# SERNOVA CORP.

## INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE THREE AND NINE MONTHS ENDED JULY 31, 2014

**(Expressed in Canadian Dollars)**
**(Unaudited)**

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These unaudited interim condensed consolidated financial statements of Sernova Corp. (the "Company") have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these interim financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

**SERNOVA CORP.**
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian dollars)
(Unaudited)
AS AT

| | Note | July 31, 2014 | October 31, 2013 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash | | $ 433,714 | $ 273,605 |
| Short-term investments | | 3,445,599 | 4,702,301 |
| Amounts receivable | 4 | 102,077 | 51,091 |
| Prepaid expenses | | 20,869 | 131,348 |
| **Total current assets** | | 4,002,259 | 5,158,345 |
| **Non-current assets** | | | |
| Equipment and furniture, net | 5 | 16,011 | 19,671 |
| Intangible assets, net | 6 | 647,546 | 1,065,755 |
| **Total non-current assets** | | 663,557 | 1,085,426 |
| **Total assets** | | $ 4,665,816 | $ 6,243,771 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | 7 | $ 223,786 | $ 225,148 |
| **Total current liabilities** | | 223,786 | 225,148 |
| **EQUITY** | | | |
| Common shares | 8 | 26,725,570 | 26,314,323 |
| Warrants | 8 | 923,863 | 929,973 |
| Contributed surplus | 8 | 2,908,044 | 2,821,895 |
| Deficit | | (26,115,447) | (24,047,568) |
| **Total equity** | | 4,442,030 | 6,018,623 |
| **Total liabilities and equity** | | $ 4,665,816 | $ 6,243,771 |

**Commitments and contingencies** (Note 11)

**Approved and authorized by the Board on September 26, 2014:**

*"Dr. George Adams"* Director
Dr. George Adams

*"Dr. Philip Toleikis"* Director
Dr. Philip Toleikis

See accompanying notes to the interim condensed consolidated financial statements.

**SERNOVA CORP.**
CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
(Expressed in Canadian dollars)
(Unaudited)

| | Note | Three Months Ended July 31, 2014 | Three Months Ended July 31, 2013 | Nine Months Ended July 31, 2014 | Nine Months Ended July 31, 2013 |
|---|---|---|---|---|---|
| **EXPENSES** | | | | | |
| Research and development | 10 | $ 546,570 | $ 309,494 | $ 1,413,451 | $ 1,140,871 |
| General and administrative | 10 | 209,579 | 87,760 | 692,888 | 369,443 |
| Total operating expenses | | 756,149 | 397,254 | 2,106,339 | 1,510,314 |
| **OTHER ITEMS** | | | | | |
| Finance income | | (11,578) | (17,401) | (40,957) | (46,515) |
| Finance costs | | 1,268 | 2,540 | 2,497 | 1,679 |
| Net finance income | | (10,310) | (14,861) | (38,460) | (44,836) |
| **Loss and comprehensive loss for the period** | | $ 745,839 | $ 382,393 | $ 2,067,879 | $ 1,465,478 |
| **Weighted average number of common shares** | | 130,911,058 | 126,171,136 | 130,109,159 | 122,129,011 |
| **Basic and diluted loss per common share** | | $ (0.01) | $ (0.01) | $ (0.02) | $ (0.01) |

See accompanying notes to the interim condensed consolidated financial statements.

**SERNOVA CORP.**
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian dollars)
(Unaudited)

| | Nine Months Ended July 31, 2014 | July 31, 2013 |
|---|---|---|
| **CASH PROVIDED BY (USED IN):** | | |
| **OPERATING ACTIVITIES** | | |
| Loss for the period | $ (2,067,879) | $ (1,465,478) |
| Non-cash items: | | |
| Depreciation of equipment and furniture | 3,660 | 1,486 |
| Patent licence and intellectual property amortization | 489,903 | 526,223 |
| Share-based compensation | 261,106 | 104,849 |
| Interest accrued on short-term investments | (11,578) | (38,335) |
| | (1,324,788) | (871,255) |
| Changes in non-cash working capital balances: | | |
| Amounts receivable | (50,986) | (47,408) |
| Prepaid expenses | 110,479 | (58,389) |
| Accounts payable and accrued liabilities | (1,362) | 953 |
| Total changes in non-cash working capital balances | 58,131 | (104,844) |
| Net cash used in operating activities | (1,266,657) | (976,099) |
| **INVESTING ACTIVITIES** | | |
| Short-term investments, net | 1,268,280 | (845,839) |
| Acquisition of equipment | -- | (734) |
| Acquisition of patent rights | (71,694) | (33,581) |
| Net cash provided by (used in) investing activities | 1,196,586 | (880,154) |
| **FINANCING ACTIVITIES** | | |
| Issue of common shares | -- | 1,750,000 |
| Issue of warrants | -- | 250,000 |
| Share issue costs | -- | (168,569) |
| Issue of common shares on exercise of warrants | 20,000 | -- |
| Issue of common shares on exercise of stock options | 210,180 | 2,400 |
| Net cash provided by financing activities | 230,180 | 1,833,831 |
| **Change in cash during the period** | 160,109 | (21,996) |
| **Cash, beginning of period** | 273,605 | 255,557 |
| **Cash, end of period** | $ 433,714 | $ 233,561 |
| **Supplemental disclosure with respect to cash flows:** | | |
| Finder's warrants issued | $ - | $ 60,240 |

See accompanying notes to the interim condensed consolidated financial statements.

**SERNOVA CORP.**
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in Canadian dollars)
(Unaudited)

| | Common Shares Number | (Note 8) Amount | Warrants Number | (Note 8) Amount | Contributed Surplus | Deficit | Total |
|---|---|---|---|---|---|---|---|
| **Balance, October 31, 2013** | 129,643,636 | $ 26,314,323 | 31,153,263 | $ 929,973 | $ 2,821,895 | $ (24,047,568) | $ 6,018,623 |
| **Loss and comprehensive loss for the period** | - | - | - | - | - | (2,067,879) | (2,067,879) |
| **Transactions with owners of the Company, recognized directly in equity** | | | | | | | |
| Exercise of warrants | 100,000 | 26,110 | (100,000) | (6,110) | - | - | 20,000 |
| Exercise of options | 1,634,195 | 385,137 | - | - | (174,957) | - | 210,180 |
| Share-based compensation (Note 8) | - | - | - | - | 261,106 | - | 261,106 |
| **Balance, July 31, 2014** | 131,377,831 | $ 26,725,570 | 31,053,263 | $ 923,863 | $ 2,908,044 | $ (26,115,447) | $ 4,442,030 |
| | | | | | | | |
| **Balance, October 31, 2012** | 119,623,636 | $ 24,761,758 | 29,161,942 | $ 648,281 | $ 2,703,297 | $ (22,044,647) | $ 6,068,689 |
| **Loss and comprehensive loss for the period** | - | - | - | - | - | (1,465,478) | (1,465,478) |
| **Transactions with owners of the Company, recognized directly in equity** | | | | | | | |
| Issue of units under private placement | 10,000,000 | 1,750,000 | 10,000,000 | 250,000 | - | - | 2,000,000 |
| Share issue costs | - | (199,835) | - | (28,548) | - | - | (228,383) |
| Finder's warrants issued | - | - | 985,931 | 60,240 | - | - | 60,240 |
| Warrants expired | - | - | (7,484,608) | - | - | - | - |
| Exercise of options | 20,000 | 2,400 | - | - | - | - | 2,400 |
| Share-based compensation (Note 8) | - | - | - | - | 104,849 | - | 104,849 |
| **Balance, July 31, 2013** | 129,643,636 | $ 26,314,323 | 32,663,265 | $ 929,973 | $ 2,808,146 | $ (23,510,125) | $ 6,542,317 |

See accompanying notes to the interim condensed consolidated financial statements.

## 1. NATURE AND CONTINUANCE OF OPERATIONS

Sernova Corp. (the "Company") was incorporated under the Company Act (British Columbia) on August 19, 1998. Effective May 29, 2001, the Company was continued under the Canada Business Corporations Act.

The Company's head office is located at 700 Collip Circle, Suite 114, London, Ontario, N6G 4X8. The Company's registered address is Suite 1500 – 1055 West Georgia Street, Vancouver, British Columbia, V6E 2N7.

In fiscal 2006, the Company acquired a sublicense to certain patent licences and intellectual property and a subsidiary, Sertonex Inc. ("Sertonex"), and became engaged in the research and development of a commercially-viable treatment for insulin-dependent human diabetes and other metabolic, blood and neurological diseases with therapeutic cells placed into implanted prevascularized medical devices and protected from immune system attack. The Company is focused on the manufacture and clinical evaluation of the Cell Pouch™ for insulin-dependent diabetes, and research and development of the Cell Pouch™ to treat other chronic diseases. As at the date of this report no products are in commercial production or use.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") assuming the Company will continue on a going-concern basis. The Company has incurred losses and negative operating cash flows since inception. The ability of the Company to continue as a going concern in the long-term depends upon its ability to develop profitable operations and to continue to raise adequate financing. Management is actively targeting sources of additional financing which would assure continuation of the operations and research programs. Management believes that the Company has sufficient working capital to maintain its operations for at least the next twelve months.

## 2. BASIS OF PRESENTATION

### (a) Statement of compliance

These interim condensed consolidated financial statements have been prepared in compliance with International Accounting Standard 34 ("IAS 34") Interim Financial Reporting. The notes presented in these condensed consolidated interim financial statements include only significant events and transactions occurring since our last fiscal year end and are not fully inclusive of all matters required to be disclosed in our annual audited consolidated financial statements.

The policies applied in these condensed consolidated interim financial statements are based on International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). The Board of Directors approved the interim condensed consolidated financial statements on September 26, 2014. Any subsequent changes to IFRS or their interpretation, that are given effect in the Company's annual consolidated financial statements for the year ended October 31, 2014, could result in a restatement of these unaudited interim condensed consolidated financial statements.

## 2. BASIS OF PRESENTATION (CONT'D)

### (b) Basis of measurement

These interim condensed consolidated financial statements have been prepared on the historical cost basis, except for held-for-trading financial assets which are measured at fair value. These consolidated financial statements include the accounts of Sernova Corp., Sertocell Biotechnology (US) Inc. ("Sertocell") and Sertonex, its wholly-owned and controlled subsidiaries. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries, including entities which the Company controls, are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All significant intercompany transactions and balances have been eliminated.

### (c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

### (d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, revenue and expenses and the related disclosure of contingent assets and liabilities and the determination of the Company's ability to continue as a going concern. Actual results could differ materially from these estimates and assumptions. The Company reviews its estimates and underlying assumptions on an ongoing basis. Revisions are recognized in the period in which the estimates are revised and may impact future periods.

Management has applied significant estimates and assumptions to the measurement of share-based compensation and warrants, measurement of the period of use and potential impairment of intangible assets, as well as estimates of the future cash flows for assessing the support of the going concern uncertainty. Significant assumptions about the future and other sources of estimation uncertainty that management has made at the statement of financial position date that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions that have been made relate to the following key estimates:

i. Intangible assets – impairment

The application of the Company's accounting policy for intangible assets expenditures requires judgment in determining whether it is likely that future economic benefits will flow to the Company, which may be based on assumptions about future events or circumstances. Estimates and assumptions may change if new information becomes available. If, after expenditures are capitalized, information becomes available suggesting that the recovery of expenditures is unlikely, the amount capitalized is written off in profit or loss in the period the new information becomes available.

ii. Intangible assets – useful lives

Following initial recognition, the Company carries the value of intangible assets at cost less accumulated amortization and any accumulated impairment losses. Amortization is recorded on a straight-line basis based upon management's estimate of the useful life and residual value. The estimates are reviewed at least annually and are updated if expectations change as a result of technical obsolescence or legal and other limits to use. A change in the

## 2. BASIS OF PRESENTATION (CONT'D)

useful life or residual value will impact the reported carrying value of the intangible assets resulting in a change in related amortization expense.

iii. Share-based compensation

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payment transactions are discussed in Note 8.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The Company's principal accounting policies were outlined in the Company's annual audited consolidated financial statements for the year ended October 31, 2013 and have been applied consistently to all periods presented in these interim condensed consolidated financial statements. These statements should be read in conjunction with the annual audited consolidated financial statements for the year ended October 31, 2013.

**New standards and interpretations not yet effective**

IFRS 9, *Financial Instruments: Classification and Measurement*

IFRS 9 (2010) reflects the first phase of the IASB's work on the replacement of IAS 39, *Financial instruments: Recognition and Measurement* and deals with the classification and measurement of financial assets and financial liabilities. This standard establishes two primary measurement categories for financial assets, amortized cost and fair value, and eliminates the existing categories of held to maturity, available for sale, and loans and receivables. The new classification will depend on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard effective date is unknown due to postponement. The Company does not expect IFRS 9 (2010) to have a material impact on the financial statements. The classification and measurement of the Company's financial assets is not expected to change under IFRS 9 (2010) because of the nature of the Company's operations and the types of financial assets that it holds.

IFRS 10, *Consolidated Financial Statements*

This amendment provides a single model to be applied in the control analysis for all investees. The amendments issued in June 2012 simplify the process of adopting IFRS 10 and provide additional relief from certain disclosures. The standard is effective for annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of the standard on the consolidated financial statements.

IFRS 12, *Disclosure of involvement with Other Entities*

IFRS 12 includes all of the disclosures that were previously in IAS 27, *Consolidated and Separate Financial Statements* related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31, *Investment in Associates.* These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. The standard is effective for annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of the standard on the consolidated financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

**New standards and interpretations not yet effective (cont'd)**

IFRS 13, *Fair Value Measurement*

In May 2011, the IASB published IFRS 13 *Fair Value Measurement*, which is effective prospectively for annual periods beginning on or after January 1, 2013. The disclosure requirements of IFRS 13 need not be applied in comparative information for periods before initial application. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. The Company adopted IFRS 13 prospectively in its financial statements for the annual period beginning on November 1, 2013. The Company does not expect IFRS 13 to have a material impact on the financial statements.

Annual Improvements to IFRS (2010 – 2012) and (2011-2013) cycles

In December 2013, the IASB issued narrow-scope amendments to a number of standards as part of its annual improvements process. The IASB uses the annual improvements process to make non-urgent but necessary amendments to IFRS. Amendments were made to clarify the following in their respective standards:

IFRS version that a first-time adopter can apply in IFRS 1 *First-time Adoption of International Financial Reporting Standards*;

Definition of "vesting condition" in IFRS 2 *Share-based payment*;

Classification and measurement of contingent consideration; and scope exclusion for the formation of joint arrangements in IFRS 3 *Business Combinations*;

Disclosures on the aggregation of operating segments in IFRS 8 *Operating segments*;

Measurement of short-term receivables and payables; and scope of portfolio exception in IFRS 13 *Fair Value Measurement*;

Restatement of accumulated depreciation (amortization) on revaluation in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*;

Definition of "related party" in IAS 24 *Related Party Disclosures*; and

Inter-relationship of IFRS 3 and IAS 40 in IAS 40 *Investment Property*.

Special transitional requirements have been set for amendments to IFRS 2, IAS 16, IAS 38 and IAS 40.

(Expressed in Canadian dollars)

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

**New standards and interpretations not yet effective (cont'd)**

Most amendments will apply prospectively for annual periods beginning on or after July 1, 2014; earlier application is permitted, in which case, the related consequential amendments to other IFRSs would also apply. The Company intends to adopt these amendments in its financial statements for the annual period beginning on November 1, 2014. The extent of the impact of adoption of the amendments has not yet been determined.

## 4. AMOUNTS RECEIVABLE

| | April 30, 2014 | October 31, 2013 |
|---|---|---|
| Government programs receivable | $ 72,900 | $ 29,537 |
| Sales tax credit receivable | 29,177 | 21,554 |
| | $ 102,077 | $ 51,091 |

The Company is eligible for both federal and provincial investment tax credits on its qualifying research activities. Federal investment tax credits are not refundable but can be used to reduce income taxes otherwise payable. Provincial investment tax credits are refundable and these amounts are recorded as an asset in the period in which there is reasonable assurance that such amounts will be received with a corresponding credit to research and development expense. The amounts are subject to a government tax audit and the final amounts received may differ from those recorded. There are no unfulfilled conditions or contingencies associated with the government assistance received.

On March 25, 2013, the Company was awarded a third non-repayable financial contribution of up to $254,300 from the National Research Council of Canada Industrial Research Assistance Program, along with technical and business orientated advisory services, for the optimization of its Sertolin™ technology within its Cell Pouch™ for the treatment of chronic disease. The Company will be reimbursed for 80% of designated salary costs to a maximum of $184,300, and 50% of contractor fees to a maximum of $70,000. To the end of July 31, 2014, the Company had claimed $254,300 of the grant receivable, leaving the balance of $nil to be claimed between August 1, 2014 and October 31, 2014.

(Expressed in Canadian dollars)

## 5. EQUIPMENT AND FURNITURE

| | Computer Equipment | Office Furniture | Laboratory Equipment | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance, October 31, 2012 | $ 16,758 | $ - | $ - | $ 16,758 |
| Additions | 3,565 | 735 | 12,579 | 16,879 |
| Balance, October 31, 2013 and July 31, 2014 | $ 20,323 | $ 735 | $ 12,579 | $ 33,637 |
| **Accumulated depreciation** | | | | |
| Balance, October 31, 2012 | $ 11,206 | $ - | $ - | $ 11,206 |
| Depreciation for the year | 2,020 | 111 | 629 | 2,760 |
| Balance, October 31, 2013 | 13,226 | 111 | 629 | 13,966 |
| Depreciation for the period | 1,773 | 93 | 1,794 | 3,660 |
| Balance, July 31, 2014 | $ 14,999 | $ 204 | $ 2,423 | $ 17,626 |
| **Net carrying amounts** | | | | |
| October 31, 2013 | $ 7,097 | $ 624 | $ 11,950 | $ 19,671 |
| July 31, 2014 | $ 5,324 | $ 531 | $ 10,156 | $ 16,011 |

## 6. INTANGIBLE ASSETS

| | Patent Licenses | Intellectual Property | Total |
|---|---|---|---|
| **Cost** | | | |
| Balance, October 31, 2012 | $ 4,490,326 | $ 2,191,856 | $ 6,682,182 |
| Additions | 35,680 | - | 35,680 |
| Balance, October 31, 2013 | 4,526,006 | 2,191,856 | 6,717,862 |
| Additions | 71,694 | - | 71,694 |
| Balance, July 31, 2014 | $ 4,597,700 | $ 2,191,856 | $ 6,789,556 |
| **Accumulated amortization** | | | |
| Balance, October 31, 2012 | $ 3,300,394 | $ 1,641,210 | $ 4,941,604 |
| Amortization for the year | 490,245 | 220,258 | 710,503 |
| Balance, October 31, 2013 | 3,790,639 | 1,861,468 | 5,652,107 |
| Amortization for the period | 324,708 | 165,195 | 489,903 |
| Balance, July 31, 2014 | $ 4,115,347 | $ 2,026,663 | $ 6,142,010 |
| **Net carrying amounts** | | | |
| October 31, 2013 | $ 735,367 | $ 330,388 | $ 1,065,755 |
| July 31, 2014 | $ 482,353 | $ 165,193 | $ 647,546 |

(Expressed in Canadian dollars)

## 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | July 31, 2014 | October 31, 2013 |
|---|---|---|
| Accounts payable | $ 62,301 | $ 110,952 |
| Accrued liabilities | 161,485 | 114,196 |
| | $ 223,786 | $ 225,148 |

## 8. COMMON SHARES, WARRANTS AND CONTRIBUTED SURPLUS

**Authorized**

Unlimited number of common shares, without par value.

**Summary of Financings – nine months ended July 31, 2014 and 2013**

For the nine months ended July 31, 2014, 1,634,195 stock options were exercised for gross proceeds of $210,180 and 100,000 warrants were exercised for gross proceeds of $20,000.

On February 19, 2013 the Company completed a non-brokered private placement in the amount of $2.0 million. The offering consisted of 10 million units sold at a price of $0.20 per unit. Each unit consists of one common share and one common share purchase warrant, with each warrant entitling the holder thereto to purchase one common share of the Company for a period of 36 months from closing of the offering at a price of $0.35 per share for the first 24 months and at a price of $0.40 per share for the last 12 months. The warrants were ascribed a value of $250,000 representing the difference between the issue price of the unit and the fair market value of the shares at the time received as part of the offering.

Costs associated with the private placement totaled $228,383 including a finder's commission of $140,000 and the issue of 985,931 finder's warrants valued at $60,240, which costs have been deducted from the gross proceeds.

**Performance escrow shares**

Included in issued common shares and representing escrow shares as at July 31, 2014 are 3,472,500 (October 31, 2013 – 3,472,500) common shares which will not be released, transferred or assigned without the consent of the regulatory authorities, and which shares are subject to performance-based release terms as follows:

a) 1,736,250 common shares on the date the Company receives approval from authorities for the initiation of human trials for a licensed product involving Sertolin™;
b) 1,736,250 common shares on the date the Company enrolls the first patient in a Phase 3 human clinical efficacy trial for a licensed product involving Sertolin™.

Any remaining performance-based escrow shares will be cancelled and returned to treasury upon the earlier of (i) August 2016, and (ii) the Company ceasing to hold an interest in the intellectual property, or iii) the mutual agreement of the Company and the shareholders.

(Expressed in Canadian dollars)

## 8. COMMON SHARES, WARRANTS AND CONTRIBUTED SURPLUS (CONT'D)

### Warrants

The following table summarizes warrants outstanding as at July 31, 2014:

| | Number of Warrants | Exercise Price | Expiry Date |
|---|---|---|---|
| **Warrants** | | | |
| | 19,395,110 | $0.35 | February 28, 2015 |
| | 772,222 | $0.35 | March 30, 2015 |
| | 885,931 | $0.20 | February 19, 2015 |
| | 10,000,000 | $0.35 | February 19, 2015 |
| | | then at $0.40 | February 19, 2016 |
| | 31,053,263 | | |

All warrants are exercisable on issuance. Changes in the number of warrants outstanding for the nine months ended July 31 were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Number of Warrants | Weighted Average Exercise Price | Number of Warrants | Weighted Average Exercise Price |
| Balance outstanding, beginning of period | 31,153,263 | $0.35 | 29,161,942 | $ 0.23 |
| Issued | -- | -- | 10,985,931 | $ 0.34 |
| Warrants – re-pricing | -- | -- | (20,167,332) | $ 0.20 |
| Warrants – re-pricing | -- | -- | 20,167,332 | $ 0.35 |
| Exercised | (100,000) | $0.20 | -- | -- |
| Expired | -- | -- | (7,484,608) | $0.30 |
| Balance outstanding, end of period | 31,053,263 | $0.35 | 32,663,265 | $0.34 |

During the nine months ended July 31, 2013, the Company issued 10,000,000 common share purchase warrants with an ascribed value of $250,000. In addition, during the nine months ended July 31, 2013, the Company issued 985,931 non-transferable finder's warrants. Each finder's warrant entitles the holder to purchase one common share of the Company at a price of $0.20 for a period of 24 months from the date of issuance.

In the same period 7,484,608 warrants expired unexercised. Subsequent to July 31, 2013, an additional 1,510,002 warrants expired unexercised.

(Expressed in Canadian dollars)

## 8. COMMON SHARES, WARRANTS AND CONTRIBUTED SURPLUS (CONT'D)

The fair value of the finder's warrants was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

| Nine months ended July 31 | 2014 | 2013 |
|---|---|---|
| Dividend yield | n/a | 0% |
| Expected volatility | n/a | 83% |
| Risk free interest rate | n/a | 1.2% |
| Expected life of options | n/a | 2.0 years |

### Incentive stock option plan

The Company has adopted an Incentive Stock Option Plan (the "Plan") pursuant to which the Board of Directors may grant stock options to directors, officers, employees or consultants of the Company. The current terms of the Plan, approved by the Company shareholders on April 26, 2013, provides that the maximum number of common shares available for issuance under the plan does not exceed 10% of the Company's issued and outstanding shares at any time. The vesting schedule of all granted options is determined at the discretion of the Board.

As at July 31, 2014 there were 8,213,750 options outstanding, representing 6.3% of the Company's issued and outstanding common shares (October 31, 2013 – 7,675,445 options outstanding representing 5.8%).

The following table summarizes options outstanding as at July 31, 2014:

| | Number of Options | Exercise Price | Expiry Date |
|---|---|---|---|
| **Options** | 225,000 | 0.17 | January 27, 2015 |
| | 295,000 | 0.12 | September 5, 2015[(2)] |
| | 160,000 | 0.15 | September 11, 2015 |
| | 250,000 | 0.20 | October 28, 2015 |
| | 1,373,750 | 0.15 | October 28, 2015 |
| | 300,000 | 0.15 | November 7, 2015 |
| | 835,000 | 0.18 | March 6, 2017 |
| | 2,015,000 | 0.18 | April 18, 2017 |
| | 500,000 | 0.18 | April 19, 2017 |
| | 2,110,000 | 0.15 | January 27, 2019 |
| | 150,000 | 0.15 | February 11, 2019 |
| | 8,213,750 | | |

(Expressed in Canadian dollars)

## 8. COMMON SHARES, WARRANTS AND CONTRIBUTED SURPLUS (CONT'D)

**Incentive stock option plan** (cont'd)

Changes in the number of options outstanding during the nine months ended July 31 were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Balance outstanding, beginning of period | 7,675,445 | $0.16 | 8,001,376 | $0.16 |
| Granted | 3,360,000 | $0.15 | - | - |
| Expired | (143,250) | $0.14 | (130,000) | $0.30 |
| Cancelled | (1,044,250) | $0.15 | (285,931) | $0.18 |
| Exercised | (1,634,195) | $0.13 | (20,000) | $0.12 |
| Balance outstanding, end of period | 8,213,750 | $0.16 | 7,565,445 | $0.16 |
| Options exercisable, end of period | 6,153,092 | $0.16 | 6,845,091 | $0.15 |

During the nine months ended July 31, 2014, the Company granted 3,360,000 stock options to directors, officers, employees and consultants at an exercise price of $0.15 per share with expiry dates ranging from November 2015 to February 2019. The weighted average grant-date fair value of the stock options granted during the nine months ended July 31, 2014 was $0.12. No options were granted in the nine months ended July 31, 2013.

The Black-Scholes model used by the Company to calculate option values was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differs from the Company's stock options awards. This model also requires highly subjective assumptions, including future stock price volatility, average option life and forfeiture rates which greatly impact the calculated values.

The risk-free interest rate is based on the implicit yield on a Canadian Government zero-coupon issued with a remaining term equal to the expected term of the option. The volatility is based solely on historical volatility equal to the expected life of the option. The life of the option is estimated considering the vesting period at the grant date, the life of the option and the average length of time similar grants have remained outstanding in the past. The forfeiture rate has been assigned a zero rate and is an estimate based on history of the Company stock options. The dividend yield has been assigned a zero value since it is the present policy of the Company to retain all earnings to finance operations and future growth.

The share-based compensation expense was determined based on the fair value of all options at the date of measurement using the Black- Scholes option pricing model with the following weighted-average assumptions:

| Nine months ended July 31 | 2014 | 2013 |
|---|---|---|
| Dividend yield | 0% | n/a |
| Expected volatility | 143% | n/a |
| Risk free interest rate | 1.7% | n/a |
| Expected life of options | 4.6 years | n/a |

(Expressed in Canadian dollars)

## 8. COMMON SHARES, WARRANTS AND CONTRIBUTED SURPLUS (CONT'D)

**Incentive stock option plan** (cont'd)

The expense recognized for employee services received during the three and nine months ended July 31, 2014, which is included in the interim condensed consolidated statement of loss and comprehensive loss was $91,440 and $261,106 respectively (2013- $14,687 and $104,849). The weighted average remaining contractual life for the stock options outstanding as at July 31, 2014 was 2.1 years (2013 – 2.6 years). The range of exercise prices for the options outstanding as at July 31, 2014 was $0.12 to $0.20 (2013 - $0.10 to $0.20).

During the nine months ended July 31, 2014, 1,634,195 stock options were exercised at an average price of $0.13 per share for gross proceeds of $210,180. During the nine months ended July 31, 2013, 20,000 stock options were exercised at an average price of $0.12 per share for gross proceeds of $2,400.

## 9. RELATED PARTY TRANSACTIONS

The key management personnel of the Company are the Directors, Chief Executive Officer and President and the Chief Financial Officer.

Amounts due to related parties, including amounts due to key management personnel, at the period-end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. There are no amounts due to or due from related parties as at July 31, 2014 and October 31, 2013.

Compensation for key management personnel of the Company and the Directors for the three and nine months ended July 31 was as follows:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | July 31, 2014 | July 31, 2013 | July 31, 2014 | July 31, 2013 |
| Salaries, benefits and consulting fees | $ 95,596 | $ 176,844 | $ 305,215 | $ 496,085 |
| Director fees and expenses | 29,725 | - | 69,258 | - |
| Share-based compensation | 60,907 | 14,687 | 174,428 | 92,383 |
| Total expense | $ 186,228 | $ 191,531 | $ 548,901 | $ 588,468 |

Key management personnel, including the directors, control 3.0% of the issued common shares of the Company as at July 31, 2014.

During the three and nine months ended July 31, 2014 the Company paid $13,750 and $34,809, respectively (2013- $20,625 and $41,250 respectively) in consulting fees for the services of a chief financial officer.

(Expressed in Canadian dollars)

## 10. STATEMENT OF LOSS AND COMPREHENSIVE LOSS SUPPLEMENTARY INFORMATION

Components of the research and development expenses for the three and nine months ended July 31 were as follows:

| | Three months ended July 31, 2014 | Three months ended July 31, 2013 | Nine months ended July 31, 2014 | Nine months ended July 31, 2013 |
|---|---|---|---|---|
| Salaries, supplies and contract payments | $ 358,193 | $ 237,286 | $ 852,832 | $ 647,174 |
| Patent fees and costs | 35,168 | 40,411 | 130,177 | 125,227 |
| Depreciation of equipment and furniture | 1,189 | 734 | 3,567 | 1,337 |
| Amortization of intangible assets | 126,939 | 177,401 | 489,903 | 526,223 |
| Share-based compensation | 51,159 | 13,140 | 86,677 | 65,673 |
| Contributions and tax credits | (26,078) | (159,478) | (149,705) | (224,763) |
| Total expense | $ 546,570 | $ 309,494 | $ 1,413,451 | $ 1,140,871 |

Components of the general and administrative expenses for the three and nine months ended July 31 were as follows:

| | Three months ended July 31, 2014 | Three months ended July 31, 2013 | Nine months ended July 31, 2014 | Nine months ended July 31, 2013 |
|---|---|---|---|---|
| Consulting fees | $ 85,513 | $ 25,450 | $ 128,661 | $ 78,427 |
| Professional fees | 15,493 | 15,394 | 86,756 | 77,902 |
| Directors fees and expenses | 29,725 | - | 69,258 | - |
| Investor relations | 35,385 | 27,807 | 119,340 | 85,435 |
| Other costs | 3,151 | 17,480 | 114,351 | 88,354 |
| Depreciation of equipment and furniture | 31 | 82 | 93 | 149 |
| Share-based compensation | 40,281 | 1,547 | 174,429 | 39,176 |
| Total expense | $ 209,579 | $ 87,760 | $ 692,888 | $ 369,443 |

## 11. COMMITMENTS AND CONTINGENCIES

The Company is committed to the payment of certain costs related to its clinical trial. The study is a Phase I/II study with a primary endpoint of safety and a secondary endpoint of efficacy. The study is designed to allow for interim analyses at various points as sufficient data are collected. In this study patients will also be followed for a minimum of three years to assess longer-term safety and efficacy of the Cell Pouch™ with transplanted islets. The commitment under the agreement includes the cost of clinical staff and overhead thereon, trial insurance, and may include travel and a portion of drug-or procedure–related expenses or transplantation expenses not covered by insurance. The total commitment over the duration of the trial is expected to be approximately $2,000,000 but will be impacted by such factors as the rate of enrollment, the province in which the patient resides and the specifics of patient insurance.

The Company is committed to an estimated payment of approximately $80,000 USD in fees to maintain the patents in good standing for the year ending October 31, 2014. Similar payments will be required for subsequent years.

The Company has an annual commitment of $40,000 for the rental of laboratory space which is short-term in nature but essentially subject to an annual renewal.