

**TITAN MEDICAL INC.  
FINANCIAL STATEMENTS  
YEARS ENDED DECEMBER 31, 2012 AND 2011**



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## Independent Auditor's Report

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To the Shareholders of  
Titan Medical Inc.

We have audited the accompanying financial statements of Titan Medical Inc., which comprise the balance sheets as at December 31, 2012 and December 31, 2011 and the statements of shareholders' equity and deficit, operations and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Titan Medical Inc. as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) BDO Canada LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Ontario  
February 19, 2013

TITAN MEDICAL INC.  
Balance Sheets  
As at December 31, 2012, December 31, 2011

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	<b>December 31, <u>2012</u></b>	<b>December 31, <u>2011</u></b>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	\$4,617,016	\$9,738,822
Amounts receivable	70,188	275,470
Deposits (Note 7)	294,161	703,886
Prepaid expenses	<u>202,848</u>	<u>70,497</u>
Total Current Assets	5,184,213	10,788,675
Furniture and Equipment (Note 3)	335,398	366,785
Patent Rights (Notes 4)	<u>201,520</u>	<u>194,935</u>
	<b><u>\$5,721,131</u></b>	<b><u>\$11,350,395</u></b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	<u>\$1,098,658</u>	<u>\$2,007,265</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share Capital (Note 5(a))	26,682,137	24,492,101
Contributed Surplus	1,978,154	1,747,497
Warrants (Note 5 (b))	7,593,119	6,977,225
Deficit	<u>(31,630,937)</u>	<u>(23,873,693)</u>
Total Equity	<u>4,622,473</u>	<u>9,343,130</u>
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b><u>\$5,721,131</u></b>	<b><u>\$11,350,395</u></b>

Commitments (Note 7)  
See accompanying notes to financial statements

Approved on behalf of the Board:

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Craig Leon  
Director

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Martin Bernholtz  
Director

**TITAN MEDICAL INC.**  
**Statements of Shareholders' Equity and Deficit**  
**For the Years ended December 31, 2012 and December 31, 2011**

	Share Capital Number	Share Capital Amount	Contributed Surplus	Warrants	Deficit	Total Equity
<b>Balance - December 31, 2010</b>	<b>50,051,571</b>	<b>\$ 12,540,146</b>	<b>\$ 1,426,764</b>	<b>\$ 3,009,823</b>	<b>\$ (7,746,164)</b>	<b>\$ 9,230,569</b>
Issued pursuant to agency agreements	10,457,500	16,766,875				16,766,875
Share issue expense		(1,808,618)				(1,808,618)
Warrants issued during the year		(4,127,225)		4,127,225		-
Warrants exercised during the year	1,227,956	746,974		(159,823)		587,151
Options exercised during the year	578,310	373,949	(192,590)			181,359
Stock based compensation expense			513,323			513,323
Net and comprehensive loss for the year ended December 31, 2011					(16,127,529)	(16,127,529)
<b>Balance – December 31, 2011</b>	<b>62,315,337</b>	<b>\$ 24,492,101</b>	<b>\$ 1,747,497</b>	<b>\$ 6,977,225</b>	<b>\$ (23,873,693)</b>	<b>\$ 9,343,130</b>
Issued pursuant to agency agreement	1,986,755	3,000,000				3,000,000
Share issue expense		(444,968)				(444,968)
Warrants issued during the year		(615,894)		615,894		-
Options exercised during the year	442,800	250,898	(104,068)			146,830
Stock based compensation expense			334,725			334,725
Net and comprehensive loss for the year ended December 31, 2012					(7,757,244)	(7,757,244)
<b>Balance – December 31, 2012</b>	<b><u>64,744,892</u></b>	<b><u>\$ 26,682,137</u></b>	<b><u>\$ 1,978,154</u></b>	<b><u>\$ 7,593,119</u></b>	<b><u>\$ (31,630,937)</u></b>	<b><u>\$ 4,622,473</u></b>

See accompanying notes to financial statements

**TITAN MEDICAL INC.**  
**Statements of Operations**  
**For the Years ended December 31, 2012 and December 31, 2011**

	<b>Year Ended December 31, 2012</b>	<b>Year Ended December 31, 2011</b>
<b>REVENUE</b>	\$ _____ -	\$ _____ -
<b>EXPENSES</b>		
Amortization	131,968	97,689
Consulting fees	217,801	268,300
Stock based compensation (Notes 2 and 5(b))	334,725	513,323
Insurance	43,053	36,825
Management and administrative salaries	1,301,817	1,394,801
Marketing and investor relations	125,916	245,891
Office and general	324,380	409,495
Professional fees	357,323	420,392
Rent	164,228	106,056
Research and development	4,638,239	12,493,728
Travel	204,598	236,096
	7,844,048	16,222,596
<b>OTHER INCOME</b>		
Interest	86,804	95,067
<b>NET AND COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>\$(7,757,244)</b>	<b>\$(16,127,529)</b>
<b>BASIC AND DILUTED LOSS PER SHARE</b>	<b>\$(0.12)</b>	<b>\$(0.30)</b>
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES, Basic and Diluted</b>	<b>64,071,363</b>	<b>54,286,488</b>

See accompanying notes to financial statements

**TITAN MEDICAL INC.**  
**Statements of Cash Flows**  
**For the Years ended December 31, 2012 and December 31, 2011**

	<b>Year Ended December 31, 2012</b>	<b>Year Ended December 31, 2011</b>
<b>OPERATING ACTIVITIES</b>		
Net loss for the year	\$(7,757,244)	\$(16,127,529)
Items not involving cash:		
Amortization	131,968	97,689
Stock based compensation	334,725	513,323
Changes in non-cash working capital items		
Amounts receivable, prepaid expenses and deposits	482,656	(913,056)
Accounts payable and accrued liabilities	(908,607)	1,279,556
Cash used in operating activities	(7,716,502)	(15,150,017)
<b>FINANCING ACTIVITIES</b>		
Net proceeds from issuance of common shares and warrants	2,701,862	15,726,767
Cash provided by financing activities	2,701,862	15,726,767
<b>INVESTING ACTIVITIES</b>		
Purchase of Furniture and Equipment	(78,505)	(353,092)
Patent Costs	(28,661)	(99,634)
Cash used in investing activities	(107,166)	(452,726)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(5,121,806)	124,024
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	9,738,822	9,614,798
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	\$4,617,016	\$9,738,822
<b>CASH AND CASH EQUIVALENTS COMPRISE:</b>		
Cash	\$156,317	\$659,067
Term Deposits	4,460,699	9,079,755
	\$4,617,016	\$9,738,822

See accompanying notes to financial statements

**1. DESCRIPTION OF BUSINESS**

**Basis of Preparation:**

- (a) Statement of Compliance

The financial statements of the Company for the years ending December 31, 2012 and December 31, 2011 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

- (b) Basis of Measurement

These financial statements have been prepared on the historical cost basis except for the following items.

- stock based compensation amounts are measured at fair value

- (c) Functional and Presentation Currency

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

The financial statements were authorized for issue by the Board of Directors on February 19, 2013.

**Nature of Operations**

The Company’s business continues to be in the development stage and is focused on the continued research and development of the next generation surgical robotic platform. In the near term, the Company will continue efforts toward a clinical grade platform to be used for clinical trials and satisfaction of appropriate regulatory requirements. Upon receipt of regulatory approvals, the Company will be in a position to transition from research and development stage to commercialization stage. The completion of these latter stages will be subject to the Company receiving additional funding in the future.

The Company is incorporated in Ontario, Canada in accordance with the Business Corporations Act.

The address of the Company’s corporate office and its principal place of business is Toronto, Canada.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates and Judgements**

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of provisions at the date of the financial statements and the reported amount of expenses during the period. Financial statement items subject to significant judgement include the valuation of patent rights, and the measurement of stock based compensation. While management believes that the estimates and assumptions are reasonable, actual results may differ.

The Black-Scholes model used by Titan to determine fair values of stock options was developed for use in estimating the fair value of the stock options and warrants. This model requires the input of highly subjective assumptions including future stock price volatility and expected time until exercise. Changes in the subjective input assumptions can materially affect the fair value estimate.

**Significant Accounting Policies**

The accounting policies set out below have been applied consistently, in accordance with the appropriate IFRS during the periods presented.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**Cash and Cash Equivalents**

Cash and cash equivalents include cash balances and term deposits with our Bank, having a maturity of 90 days or less at the time of issue.

**Furniture and Equipment**

Furniture and equipment are recorded at cost less accumulated amortization and accumulated impairment losses, if any. The Company records amortization using the straight-line method over the estimated useful lives of the capital assets as follows:

a) Leasehold Improvements	Term of the lease
b) Computer Equipment	3 years
c) Furniture and Fixtures	3 – 5 years

**Impairment of long-lived assets**

The Company reviews furniture and equipment and patent rights for objective evidence of impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Recoverability is measured by comparison of the assets carrying amount to the assets recoverable amount, which is the greater of fair value less cost to sell and value in use. Value in use is measured as the expected future discounted cash flows expected to be derived from the asset. If the carrying value exceeds the recoverable amount, the asset is written down to the recoverable amount.

**Patent Rights**

Patent rights are recorded at cost less accumulated amortization and accumulated impairment loss. Straight line amortization is provided over the estimated useful lives of the assets, as prescribed by the granting body, useful lives range up to twenty years.

**Deferred Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, unused tax losses and income tax reductions, and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

Management has determined not to recognize its net deferred tax assets, as it is not considered probable that future tax benefits will be realized.

**Foreign Currency**

Transactions in foreign currencies are translated at exchange rates in effect at the dates of the transactions. When the transaction is settled, at the actual cost of the foreign currency, any difference in the exchange rate is booked to the corresponding expense account. Monetary period end balances are converted to Canadian dollars at the rate in effect at that time as per the Bank of Canada. Exchange gains or losses are booked to the foreign exchange gain or loss account.



2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**Stock Based Compensation**

Currently all stock option grants are valued using the Black-Scholes option-pricing model. IFRS 2 requires options granted to employees and others providing similar services to be measured at the fair value of goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure the value and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, which the Company does through the use of the Black-Scholes option-pricing model. The fair value of the options granted is as at the grant date.

Stock options granted to non-employees are valued using the Black-Scholes option-pricing model, rather than on the basis of the fair value of the services received. The Company does not have a history of performance with non-employees to reasonably estimate the fair value of the services to be received nor is there a definite expectation that their services will be required in the future.

**Research and Development Costs**

Research and development activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding are expensed as incurred. The costs of developing new products are capitalized as deferred development costs, if they meet the development capitalization criteria under IFRS. These criteria include the ability to measure development costs reliably, the product is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. To date, all of the research and development costs have been expensed as all of the criteria for capitalization have not yet been met.

**Earnings (loss) per Share**

Basic earnings (loss) per share are calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share considers the dilutive impact of the exercise of 2,602,452 outstanding stock options (December 31, 2011 – 2,882,404) and 17,444,255 warrants, (December 31, 2011 – 15,457,500) as if the events had occurred at the beginning of the period or at a time of issuance, if later. Diluted loss per share has not been presented in the accompanying financial statements, as the effect would be anti-dilutive.

**Investment tax credits**

As a result of incurring scientific research and development expenditures, management has estimated that there will be non-refundable federal and refundable and non-refundable provincial investment tax credits receivable following the completion of an audit process by tax authorities. Investment tax credits are recorded when received or when there is reasonable assurance that the credits will be realized. Upon recognition, amounts will be recorded as a reduction of research and development expenditures.

**Financial Instruments**

The Company has designated its cash and cash equivalents and amounts receivable as loans and receivables, which are measured at amortized cost. Amounts receivable include HST recoverable and accrued interest. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

**Short term Employee Benefits**

Short-term employee benefit obligations including Company paid medical, dental and life insurance plans, are measured on an undiscounted basis and are expensed as the related service is provided.

**Provisions**

A provision is recognized, if as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Presently the Company is not aware of the need for any provisions nor has it recorded any provisions.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**Government Grants**

Grants that compensate the Company for expenses incurred are taken into income against the appropriate expense in the same periods in which the expenses are recognized. Previously the Company participated in a Youth Internship Program sponsored by the NRC-IRAP which covers the cost of a new graduate to a maximum of \$30,000. Participation in this program expired June 30, 2011.

**Lease payments**

Payments made under operating leases are recognized as an expense on a straight line basis over the term of the lease. Lease incentives received, if any, are recognized as an integral part of the total lease expense over the term of the lease.

**Standards, Amendments and Interpretations Not Yet Effective**

Following is a listing of amendments, revisions and new IFRSs, which have been issued but are not effective until annual periods beginning after January 1, 2013 and which have not been early adopted in these financial statements. The Company has reviewed these items and is satisfied they will not have a material effect on the Company's future results and Financial position.

IFRS 7 Transfers of Financial Assets

IFRS 9 Financial Instruments, to replace IAS 39 and IFRIC 9, effective for annual periods beginning on or after January 1, 2015

IFRS 10 Consolidated Financial Statements, to replace consolidation requirements in IAS 27 and SIC-12

IFRS 11 Joint arrangements, to replace IAS 31 and SIC-13

IFRS 12 Disclosure of Interests in other Entities, to replace disclosure requirements in IAS 27, IAS 28 and IAS 31

IFRS 13 Fair value measurement

IAS 1 Presentation of Financial Statements, amendments regarding Presentation of Items of Other Comprehensive Income

IAS 19 Employee benefits

IAS 27 Separate Financial Statements

IAS 28 Investments in Associates and Joint Ventures

IAS 32 Financial Instruments presentation

**Comparative Figures**

Certain of the prior period figures have been reclassified to conform to the current period's presentation. There is no effect on the 2011 Net Comprehensive Loss for the year or Deficit as a result of these reclassifications.

**TITAN MEDICAL INC.**  
**Notes to the Financial Statements**  
December 31, 2012 and 2011

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**3. FURNITURE AND FIXTURES**

	<b>Computer Equipment</b>	<b>Furniture and Fixtures</b>	<b>Leasehold Improvements</b>	<b>Total</b>
<b>Cost</b>				
Balance at December 31, 2010	\$17,130	\$ 62,869	\$ 24,314	\$104,313
Additions	<u>49,959</u>	<u>155,944</u>	<u>147,189</u>	<u>353,092</u>
Balance at December 31, 2011	67,089	218,813	171,503	457,405
Additions	<u>1,034</u>	<u>65,395</u>	<u>12,076</u>	<u>78,505</u>
Balance at December 31, 2012	<u>\$68,123</u>	<u>\$284,208</u>	<u>\$183,579</u>	<u>\$535,910</u>
<b>Amortization &amp; Impairment Losses</b>				
Balance at December 31, 2010	\$ 3,086	\$ 8,318	\$ 5,771	\$17,175
Amortization for the period	17,842	34,640	20,963	73,445
Impairment loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at December 31, 2011	20,928	42,958	26,734	90,620
Amortization for the period	22,700	65,216	21,976	109,892
Impairment loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at December 31, 2012	<u>\$43,628</u>	<u>\$108,174</u>	<u>\$48,710</u>	<u>\$200,512</u>
<b>Net Book Value</b>				
At December 31, 2011	<u>\$46,161</u>	<u>\$175,855</u>	<u>\$144,769</u>	<u>\$366,785</u>
At December 31, 2012	<u>\$24,495</u>	<u>\$176,034</u>	<u>\$134,869</u>	<u>\$335,398</u>

**4. PATENT RIGHTS**

**Cost**

Balance at December 31, 2010	\$220,840
Additions	<u>99,634</u>
Balance at December 31, 2011	320,474
Additions	<u>28,661</u>
Balance at December 31, 2012	<u>\$349,135</u>

**Amortization & Impairment Losses**

Balance at December 31, 2010	\$101,295
Amortization for the year	24,244
Impairment loss	<u>-</u>
Balance at December 31, 2011	125,539
Amortization for the year	22,076
Impairment loss	<u>-</u>
Balance at December 31, 2012	<u>\$147,615</u>

**Net Book Value**

At December 31, 2011	<u>\$194,935</u>
At December 31, 2012	<u>\$201,520</u>

**5. SHARE CAPITAL**

a) **Authorized:** unlimited number of common shares, no par value

**Issued:** 64,744,892 (December 31, 2011: 62,315,337)

On December 23, 2009, Titan completed a private placement offering resulting in the issuance of 5,822,000 units for gross proceeds of \$2,328,800 (\$1,991,323 net of closing costs including cash commissions). Each unit was issued at \$0.40 and comprised one common share of Titan and a ½ warrant. Each whole warrant, of which there were 2,911,000, entitles its holder to purchase one additional common share of Titan for \$0.48 and expired June 23, 2011. At June 30, 2011, all of these warrants had been exercised. At closing, Titan paid the agent and members of the selling group aggregate cash commission of 7% of the gross proceeds from the offering (\$163,016). In addition, Titan issued to the agent and members of the selling group non-assignable compensation options equal to 7% of all units sold (407,540 options) pursuant to the offering. Each compensation option entitles its holder to purchase one unit at \$0.40 at any time on or before December 23, 2011, the expiration date. Each unit comprised one share of the Company's common stock plus a ½ warrant. The compensation options were valued at \$187,468 using Black-Scholes option pricing model. At December 31, 2011, all of these options have been exercised.

On December 10, 2010, Titan completed an offering of securities pursuant to an agency agreement. The offering consisted of 5,000,000 units at \$1.65 each for gross proceeds of \$8,250,000 (\$7,252,858 net of closing costs including 7% cash commissions of \$577,500 paid in accordance with the terms of the agency agreement). Each unit comprised one common share of Titan and 1 warrant. Each warrant entitles its holder to purchase one additional common share of Titan for \$1.85 and will expire December 10, 2015. The warrants were valued at \$2,850,000 using the Black-Scholes option pricing model combined with a proportionate fair value method. The following variables were used in the valuation: expected life of 5 years, annualized volatility of 109%, risk free rate of 2.32% based on 5 year Government of Canada Bonds and a trading value for the common shares of \$1.30 on December 7, 2010. Based on the values determined, the unit price of \$1.65 was

**5. SHARE CAPITAL** (continued)

apportioned as to warrants at \$0.57 and common shares at \$1.08. As a result, the value assigned to the warrants at December 31, 2010 is \$2,850,000 and the balance of \$5,400,000 is allocated to common shares.

On June 21, 2011, Titan completed an offering of securities pursuant to an agency agreement. The offer consisted of 5,577,500 units at \$1.65 for gross proceeds of \$9,202,875 (\$8,286,068 net of closing costs including 7% cash commission of \$644,201 paid in accordance with the terms of the agency agreement). Each unit comprised one common share of Titan and 1 warrant. Each warrant entitles its holder to purchase one additional common share of Titan for \$2.00 and will expire June 21, 2016. The warrants were valued at \$2,175,225 using a proportionate fair value method and the balance of \$7,027,650 was allocated to common shares.

Pursuant to the agency agreement, in addition to the cash commission paid to the Agent, the Company issued to the Agent, compensation warrants ("Broker Warrants") to purchase 390,425 units. Each Broker Warrant entitles the Agent to acquire one unit of the Company (each a "Broker Unit") at the offering price of \$1.65 for a period of 24 months following the closing date of the 2011 Offering. Each Broker Unit comprises one common share and one warrant ("Broker Unit Warrant"). Each Broker Unit Warrant entitles the Agent to acquire one common share of the Company at a price of \$2.00 prior to expiry five years from closing of the offering. As at December 31, 2012 no Broker Warrants have been exercised by the Agent.

On December 22, 2011, Titan completed an offering of securities pursuant to an agency agreement. The offer consisted of 4,880,000 units at \$1.55 for gross proceeds of \$7,564,000 (\$6,703,575 net of closing costs including 7% cash commission of \$529,480 paid in accordance with the terms of the agency agreement). Each unit comprised one common share of Titan and one warrant. Each warrant entitles its holder to purchase one additional common share of Titan for \$1.75 and will expire December 22, 2016. The warrants were valued at \$1,952,000 using a proportionate fair value method and the balance of \$5,612,000 was allocated to common shares.

Pursuant to the agency agreement, in addition to the cash commission paid to the Agent, the Company issued to the Agent, compensation warrants ("Broker Warrants") to purchase 341,600 warrants. Each Broker Warrant entitles the Agent to acquire one unit of the Company (each a "Broker Unit") at the offering price of \$1.75 for a period of 24 months following the closing date of the 2011 Offering. Each Broker Unit comprises one common share and one warrant ("Broker Unit Warrant"). Each Broker Unit Warrant entitles the Agent to acquire one common share of the Company prior to expiry five years from closing of the offering. As at December 31, 2012 no Broker Warrants have been exercised by the Agent.

On March 8, 2012 Titan completed an offering of securities pursuant to an agency agreement. The offer consisted of 1,986,755 units at \$1.51 for gross proceeds of \$3,000,000 (\$2,555,032 net of closing costs including 7% cash commission of \$210,000 paid in accordance with the terms of the agency agreement). Each unit comprised one common share of Titan and one warrant. Each warrant entitles its holder to purchase one additional common share of Titan for \$1.77 and will expire March 14, 2017. The warrants were valued at \$615,894 using a proportionate fair value method and the balance of \$2,384,106 was allocated to common shares.

Pursuant to the agency agreement, in addition to the cash commission paid to the Agent, compensation warrants ("Broker Warrants") were issued to purchase 139,073 common shares at a price of \$1.77 per share for a period of 24 months following the closing date. As at December 31, 2012 none of these Broker Warrants have been exercised by the Agent.

**b) *Warrants, Stock Options and Compensation Options***

Subject to shareholder approval, Titan has reserved and set aside up to 10% of the issued and outstanding shares of Titan for granting of options to employees, officers, consultants and advisers. At December 31, 2012, 3,872,037 common shares (December 31, 2011: 3,349,130) were available for issue in accordance with the Company's stock option plan. The terms of these options are determined by the Board of Directors. A summary of the status of the Company's outstanding stock options as of December 31, 2012 and December 31, 2011 and changes during the years ended on those dates is presented in the following table:

5. **SHARE CAPITAL** (continued)

	Year Ended December 31, 2012		Year Ended December 31, 2011	
	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
Balance, beginning	2,882,404	\$ 0.47	3,220,277	\$ 0.36
Granted	237,848	1.47	282,845	1.40
Exercised	(442,800)	0.33	(620,718)	0.31
Expired	<u>(75,000)</u>	<u>1.45</u>	<u>-</u>	<u>-</u>
Balance, ending	<u>2,602,452</u>	<u>\$ 0.55</u>	<u>2,882,404</u>	<u>\$ 0.47</u>

The weighted-average share price of the stock options exercised during the year was \$1.40.

The weighted-average remaining contractual life and weighted-average exercise price of options outstanding and of options exercisable as at December 31, 2012 are as follows:

Exercise price	Options Outstanding		Weighted-average remaining contractual life (years)	Options Exercisable	
	Number outstanding	Weighted- average exercise price		Number exercisable	Weighted- average exercise price
\$0.24	621,519	\$0.24	1.6	621,519	\$0.24
\$0.30	892,500	\$0.30	1.2	892,500	\$0.30
\$0.31	246,740	\$0.31	0.6	246,740	\$0.31
\$0.32	151,000	\$0.32	2.5	151,000	\$0.32
\$0.64	85,000	\$0.64	2.6	85,000	\$0.64
\$0.68	50,000	\$0.68	2.7	50,000	\$0.68
\$1.27	160,000	\$1.27	3.1	160,000	\$1.27
\$1.39	47,532	\$1.39	4.4	47,532	\$1.39
\$1.46	25,000	\$1.46	3.5	25,000	\$1.46
\$1.49	190,316	\$1.49	4.1	142,737	\$1.49
\$1.66	32,845	\$1.66	3.7	32,845	\$1.66
\$1.67	<u>100,000</u>	<u>\$1.67</u>	<u>2.8</u>	<u>100,000</u>	<u>\$1.67</u>
	<u>2,602,452</u>	<u>\$0.55</u>	<u>2.6</u>	<u>2,554,873</u>	<u>\$0.54</u>

Options are granted to Directors, officers, employees and consultants at various times. Options are to be settled by physical delivery of shares.

5. **SHARE CAPITAL** (continued)

<b>Grant date/Person entitled Options</b>	<b>Number of Options</b>	<b>Vesting Conditions</b>	<b>Contractual life of</b>
April 23, 2008 Option grant to Directors	724,999	25% immediately and every three months thereafter	5 years
July 28, 2008 Option grants to Consultants	981,830	50% immediately 50% December 31, 2008	5 years
July 28, 2008 Option grants to Consultants	83,220	50% immediately 25% December 31, 2008 25% June 30, 2009	5 years
July 28, 2008 Option grants to Medical Advisors	100,000	immediately	5 years
August 28, 2008 Option grants to Consultants	322,826	25% immediately 25% each three months thereafter	5 years
November 4, 2008 Option grant to Director	75,000	immediately	5 years
February 4, 2009 Option grant to Medical Advisor	100,000	immediately	5 years
September 10, 2009 option grant to Directors, employees, consultants and Medical Advisors	704,654	25% immediately 25% each three months thereafter	5 years
June 4, 2010 Option grant to key management	600,000	25% every 6 months from date of option grant	5 years
July 15, 2010 Option grant to Medical Advisors	176,000	25% every 3 months from date of option grant	5 years
August 18, 2010 Option grants to management, employees and consultants	150,000	25% every 3 months from date of option grant	5 years
September 14, 2010 Option grants to Director	50,000	25% every 3 months from date of option grant	5 years
October 19, 2010 Option grants to Medical Advisors	100,000	25% every 3 months from date of option grant	5 years
February 9, 2011 Option grants to key management	160,000	25% every 3 months from date of option grant	5 years
July 11, 2011, option grants to key employees	25,000	25% every 3 months from date of option grant	5 years
August 2, 2011, option grants to key employees	65,000	25% every 3 months from date of option grant	5 years
August 16, 2011, option grants to Directors	32,845	immediately	5 years
February 14, 2012, option grants to key employees	190,316	25% every 3 months from date of option grant	5 years
May 15, 2012, option grants to Directors	47,532	immediately	5 years

5. **SHARE CAPITAL** (continued)

Inputs for Measurement of Grant Date Fair Values

The grant date fair value of all share based payment plans was measured based on the Black-Scholes formula. Expected volatility was estimated by considering historic average share price volatility. The inputs used in the measurement of fair values at grant date of the share based option plan are as follows:

	Directors, Management, Employees, Medical Advisors and Consultants 2012	Directors, Management, Employees, Medical Advisors and Consultants 2011
Fair Value at grant date	\$1.105 - \$1.46	\$1.15 - \$1.46
Share price at grant date	\$1.39 - \$1.66	\$1.27 - \$1.66
Exercise price	\$1.39 - \$1.49	\$1.27 - \$1.36
Expected Volatility	111% -146%	137% -146%
Option Life	5 years	5 years
Expected dividends	nil	nil
Risk-free interest rate (based on government bonds)	1.41% - 2.78%	1.52% - 2.78%

The following is a summary of outstanding warrants as at December 31, 2012 and December 31, 2011 and changes during the years then ended.

	<b>Number of Warrants</b>	<b>Amount</b>	<b>Number of Warrants</b>	<b>Amount</b>
	December 31, 2012		December 31, 2011	
Opening Balance	15,457,500	\$6,977,225	6,004,988	\$3,009,823
Issued June 2011 Exercise Price of \$2.00 Expires June 2016	-	-	5,577,500	2,175,225
Exercised during 2011 at \$0.48	-	-	(1,004,988)	(159,823)
Issued December 2011 Exercise price of \$1.75 Expires December 2016	-	-	4,880,000	1,952,000
Issued March, 2012 Exercise Price of \$1.77 Expires December, 2017	<u>1,986,755</u>	<u>615,894</u>	<u>-</u>	<u>-</u>
Ending Balance	<u>17,444,255</u>	<u>\$7,593,119</u>	<u>15,457,500</u>	<u>\$6,977,225</u>

In addition to the warrants listed above, the Company has also issued 871,098 Broker Warrants, as more fully described in note 5(a). As at December 31, 2012 none of these Broker Warrants have been exercised.



**6. INCOME TAXES**

**a) Current Income Taxes**

A reconciliation of combined federal and provincial corporate income taxes at the Company's effective tax rate of 26.5% (2011 – 28.25%) follows. Scheduled changes to the federal and provincial tax rates took effect in 2011 which resulted in a reduction of the effective tax rate for 2012 compared to 2011.

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Net loss before income taxes	<u>\$(7,757,244)</u>	<u>\$(16,127,529)</u>
Income taxes at statutory rates	\$(2,055,670)	\$(4,556,027)
Tax effect of expenses not deductible for income tax purposes:		
Tax rate changes and other adjustments	(243,957)	342,879
Permanent differences	15,857	77,680
Unrecognized share issue costs	<u>(117,917)</u>	<u>(452,154)</u>
	<u>(2,401,687)</u>	<u>(4,587,622)</u>
Tax assets not recognized	<u>2,401,687</u>	<u>4,587,622</u>
	<u>\$ -</u>	<u>\$ -</u>

**b) Deferred Income Taxes**

Changes to the provincial income tax rate in 2012 resulted in an adjustment to the opening carrying value of temporary differences. Deferred income tax assets and liabilities result primarily from differences in recognition of certain timing differences that give rise to the Company's future tax assets (liabilities) and are as follows:

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Non-capital losses	\$ 5,848,671	\$ 5,046,295
Qualifying research and development expenditures	2,353,287	756,845
Share issue costs and other	<u>692,536</u>	<u>689,667</u>
	8,894,494	6,492,807
Tax assets not recognized	<u>(8,894,494)</u>	<u>(6,492,807)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

In assessing the realizability of deferred tax assets, management considers whether it is probable that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Management has determined not to recognize its deferred tax assets, as it is not considered probable that future tax benefits will be realized.

6. **INCOME TAXES** (continued)

c) **Losses carried forward**

The Company has non-capital losses of approximately \$22,070,455 available to reduce future income taxes. The non-capital losses expire approximately as follows:

2023	\$ 15,369
2024	272,037
2025	230,224
2026	245,530
2027	114
2028	673,910
2029	198,583
2030	2,131,030
2031	10,023,074
2032	<u>8,280,584</u>
	<u>\$22,070,455</u>

The Company also has accumulated Qualifying Research and Development expenses of \$8,880,330 (December 31, 2011 - \$3,027,380) as a result of ongoing research and development. These expenditures may be carried forward indefinitely and used to reduce taxable income in future years.

d) **Investment Tax Credits**

At December 31, 2012, the Company has \$1,841,302 (2011 - \$607,442) of unclaimed investment tax credits available to reduce federal income taxes payable in future years. If not utilized, these investment tax credits will start expiring in 2028.

At December 31, 2012, the Company has \$379,535 (2011 - \$88,835) of unclaimed Ontario Research and Development Tax Credit (ORDTC) available to reduce Ontario income taxes payable in future years. If not utilized, these ORDTC will start expiring in 2029.

In August 2012, the Company received the amount of \$300,000 (\$250,000 net after commission) with regards to the amount claimed as Ontario Investment Tax Credit (OITC) for the year ended December 31, 2011.

7. **COMMITMENTS**

Effective April 15, 2010 the Company entered into a lease in Ancaster to be used for the Amadeus™ Robotic Surgical Platform research and development program. This lease is for a term of 36 months at \$5,912 per month.

On July 15, 2011, the Company entered into a lease for additional premises in Ancaster, for its research and development program. This lease is for a term of 7.5 years. Monthly rent for the first 5 years is \$7,463 and for the remaining 2.5 years is \$8,210, plus HST. The initial leased space for research and development is now redundant. The space has been sublet for the balance of the term.

Effective February 1, 2012, the Company has exercised its option to lease an additional 4,477 square feet adjacent to its existing research and development facilities in Ancaster, Ontario. The additional space is under the same terms and conditions as the original lease, dated July 15, 2011.

Effective August 1, 2012, 3,957 square feet of this additional space has been sublet for a five year term.

7. **COMMITMENTS** (continued)

Effective March 1, 2012, the Company has relocated its corporate office within Toronto. The new space occupies 1,000 square feet and is on a month to month basis at an annual rental of \$39,000 per year.

As a part of its program of research and development around the Amadeus™ Surgical System, the Company has outsourced certain aspects of the design and development to a U.S. based technology and development company. As at December 31, 2012 the Company has issued individual purchase orders to this technology and development company which total CDN \$2,807,807 (U.S. \$2,822,200). At December 31, 2012, CDN \$886,945 (U.S. \$891,491) remains outstanding. Subsequent to December 31, 2012 a further CDN \$744,864 (U.S. \$745,460) in purchase orders were issued to the same company. The Company also has on deposit with this same U.S. supplier CDN \$257,700 to be applied against future invoices.

The Company has entered into a number of licensing agreements with suppliers and Universities that will require payments to be made to them, in future years, based on the achievement, by the Company, of certain milestones which could total up to \$375,000. Subsequently, following commercialization, royalty payments will be required, based on a percentage of annual net sales of the licensed product, in the range of 4% to 6%.

The Company has entered into a number of licensing agreements with educational and medical institutions as well as suppliers, for the development and provision of items to be incorporated into the Amadeus™. These agreements require Titan to make periodic payments in 2013 and beyond.

2013	\$64,000
2014	\$77,500
2015	\$80,000
2016	\$80,000
2017 and thereafter	\$85,000

8. **RELATED PARTY TRANSACTIONS**

Senior Executives and Directors of the Company received total compensation in 2012 of \$1,530,655 (December 31, 2011 - \$1,352,013). In addition to cash compensation, Management and Directors received additional compensation composed of:

	2012	2011
Short-term employee benefits	\$ 39,000	\$ 29,873
Post-employment benefits	-	-
Termination benefits	-	-
Other long-term benefits	-	-
Stock based compensation	<u>235,032</u>	<u>322,352</u>
	<u>\$274,032</u>	<u>\$352,225</u>

8. **RELATED PARTY TRANSACTIONS** (continued)

Officers and Directors of the Company control approximately 16.41% (December 31, 2011 – 16.75%) of the Company.

	<b>December 31, 2012</b>		<b>December 31, 2011</b>	
	<b>BASE</b>	<b>%</b>	<b>BASE</b>	<b>%</b>
John Barker	74,000	0.11	74,000	0.12
Martin Bernholtz	1,291,500	2.00	1,291,500	2.07
John Hargrove	6,200	0.01	-	-
Craig Leon	4,277,711	6.61	4,202,411	6.74
Stephen Randall	25,600	0.04	25,600	0.04
Reiza Rayman	4,923,677	7.60	4,848,377	7.78
John Valvo	<u>25,000</u>	<u>0.04</u>	<u>-</u>	<u>-</u>
<b>TOTAL</b>	<b><u>10,623,688</u></b>	<b><u>16.41</u></b>	<b><u>10,441,888</u></b>	<b><u>16.75</u></b>
Common Shares Outstanding	<u>64,744,892</u>	<u>100%</u>	<u>62,315,337</u>	<u>100%</u>

9. **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash and cash equivalents, amounts receivable, accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying values, unless otherwise noted, due to the short maturities of these instruments or the discount rate applied.

The Company's risk exposures and their impact on the Company's financial instruments are summarized below:

(a) **Credit risk**

The Company's credit risk is primarily attributable to cash and cash equivalents and amounts receivable. The Company has no significant concentration of credit risk arising from operations. Cash and cash equivalents are held with reputable financial institutions, from which management believes the risk of loss to be remote. Financial instruments included in amounts receivable consists of HST tax due from the Federal Government of Canada and interest receivable from term deposits. Management believes that the credit risk concentration with respect to financial instruments included in amounts receivable is remote.

(b) **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2012, the Company had cash and cash equivalents of \$4,617,016 (December 31, 2011- \$9,738,822) to settle current liabilities of \$1,098,658 (December 31, 2011 - \$2,007,265). All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms.

**9. FINANCIAL INSTRUMENTS (continued)**

**(c) Market risk**

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates.

(i) Interest rate risk

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade redeemable term deposit certificates issued by its Canadian banking institution. The Company periodically monitors the investments it makes and is satisfied with the credit risk of its bank.

(ii) Foreign currency risk

The Company's functional currency is the Canadian dollar. Expenditures transacted in Foreign Currency are converted to Canadian dollars at the rate in effect when the transaction is initially booked. The gain or loss on exchange, when the transaction is settled, is booked to the Statement of Operations. Management believes the foreign exchange risk derived from currency conversions is minimal and therefore does not hedge its foreign exchange risk. The following chart in 9(d) sets out the Company's exposure to currency risk at the dates indicated.

**(d) Sensitivity analysis**

Cash equivalents include fully redeemable term deposits which mature within 90 days. Sensitivity to a plus or minus 1% change in interest rates could affect annual net loss by \$44,607 (December 31, 2011 - \$90,798) based on the current level of cash invested in cash equivalents.

A strengthening of the Canadian dollar at December 31, 2012, as indicated below, against U.S. accounts payable of \$799,655 (December 31, 2011 - \$819,275) and GBP accounts payable of nil (December 31, 2011 - £239,210) would result in increased equity and reduced loss for the period by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Company considers to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for December 31, 2011.

<b>December 31, 2012</b>	<b>Profit or (Loss)</b>
5% strengthening	
U.S. \$	39,983
GBP	nil
<b>December 31, 2011</b>	
5% strengthening	
U.S. \$	40,964
GBP	11,961

A weakening of the Canadian dollar against the above currencies at December 31, 2012 and December 31, 2011 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

**10. CAPITAL MANAGEMENT**

The Company's capital is composed of shareholders' equity. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the development of its Amadeus™ Robotic Surgical Platform (ARSP). The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the ARSP. The Company has further progress to make in the development of the ARSP, and anticipates that the cost of completion will exceed its current resources. Accordingly, the Company will be dependent on external financing to fund a portion of its future activities. In order to carry out the completion of the ARSP and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the year ended December 31, 2012. The Company is not subject to externally imposed capital requirements.

**11. SEGMENTED REPORTING**

The Company operates in a single reportable operating segment – the research and development of Amadeus™, the next generation of surgical robotic platform.

**12. EVENTS AFTER THE REPORTING DATE**

On February 7, 2013, 30,000 options were exercised at \$0.64 for proceeds of \$19,200 and the issuance of 30,000 common shares.