30 warrants | 40,000 | 13,743 |
| Shares issued on $0.70 warrants | 80,750 | 64,826 |
| Shares issued on $0.40 agent warrants | 280,470 | 147,778 |
| Balance April 30, 2007 | 37,507,052 | $ 3,598,977 |

**9. Share capital and warrants (continued):**

| | Warrants | Amount | Weighted average exercise price | Gross proceeds on exercise |
|---|---|---|---|---|
| Balance, April 20, 2005 | - | $ - | $ - | $ - |
| Granted on private placement | 733,332 | 22,000 | 0.40 | - |
| Granted to agents on private placement | 40,000 | 2,500 | 0.30 | - |
| Balance, April 30, 2006 | 773,332 | 24,500 | 0.39 | - |
| Granted on private placement | 3,626,700 | 228,778 | 0.70 | - |
| Granted to agents on private placement | 699,400 | 94,093 | 0.40 | - |
| Granted on private placement | 1,000,000 | 151,990 | 0.60 | - |
| Exercised | (240,000) | (8,170) | 0.40 | 96,000 |
| Exercised | (40,000) | (2,500) | 0.30 | 12,000 |
| Exercised | (80,750) | (9,331) | 0.70 | 56,525 |
| Exercised | (280,470) | (41,172) | 0.40 | 112,188 |
| Balance, April 30, 2007 | 5,458,212 | $ 438,188 | $ 0.63 | $ 276,713 |

(a) On October 11, 2006 the Company completed a private placement of 6,594,000 units for gross proceeds of $2,637,600 and issued 6,594,000 common shares and 3,297,000 $0.70 warrants. Each unit consisted of one common share and one-half a common share purchase warrant at an issue price of $0.40. Each whole common share purchase warrant is exercisable into one additional common share at a price of $0.70 until April 13, 2008. Costs associated with this placement were $458,723 for net proceeds of $2,178,877. In addition, agents were issued 659,400 warrants (agent's warrants) equaling 10% of the number of units sold. Each agent's warrant has the right to purchase one unit at $0.40 until October 13, 2008.

The Company allocated a portion of the gross proceeds to each warrant class based on their pro-rata share of the calculated fair value of the total unit fair value at issuance. An allocation of $179,547 was made to the $0.70 warrants using the Black-Scholes option pricing model assuming a risk free interest rate of 4.56%, an expected volatility of 64.1%, an expected life of 18 months and no expected dividends. Agent's warrants were allocated $141,321 using assumptions of: a weighted average expected life of 30 months, a weighted average volatility of 70.8% and a weighted average risk free interest rate of 4.5%.

**9. Share capital and warrants (continued):**

(b) On October 13, 2006 Critical Outcome Technologies Inc. (Private COTI) amalgamated with Aviator Petroleum Corp. (Aviator), a public company listed on the TSXV, to form a new company with the name Critical Outcome Technologies Inc. (Public COTI) under the provisions of the Business Corporations Act (Ontario).

Under the amalgamation agreement, Aviator common shares were exchanged for 5,635,000 common shares of Public COTI. In addition, 275,000 Aviator agent's stock options outstanding were exchanged for agent's stock options of Public COTI with the same terms entitling holders to acquire up to 275,000 Public COTI common shares at $0.10 per share. The Private COTI common shares were exchanged for 28,967,332 Public COTI common shares. Each outstanding $0.40 warrant, $0.70 warrant, $0.30 agent's warrant and $0.40 agent's warrant of Private COTI was exchanged on a one for one basis for replacement securities of Public COTI with the same terms.

(c) On January 16, 2007 the Company completed a private placement of 2,000,000 units at an issue price of $0.50 per unit for gross proceeds of $1,000,000. Each unit consisted of one common share and one-half a common share purchase warrant with each whole warrant exercisable into one additional common share at a price of $0.60 per share until July 16, 2008. Costs of the private placement were $15,767. Pursuant to TSXV regulations, the 2,000,000 shares issued under the Unit offering were subject to a four month hold period ending on May 15, 2007.

The $0.60 Warrants were allocated $151,990 of the gross proceeds based on their pro-rata share of the calculated fair value of the total unit fair value at issuance using a Black-Scholes pricing model and assuming; a risk free interest rate of 4.28%, an expected volatility of 64.7%, an expected life of 18 months and no expected dividend yield.

(d) In December 2006 and January 2007, a total of 263,500 agent's stock options were exercised for 263,500 common shares with gross proceeds to the Company of $26,350 - see note 9(b) and 17(c).

(e) The details of warrants issued and exercised are summarized as follows:

During the year, warrants were exercised and common shares issued as set out in the tables above. The fair value of the embedded warrants contained in each agent's warrant were calculated as set out in note 9(a) and (c). The costs incurred to issue these shares and any associated warrants were $11,544.

## 10. Stock-based compensation:

On October 13, 2006, the Company established a stock option plan for directors, officers, employees and consultants who contribute to the long-term goals of the Company. Under the Plan, the maximum number of shares available for purchase pursuant to options granted shall not exceed 10% of the outstanding issued shares. The awarding of options, their exercise price and vesting period is determined by the compensation committee of the board.

On January 11, 2007, the Company granted 1,185,000 stock options to certain directors and employees with an exercise price of $0.64 and on January 12, 2007, issued a further 50,000 stock options with an exercise price of $0.70. On March 26, 2007, an additional 150,000 options were granted to a new director. The options have a five year maturity from the date of the grant. Certain of these options vested immediately and the balance vest one-fifth or one-sixth every six months from the date of the grant.

| Exercise price | Options granted and oustanding at April 30, 2007 | Vested | Unvested | Weighted average remaining contractual life in years | Total Stock-based compensation value | Weighted average option value |
|---|---|---|---|---|---|---|
| $ 0.64 | 1,185,000 | 754,998 | 430,002 | 4.7 | $ 350,260 | 0.296 |
| 0.70 | 50,000 | 8,333 | 41,667 | 4.7 | 15,908 | 0.318 |
| 1.35 | 150,000 | 150,000 | - | 4.9 | 176,400 | 1.176 |
| | 1,385,000 | 913,331 | 471,669 | 4.4 | $ 542,568 | 0.392 |
| Expensed at April 30, 2007 | | | | | $ 424,469 | |

| | |
|---|---|
| Available for grant at April 30, 2007 | 2,365,705 |

**10. Stock-based compensation (continued):**

The assumptions used in the Black-Scholes model in determining the stock-based compensation are set out below:

| | January, 2007 | March, 2007 |
|---|---|---|
| Risk free interest rate | 3.98 % | 4.54 % |
| Expected dividend yield | - | - |
| Expected share volatility | 60 % | 145 % |
| Expected option life in years | 2.57 | 5.00 |

Stock-based compensation expected to vest in future periods is summarized below:

| | |
|---|---|
| 2008 | $ 85,054 |
| 2009 | 30,244 |
| 2010 | 2,802 |
| | $ 118,100 |

## 11. Income taxes and investment tax credits:

The following table reconciles income taxes, calculated at combined Canadian federal and provincial tax rates, with the income tax expense in the financial statements:

| | 2007 | 2006 |
|---|---|---|
| Loss before income taxes | $ (1,430,000) | $ (591,000) |
| Statutory rate | 36.12% | 36.12% |
| Expected income tax recovery | (517,000) | (213,000) |
| Amounts not deductible for tax | 150,000 | 91,000 |
| Unutilized tax losses | - | 96,000 |
| Share issuance costs deductible for tax | (254,000) | - |
| Tax impact of amalgamation | (41,000) | - |
| Expiration of non capital losses | 18,000 | - |
| Change in future income tax rates | 55,000 | - |
| Change in valuation allowance | 626,000 | - |
| Other | (37,000) | 26,000 |
| Income tax expense | $ - | $ - |

The tax effect of temporary differences that give rise to significant portions of the future tax assets and liabilities at April 30, are presented below:

| | 2007 | 2006 |
|---|---|---|
| Losses carried forward | $ 423,000 | $ 191,000 |
| Research expenditures deferred for tax purposes | 173,000 | 40,000 |
| Capital assets | 3,000 | 6,000 |
| Intangible assets | 34,000 | 7,000 |
| Financing expenses | 229,000 | 2,000 |
| Future tax assets | 862,000 | 246,000 |
| Less future tax liabilities relating to: | | |
| Other | - | 10,000 |
| Net future tax assets | 862,000 | 236,000 |
| Less valuation allowance | (862,000) | (236,000) |
| | $ - | $ - |

**11. Income taxes and investment tax credits (continued):**

The valuation allowance for future tax assets as at April 30, 2007 is $862,000 (2006 - $236,000). In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the periods in which those temporary differences become deductible and also considers the scheduled reversal of future tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the future tax assets are deductible, management currently believes it is more likely than not that the Company will not realize the benefits of the deductible difference and therefore these benefits have not been recognized in the financial statements.

The Company has federal non-capital losses of approximately $1,263,000, and provincial non-capital losses of approximately $1,304,000, and $453,000 of federal research and development expenditures and $515,000 of provincial research and development expenditures which may be applied to reduce taxable income of future years expiring as follows:

| | Federal | Provincial |
|---|---|---|
| 2008 | $ 14,000 | $ 14,000 |
| 2009 | 127,000 | 127,000 |
| 2013 | 35,000 | 78,000 |
| 2018 | 186,000 | 186,000 |
| 2025 | 126,000 | 126,000 |
| 2026 | 323,000 | 323,000 |
| 2027 | 452,000 | 450,000 |
| Research and development expenditures, no expiry | 453,000 | 515,000 |

Certain expenses incurred by the Company during the year ended April 30, 2007 may qualify as research and development as described by regulations in the Canadian Income Tax Act. Qualified amounts for the taxation year ended April 11, 2006 were eligible for investment tax credits (ITCs) refundable to the Company. The current year and future year ITCs are only eligible to reduce taxes payable. For the year ended April 30, 2007, the Company has filed for $53,000 of refundable Ontario tax credits which have not been recorded as reasonable assurance regarding their collectibility has not been received.

**12. Financial instruments:**

(a) Fair value disclosure:

Fair value estimates are made as of a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision.

The Company has determined that the carrying value of its short-term financial assets and liabilities, including cash and cash equivalents, other receivables, accounts payable and accrued liabilities, due to shareholders and other advances, approximates their fair value because of the relatively short periods to maturity of these instruments.

The fair value of the note payable and the obligation under capital lease approximates their carrying value because the interest rate charged approximates current market rates of interest.

(b) Credit risk:

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. The Company regularly monitors credit risk exposure and takes steps to mitigate the likelihood that these exposures will result in an actual loss.

The Company does not have any financial instruments that potentially subject it to significant concentrations of credit risk.

**13. Change in non-cash operating working capital:**

| | 2007 | 2006 |
|---|---|---|
| Other receivables | $ (67,813) | $ 1,852 |
| Investment tax credit receivable | - | 13,720 |
| Prepaid expenses and deposits | (51,172) | (124) |
| Accounts payable and accrued liabilities | 7,825 | 82,075 |
| | $ (111,160) | $ 97,523 |

## 14. Commitments:

The Company had an operating lease for its 800 square foot office space with a monthly lease rate of $1,558 until May 31, 2007. Effective June 1, 2007, the Company entered into a two year lease agreement for its existing space and an additional 800 square feet of adjoining office space. The monthly lease payment for June and July 2007 under this lease was negotiated at the existing monthly rate. Effective August 1, 2007 the lease rate for the combined space is $3,115. The minimum fiscal year lease payments are: $32,709 in 2008, $37,384 in 2009 and $3,115 in 2010.

## 15. Segmented information:

Management has determined that the Company operates in one reportable segment based on the economic characteristics of its research and its services. All of the Company's operations are located in Canada.

## 16. Related party transactions:

During the year, the Company entered into transactions with its shareholders and officers under normal terms and conditions. These transactions which have been recorded at the exchange amount, being the amounts agreed to by the parties, are as follows:

| | 2007 | 2006 |
|---|---|---|
| Obligation under capital lease | $ - | $ 51,193 |
| Professional fees | 63,750 | 10,000 |

Other related party transactions are disclosed in notes 5 and 6.

**17. Subsequent events:**

(a) Subsequent to year end, the Company realized gross proceeds of $1,014,549 from the exercise of various common share warrants and on the exercise of the $0.40 agent warrants the Company issued the required $0.70 warrants. Details of the exercises are summarized below.

| | Gross proceeds | Shares issued | Warrants issued |
|---|---|---|---|
| $0.40 warrants | $ 106,666 | 266,666 | - |
| $0.40 agent warrants | 105,256 | 263,140 | - |
| $0.70 warrants | 802,627 | 1,146,609 | 263,140 |
| | $ 1,014,549 | 1,676,415 | 263,140 |

(b) On May 1, 2007, the Board of Directors approved a grant of 130,000 stock options to a director, which vested immediately, at an exercise price of $1.00. On May 11, 2007, 100,000 options were granted to the Chief Operating Officer of the Company pursuant to an employment contract and the approved plan for employee option grants. The exercise price is $1.34 per share and vesting occurs over 3.25 years based upon contact milestones with the first 25,000 options vesting on October 1, 2007. The stock-based compensation value of these grants and assumption estimates are as follows:

| | Director | Officer |
|---|---|---|
| Risk free interest rate | 4.54 % | 4.54 % |
| Expected dividend yield | - | - |
| Expected share volatility | 145 % | 145 % |
| Expected average option life in years | 2.57 | 3.25 |
| Estimated total stock-based compensation | $ 111,500 | $ 97,400 |

(c) On May 11, 2007 11,500 agent stock options granted with an exercise price of $0.10 per share expired. There are no remaining outstanding agent stock options - see note 9(b) and (d).