Fiscal 2011 First Quarter Financial Statements

(Unaudited)

For the three months ended July 31, 2010 and 2009

CRITICAL OUTCOME TECHNOLOGIES INC.

Fiscal 2011 First Quarter Financial Statements

For the three months ended July 31, 2010 and 2009

Index

	Page
Notice of No Auditor Review of Interim Financial Statements	3
Balance Sheets	4
Statements of Comprehensive Loss and Deficit	5
Statements of Cash Flows	6
Notes to the Financial Statements	7 - 16

CRITICAL OUTCOME TECHNOLOGIES INC.

Notice of No Auditor Review of Interim Financial Statements
For the three months ended July 31, 2010 and 2009

The accompanying unaudited balance sheet of Critical Outcome Technologies Inc. (COTI) as at July 31, 2010, the audited balance sheet as at April 30, 2010 and the unaudited statements of comprehensive loss and deficit and cash flows for the three month periods ended July 31, 2010 and 2009 have been prepared by, and are the responsibility of the Company's management and have been reviewed and approved by the Audit Committee as authorized by the Board of Directors.

Neither an audit nor review of the interim financial statements is required by the Company's independent auditor under regulatory reporting requirements, however, under National Instrument 51-102 para. 4.3(3)a the Company must advise whether a review has occurred or not. Accordingly, management advises that the Company's independent auditor, KPMG LLP, was not engaged to perform a review of these interim financial statements.

CRITICAL OUTCOME TECHNOLOGIES INC.
Balance Sheets

As at	July 31, 2010	April 30, 2010
	(Unaudited)	(Audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 1,401,269	$ 1,945,376
Miscellaneous receivables	10,976	29,756
Prepaid expenses and deposits	72,670	74,955
	1,484,915	2,050,087
Equipment	79,646	84,820
Intangible assets (note 2)	2,590,112	2,700,187
	$ 4,154,673	$ 4,835,094
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 246,665	$ 343,940
Due to shareholder	1,069	1,069
	247,734	345,009
Shareholders' equity:		
Share capital and warrants (note 3)	13,847,644	13,812,200
Contributed surplus (note 4)	2,351,875	2,421,193
Deficit	(12,292,580)	(11,743,308)
	3,906,939	4,490,085
	$ 4,154,673	$ 4,835,094
Commitments (note 9)		

See accompanying notes to financial statements

CRITICAL OUTCOME TECHNOLOGIES INC.

Statements of Comprehensive Loss and Deficit

(All amounts unaudited)

For the three months ended	July 31, 2010	July 31, 2009
Revenues:		
Contract services	$ -	$ -
Expenses:		
General and administration	239,404	329,615
Research and product development	196,312	425,860
Amortization	123,481	132,868
Stock-based compensation (recovery) expense (note 4)	(69,318)	33,602
Sales and marketing	62,895	61,131
Foreign exchange (gain) loss	(809)	2,407
Interest and bank charges	239	1,416
	552,204	986,899
Loss before other income	(552,204)	(986,899)
Other income:		
Investment tax credit refunds (expense)	-	(515)
Interest income	2,932	8,325
	2,932	7,810
Loss and comprehensive loss	(549,272)	(979,089)
Accumulated deficit, beginning of the period	(11,743,308)	(8,182,998)
Accumulated deficit, end of the period	$ (12,292,580)	$ (9,162,087)
Basic and diluted loss per common share	$ (0.01)	$ (0.02)
Weighted average number of common shares outstanding	49,838,093	46,720,214

See accompanying notes to financial statements

CRITICAL OUTCOME TECHNOLOGIES INC.

Statements of Cash Flows

(All amounts unaudited)

For the three months ended	July 31, 2010	July 31, 2009
Cash provided by (used in):		
Operating activities:		
Loss	$ (549,272)	$ (979,089)
Items not involving cash:		
Amortization	123,481	132,868
Stock-based compensation (recovery) expense	(69,318)	33,602
Loss on disposal of equipment	-	40
Unrealized foreign exchange (gain) loss	(1,208)	1,599
Change in non-cash operating working capital (note 7)	(75,931)	76,719
	(572,248)	(734,261)
Investing activities:		
Net short-term investment redemptions	-	932,966
Equipment purchases	-	(5,038)
Proceeds on disposal of equipment	-	792
Expenditures on intangible assets	(8,232)	(48,921)
	(8,232)	879,799
Financing activities:		
Issuance of share capital and warrants (net of issuance costs)	35,444	-
Decrease in capital lease obligations	-	(1,263)
Payments to shareholders	-	(406)
	35,444	(1,669)
Increase (decrease) in cash and cash equivalents	(545,036)	143,869
Less: unrealized foreign exchange (gain) loss on cash and cash equivalents	(929)	2,645
Cash and cash equivalents, beginning of the period	1,945,376	602,613
Cash and cash equivalents, end of the period	$ 1,401,269	$ 743,837
Represented by:		
Cash	$ 106,190	$ 184,171
Cash equivalents	1,295,079	559,666
	$ 1,401,269	$ 743,837
Supplemental cash flow information:		
Interest paid	$ -	$ 1,120

See accompanying notes to financial statements

Description of business:

Critical Outcome Technologies Inc. (“COTI” or the “Company”) is a biotechnology company focused on applying its proprietary computer-based technology, CHEMSAS®, to identify, profile and optimize commercially viable drug candidates at the earliest stage of preclinical drug development and thereby dramatically reduce the timeline and cost of getting new drug therapies to market.

Using CHEMSAS®, the Company has created a pipeline of optimized, novel, proprietary, small molecules for specific therapy targets with high morbidity and mortality rates, which currently have either poor or no effective therapies. The Company is developing these molecules in the preclinical testing stage while it seeks to sell or license them to interested pharmaceutical partners for human trials and further drug development. The molecules in various stages of development are targeted at various cancers, HIV, multiple sclerosis and Alzheimer’s disease. The Company has also initiated a collaboration strategy to use its technology with pharmaceutical partners who have their own therapy targets, which can benefit from the Company’s drug discovery technology in creating lead compounds for their targets of interest.

1. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles for the preparation of interim financial statements. This results in certain information and disclosures normally included in the notes to the annual audited financial statements being condensed or not presented in these financial statements. These interim financial statements should be read in conjunction with the Company’s most recent audited annual financial statements of April 30, 2010 and related notes.

The interim financial statements follow the same accounting policies and methods of application as the most recent annual financial statements.

Basis of presentation:

Financial statements are required to be prepared on a going concern basis unless management either intends to liquidate the Company or cease trading or has no realistic alternative but to do so within the foreseeable future. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of operations.

The accompanying financial statements have been prepared on a going concern basis. There are material uncertainties related to certain conditions and events that raise significant doubts about the validity of this assumption. In particular, the Company has not yet established commercial operating revenues and operational cash flows continue to be negative. Key financial results for the periods ended July 31, 2010 and 2009 are indicative of possible concern. These results include: a loss of $549,272 (July 31, 2009 - $979,089), negative cash flow from operations of $572,248 (July 31, 2009 - $734,261), an accumulated deficit of $12,292,580 (April 30, 2010 - $11,743,308) and shareholders'

equity of $3,906,939 (April 30, 2010 - $4,490,085). As at July 31, 2010, the Company had working capital of $1,237,181 (April 30, 2010 - $1,705,078).

Financing for the Company's operations for the balance of fiscal 2011 is available from cash generated through prior equity raises and is currently sufficient to meet spending plans to the end of fiscal 2011. Management is taking steps to address the going concern risk by: actively seeking potential customers, partners and collaborators as a means of furthering molecule development and generating revenue streams; pursuing alternative sources of financing, including but not limited to, raising capital in the public market and securing government grants; managing liquidity though the reduction or delay of discretionary and other expenditures that are not immediate in nature; and focusing research and development activities on advancing its lead compound, COTI-2, toward a licensing agreement. There is no guarantee that any of the aforementioned strategies will enable the Company to remain a going concern over the next twelve months.

These financial statements do not include any adjustments to the amounts and classifications of assets and liabilities, or the reported revenues and expense that might be necessary should the Company be unable to continue as a going concern. Any adjustments to the financial statements could be material.

2. Intangible assets:

	July 31, 2010			April 30, 2010		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Molecules	$ 3,111,169	$ 1,037,056	$ 2,074,113	$ 3,111,169	$ 939,832	$ 2,171,337
Patents	493,031	26,469	466,562	484,896	23,438	461,458
Computer software	85,198	38,705	46,493	85,198	20,689	64,509
Trademark	7,714	4,770	2,944	7,616	4,733	2,883
	$ 3,697,112	$ 1,107,000	$ 2,590,112	$ 3,688,879	$ 988,692	$ 2,700,187

Amortization expense includes the following amounts related to intangible assets:

	July 31, 2010	July 31, 2009
Molecules	$ 97,224	$ 97,224
Patents	3,030	1,623
Computer software	18,016	21,800
Trademark	37	37
	$ 118,307	$ 120,684

3. Share capital and warrants:

		July 31, 2010		April 30, 2010	
	Expiry date	Issued	Amount	Issued	Amount
Share Capital:					
Authorized:					
Unlimited common shares					
Unlimited preference shares					
Issued:					
Common shares		49,871,215	$ 13,616,285	49,758,355	$13,587,267
Share purchase warrants:					
$0.55 warrants	October 27/11	1,519,070	208,471	1,519,070	208,471
$0.40 agent warrants	October 27/11	105,607	16,462	105,607	16,462
$0.55 warrants	November 27/11	56,430	6,339	-	-
$0.40 agent warrants	November 27/11	643	87	-	-
		1,681,750	231,359	1,624,677	224,933
			$ 13,847,644		$ 13,812,200

	Shares	Amount
Balance April 30, 2009	46,720,214	$ 12,810,518
Expiry of $0.70 warrants	-	2,607
Shares issued on private placement, net of issuance costs	3,038,141	774,142
	3,038,141	776,749
Balance April 30, 2010	49,758,355	13,587,267
Shares issued on private placement, net of issuance costs	112,860	29,018
Balance July 31, 2010	49,871,215	$ 13,616,285

On May 28, 2010, the Company completed the second and final tranche of a non-brokered private placement and issued 112,860 units for gross proceeds of $39,501. 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 $0.55 until November 27, 2011. Cash costs of the private placement included $3,832 in professional fees and $225 in commissions to agents. In addition, 643 agent warrants exercisable into one additional common share at a price of $0.40 until November 27, 2011 were issued.

The aggregate warrants were allocated $6,426 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 the assumption estimates as follows:

Risk free interest rate	1.48%
Expected dividend yield	-
Expected share volatility	116%
Expected average warrant life in years	1.5

4. Stock-based compensation:

On June 16, 2010, the Company announced the resignation of its Chief Executive Officer (CEO) effective the close of business on June 30, 2010. Upon his appointment in October 2008, the CEO was issued stock-based compensation which vested over a period of time ending in October 2011. Under the terms of the Company's stock option plan, 300,000 of the options previously granted will not vest as a result of the resignation and consequently stock-based compensation expense of $110,509 previously recorded for these options has been recovered against stock-based compensation incurred in fiscal 2011.

For the period ended July 31, 2010, the Company recorded a stock-based compensation recovery of $69,318 (July 31, 2009 - $33,602 expense) related to grants in the current and prior period and on the cancellation of unvested options. Total stock-based compensation expense of $2,130,848 (July 31, 2009 - $1,663,036) has been recorded since inception.

At July 31, 2010, 1,803,758 options (April 30, 2009 – 1,492,472) are available for grant under the stock option plan.

Changes in the number of options outstanding, with their weighted average exercise prices are summarized below:

	July 31, 2010		April 30, 2010	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Opening balance	3,483,364	$ 0.71	2,796,467	$ 0.79
Granted	-	-	1,341,255	0.53
Cancelled or expired	(300,000)	0.50	(654,358)	0.66
Ending balance	3,183,364	$ 0.73	3,483,364	$ 0.71

Details of the outstanding stock options at July 31, 2010 are summarized below:

Range of Exercise Prices	Weighted average exercise price of outstanding options	Weighted average exercise price of vested options	Options granted and outstanding at July 31/10	Vested	Unvested	Weighted average remaining contractual life in years	Total stock based compensation value	Weighted average option value
$0.01 - $0.50	$ 0.49	$ 0.49	1,083,847	1,083,847	-	4.09	$ 467,901	$ 0.432
$0.51 - $1.00	0.73	0.75	1,749,517	1,499,517	250,000	2.58	899,993	0.514
$1.01 - $1.50	1.29	1.30	250,000	233,330	16,670	2.17	279,400	1.118
$1.51 - $2.00	2.00	2.00	100,000	100,000	-	2.19	176,700	1.767
	$ 0.73	$ 0.74	3,183,364	2,916,694	266,670	3.05	$ 1,823,994	$ 0.573
Stock-based compensation expected to vest in future periods is summarized below:								
2011							$ 31,910	

The following table summarizes the change in contributed surplus for the period ended July 31, 2010 and the year ended April 30, 2010:

	July 31, 2010	April 30, 2010
Opening balance	$ 2,421,193	$ 1,850,461
Stock-based compensation (recovery) expense	(69,318)	570,732
Ending balance	$ 2,351,875	$ 2,421,193

5. 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:

	July 31, 2010	April 30, 2010
Loss before income taxes	$ (549,272)	$ (3,560,310)
Statutory rate	30.08%	32.33%
Expected income tax recovery	(165,000)	(1,151,000)
Amounts not deductible for tax	(19,000)	198,000
Share issuance costs deductible for tax	(18,000)	(82,000)
Change in future income tax rates	25,000	413,000
Change in valuation allowance	147,000	523,000
Tax credits realized	13,000	80,000
Other	17,000	19,000
Income tax expense	$ -	$ -

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities are presented below:

	July 31, 2010	April 30, 2010
Losses carried forward	$ 1,823,000	$ 1,712,000
Total research expenditures deferred for tax purposes	613,000	592,000
Financing expenses	91,000	107,000
Equipment	3,000	3,000
Other	75,000	74,000
Future tax assets	2,605,000	2,488,000
Less future tax liabilities related to:		
Intangible assets	(523,000)	(553,000)
Net future tax assets	2,082,000	1,935,000
Less valuation allowance	(2,082,000)	(1,935,000)
	$ -	$ -

The Company has non-capital losses of approximately $7,290,000 and research and development expenditures of $2,798,000, which may be applied to reduce taxable income of future years expiring as follows:

2013	$ 36,000
2014	186,000
2025	178,000
2026	463,000
2027	580,000
2028	1,297,000
2029	2,037,000
2030	2,075,000
2031	438,000
Total non-capital losses	$ 7,290,000
Total research and development expenditures, no expiry	$ 2,798,000

6. Financial instruments:

The details of financial instruments and their designation are set out below:

As at July 31, 2010	Held for trading	Loans and receivables	Other financial liabilities	Total carrying value	Non financial instruments	Balance sheet carrying value
Cash and cash equivalents	$1,401,269	$ -	$ -	$1,401,269	$ -	$ 1,401,269
Miscellaneous receivables	-	7,454	-	7,454	3,522	10,976
Accounts payable and accrued liabilities	-	-	(226,584)	(226,584)	(20,081)	(246,665)
Due to shareholders	-	-	(1,069)	(1,069)	-	(1,069)
	$1,401,269	$ 7,454	$ (227,653)	$1,181,070	$ (16,559)	$ 1,164,511

Fair value estimates are made as of a specific point in time using available information about the financial instrument. The fair value of cash is measured at Level 1 of the fair value hierarchy as quoted market prices are readily available while cash equivalents are measured at Level 2 as quoted prices are not readily available on a public market but must be obtained in the secondary market. The Company has determined that the carrying value of its remaining financial assets and liabilities approximates their fair value because of the relatively short periods to maturity of these instruments and their capacity for prompt liquidation.

(a) 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 credit risk. There have been no material changes to the Company's credit risk exposure or processes related to this risk during the period.

The Company's maximum exposure to credit risk is quantified by the carrying value of the following financial assets, and the aging thereon as detailed below:

As at July 31, 2010	Total	Current	31 - 60 days	61 - 90 days	Over 90 days
Trade receivables	$ -	$ -	$ -	$ -	$ -
Miscellaneous receivables	7,454	7,454	-	-	-
	$ 7,454	$ 7,454	$ -	$ -	$ -

The Company's receivables are deemed to be of high credit quality and consequently, it does not require collateral to secure its receivables.

(b) Liquidity risk:

Liquidity risk relates to potential difficulty in raising funds to meet commitments associated with financial instruments. Based upon the high credit ratings associated with its financial assets and the Company's spending plans, the Company is of the view that it will have sufficient cash available to meet its financial obligations during the 2011 fiscal year. Additional funding for operations is being pursued by the Company to improve cash flow and maintain liquidity for future periods (note 1(a)). There have been no changes to the Company's processes related to liquidity risk during the period.

The contractual maturities of the Company's financial assets (other than receivables), on an undiscounted cash flow basis, are as follows:

		Days to Maturity			
As at July 31, 2010	Total	0 - 90	91 - 180	181 - 270	Over 270
Cash and cash equivalents	$1,401,269	$1,401,269	$ -	$ -	$ -

At July 31, 2010 and April 30, 2010, all of the excess cash of the Company was invested in instruments with a maturity of three months or less. Instruments available with maturities greater than three months offered returns that were inadequate to compensate the Company for the longer maturity term.

The contractual maturities of the Company's financial liabilities, on an undiscounted cash flow basis, are as follows:

		Days to Maturity			
As at July 31, 2010	Total	0 - 90	91 - 180	181 - 270	Over 270
Trade payables	$ 103,663	$ 103,663	$ -	$ -	$ -
Accrued liabilities	122,921	107,921	-	-	15,000
Due to shareholders	1,069	1,069	-	-	-
	$ 227,653	$ 212,653	$ -	$ -	$ 15,000

Given the nature of the Company's financial liabilities, there is limited risk that that future settlement amounts will differ from the current carrying values. The Company has determined that it has sufficient working capital to manage its maturing financial liabilities as they come due.

(c) Market risk:

(i) Foreign currency risk:

The Company has contracts denominated in United States dollars (USD) and Euros (EURO) and is exposed to risk with respect to fluctuations in exchange rates between Canadian dollars, USD and EURO. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. As a result, variations in foreign exchange rates could cause fluctuations in the Company's operating results and cash flows. The Company's foreign currency risk exposure during the period was consistent with the foreign currency risk exposure during the year ended April 30, 2010. The amount of this exposure is not material to the financial statements.

(ii) Interest rate risk:

Interest rate risk arises from fluctuations in the interest rates applied to financial assets and liabilities. The financial asset exposure to interest rate risk is concentrated in cash equivalents as the interest rate obtained upon renewal will fluctuate with market pricing. The Company regularly monitors the rates available as the instruments mature, with the selection of investments restricted to those with high credit ratings, in accordance with the Company's investment policy. There is no financial liability exposure to interest rate risk. The Company's interest rate risk exposure has remained consistent during the period. The amount of interest rate risk exposure is not considered material to the financial statements.

7. Change in non-cash operating working capital:

	July 31, 2010	July 31, 2009
Miscellaneous receivables	$ 18,780	$ 40,381
Prepaid expenses and deposits	2,285	(15,479)
Accounts payable and accrued liabilities	(96,996)	51,817
	$ (75,931)	$ 76,719

8. Government assistance:

For the period ended July 31, 2010, the Company recorded $2,693 for government assistance under a Youth Internship Program agreement with the National Research Council of Canada (July 31, 2009 – $5,769). Under the agreement that ended on May 31, 2010, the Company was eligible for reimbursement of 50% of the salary of a marketing analyst intern to a maximum of $30,000 with no liability for repayment. Government assistance received or accrued has been credited against sales and marketing expense.

On June 16, 2010, the Company received notice of a non-repayable financial contribution of up to $300,000 for the development of its Acute Myelogenous Leukemia project from the National Research Council of Canada Industrial Research Assistance Program. The project has an estimated total cost of $955,470 and is expected to last 16 months from commencement. The start date for the project was July 1, 2010. The Company recorded $5,132 in government assistance under this project during the period, which has been credited against research and product development expense.

9. Commitments:

(a) Research and development contracts:

The Company is committed to pay $242,681 in fiscal 2011 and $506,637 in fiscal 2012 for the completion of research and development contracts existing at the period end.

(b) Other commitments:

The Company is committed to pay $67,750 in the remainder of fiscal 2011 under the terms of consulting service agreements.

10. Comparative figures:

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

11. Future changes in accounting policies:

(a) International financial reporting standards (IFRS):

In February 2008, the AcSB confirmed that Canadian publicly accountable enterprises would be required to adopt IFRS for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparative financial statements for the prior fiscal year. For the Company, the change to reporting financial results under IFRS will be required for the interim and annual financial statement reporting periods of its fiscal year ending April 30, 2012. However, in order to provide comparative data for this reporting period the Company will need to capture its financial results under IFRS commencing with reporting for its April 30, 2011 year end.

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

In December 2008, the AcSB issued Section 1582, "Business Combinations", which replaced Section 1581, "Business Combinations", Section 1601, "Consolidated Financial Statements" which replaced Section 1600, "Consolidated Financial Statements", and amended Section 1602, "Non-controlling Interests". For the Company, these Sections will become effective for 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 so as 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.