

TITAN MEDICAL INC.
Unaudited Condensed Interim Financial Statements
Three and Nine Months Ended September 30, 2012 and 2011

TITAN MEDICAL INC.
Unaudited Condensed Interim Balance Sheets
As at September 30, 2012 and December 31, 2011

	September 30, <u>2012</u>	December 31, <u>2011</u>
ASSETS		
CURRENT		
Cash and cash equivalents	\$6,161,095	\$9,738,822
Amounts receivable	61,662	275,470
Deposits	283,676	703,886
Prepaid expenses	<u>45,028</u>	<u>70,497</u>
Total Current Assets	6,551,461	10,788,675
Furniture and Equipment (Note 3)	363,265	366,785
Patent Rights (Note 4)	<u>194,728</u>	<u>194,935</u>
	<u>\$7,109,454</u>	<u>\$11,350,395</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	<u>\$674,030</u>	<u>\$2,007,265</u>
SHAREHOLDERS' EQUITY		
Share Capital (Note 5(a))	26,643,399	24,492,101
Contributed Surplus	1,965,741	1,747,497
Warrants (Note 5 (b))	7,593,119	6,977,225
Deficit	<u>(29,766,835)</u>	<u>(23,873,693)</u>
Total Equity	<u>6,435,424</u>	<u>9,343,130</u>
TOTAL LIABILITIES & EQUITY	<u>\$7,109,454</u>	<u>\$11,350,395</u>

Commitments (Note 7)
See accompanying notes to financial statements

Approved on behalf of the Board:

Craig Leon
Director

Martin Bernholtz
Director

TITAN MEDICAL INC.
Unaudited Condensed Interim Statements of Shareholders' Equity and Deficit
For the Periods ended September 30, 2012 and 2011

	Share Capital Number	Share Capital Amount	Contributed Surplus	Warrants	Deficit	Total Equity
Balance - December 31, 2010	50,051,571	\$ 12,540,146	\$ 1,426,764	\$ 3,009,823	\$ (7,746,164)	\$ 9,230,569
Issued pursuant to agency agreement	5,577,500	9,202,875				
Share issue expense		(950,109)				
Warrants issued during the period		(2,175,225)		2,175,225		
Warrants exercised during the period	1,227,956	746,974		(159,823)		
Options exercised in the period	574,148	331,671	(151,977)			
Stock based compensation expense			436,734			
Net and Comprehensive loss for the period					(10,967,989)	
Balance – September 30, 2011	57,431,175	\$ 19,696,332	\$ 1,711,521	\$ 5,025,225	\$ (18,714,153)	\$ 7,718,925
Balance - December 31, 2011	62,315,337	\$ 24,492,101	\$ 1,747,497	\$ 6,977,225	\$(23,873,693)	\$ 9,343,130
Issued pursuant to agency agreement	1,986,755	3,000,000				
Share issue expense		(444,968)				
Warrants issued during the period		(615,894)		615,894		
Options exercised in the period	367,800	212,160	(88,117)			
Stock based compensation expense			306,361			
Net and Comprehensive loss for the period					(5,893,142)	
Balance – September 30, 2012	64,669,892	\$ 26,643,399	\$ 1,965,741	\$ 7,593,119	\$(29,766,835)	\$ 6,435,424

See accompanying notes to financial statements.

TITAN MEDICAL INC.
Unaudited Condensed Interim Statements of Operations
For the Three and Nine Months ended September 30, 2012 and 2011

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
REVENUE	\$ _____ -	\$ _____ -	\$ _____ -	\$ _____ -
EXPENSES				
Amortization	32,376	98,806	33,770	68,022
Consulting fees	45,226	168,641	48,604	155,973
Stock based compensation (Note 5(b))	57,587	306,361	161,508	436,734
Insurance	10,859	32,366	9,319	26,600
Management and administrative salaries	162,666	1,021,434	361,010	888,653
Marketing and investor relations	15,615	107,842	65,250	186,710
Office and general	48,113	279,000	151,624	282,708
Professional fees	95,722	304,609	97,980	336,501
Rent	37,494	129,954	23,562	64,483
Research and development	601,625	3,354,874	5,088,900	8,447,801
Travel	26,045	159,393	60,814	149,675
	1,133,328	5,963,280	6,102,341	11,043,860
OTHER INCOME				
Interest	20,950	70,138	34,765	75,871
NET AND COMPREHENSIVE LOSS FOR THE PERIOD	\$(1,112,378)	\$(5,893,142)	\$(6,067,576)	\$(10,967,989)
BASIC AND DILUTED LOSS PER SHARE	\$(0.01)	\$(0.09)	\$(0.11)	\$(0.21)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES, Basic and Diluted	64,499,321	63,867,583	57,210,708	53,099,621

See accompanying notes to financial statements

TITAN MEDICAL INC.
Unaudited Condensed Interim Statements of Cash Flows
For the Three and Nine Months ended September 30, 2012 and 2011

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
OPERATING ACTIVITIES				
Net loss for the period	\$(1,112,378)	\$(5,893,142)	\$(6,067,576)	\$(10,967,989)
Items not involving cash:				
Amortization	32,376	98,806	33,700	68,022
Stock based compensation	57,587	306,361	161,508	436,734
Changes in non-cash working capital items:				
Amounts receivable, prepaid expenses and deposits	(28,524)	659,487	(791,467)	(1,629,900)
Accounts payable and accrued liabilities	10,843	(1,133,235)	1,364,596	2,056,112
Cash used in operating activities	(1,040,096)	(6,161,723)	(5,299,169)	(10,037,021)
FINANCING ACTIVITIES				
Net proceeds from issuance of common shares and warrants	56,700	2,679,074	128,744	9,019,611
Cash provided by financing activities	56,700	2,679,074	128,744	9,019,611
INVESTING ACTIVITIES				
Purchase of Furniture and Equipment	-	(78,580)	(247,832)	(305,572)
Costs of Patents	(2,375)	(16,498)	(13,767)	(23,767)
Cash used in investing activities	(2,375)	(95,078)	(261,599)	(329,339)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(985,771)	(3,577,727)	(5,432,024)	(1,346,749)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	7,146,866	9,738,822	13,700,073	9,614,798
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$6,161,095	\$ 6,161,095	\$8,268,049	\$8,268,049
CASH AND CASH EQUIVALENTS COMPRISE:				
Cash (bank overdraft)	\$392,927	\$392,927	\$(636,398)	\$(636,398)
Term Deposits	\$5,768,168	\$5,768,168	\$8,904,049	\$8,904,447
	\$6,161,095	\$6,161,095	\$8,268,049	\$8,268,049

See accompanying notes to financial statements

TITAN MEDICAL INC.

Notes to the Unaudited Condensed Interim Financial Statements

Nine Months Ended September 30, 2012 and December 31, 2011

1. DESCRIPTION OF BUSINESS

Basis of Preparation:

(a) Statement of Compliance

These condensed interim financial statements for the three and nine months ending September 30, 2012 have been prepared in accordance with IAS 34 Interim Financial Reporting.

These condensed interim financial statements should be read in conjunction with the Company's 2011 annual financial statements which have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The condensed interim financial statements have been prepared using accounting policies consistent with those used in the Company's 2011 annual financial statements except for income tax expense which is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

(b) Basis of Measurement

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

- financial instruments at amortized cost
- stock-based compensation amounts are measured at fair value

(c) Functional and Presentation Currency

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

The condensed interim financial statements were authorized for issue by the Board of Directors on November 1, 2012.

Nature of Operations

The Company's business continues to be in the development stage, engaged in the design and development of its robotic technologies, known as Amadeus™, for application in minimally invasive surgery ("MIS"). The Amadeus™ system, currently under development, comprises a surgeon-controlled robotic platform that includes a 3D vision system, interactive instruments for performing MIS procedures, and a surgeon workstation that provides the surgeon with an interface to the robotic platform and also provides a 3D endoscopic view of inside a patient's body during MIS procedures. The Amadeus™ system includes a single-site and a multi-port platform having the objective of performing complex procedures directed by a surgical team. The Amadeus™ system is being designed to allow for the expansion of robotic surgery into areas of surgical specialities and simple and complex procedures that are currently under-served and to allow surgeons to perform procedures within small to medium size surgical spaces such as general surgery and colecystectomy. 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 address of the Company's corporate office is Toronto, Canada and its principal place of business is Ancaster, Ontario.

TITAN MEDICAL INC.

Notes to the Unaudited Condensed Interim Financial Statements

Nine Months Ended September 30, 2012 and December 31, 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates and Judgements

The preparation of condensed interim financial statements in conformity with IAS 34, Interim Financial Reporting, 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 condensed interim financial statements and the reported amount of expenses during the period. Financial statement items subject to significant judgement include the valuation of patent rights, the completeness of accounts payable and accrued liabilities, measurement of stock based compensation and the valuation of future income tax assets. 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.

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, 2012 and which have not been early adopted in these financial statements. The Company is currently reviewing these items for any effects they may have on the Company's future results and financial position.

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

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 with the current period's presentation. There is no effect on the 2011 Net Comprehensive Loss for the period or Deficit as a result of these reclassifications.

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
Nine Months Ended September 30, 2012 and December 31, 2011

3. FURNITURE AND EQUIPMENT

	Computer Equipment	Furniture and Fixtures	Leasehold Improvements	Total
Cost				
Balance at December 31, 2011	\$67,089	\$218,813	\$171,503	\$457,405
Additions	<u>1,110</u>	<u>65,395</u>	<u>12,075</u>	<u>78,580</u>
Balance at September 30, 2012	<u>\$68,199</u>	<u>\$284,208</u>	<u>\$183,578</u>	<u>\$535,985</u>
Amortization & Impairment Losses				
Balance at December 31, 2011	\$20,928	\$42,958	\$26,734	\$90,620
Amortization for the period	17,018	48,649	16,433	82,100
Impairment loss	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Balance at September 30, 2012	<u>\$37,946</u>	<u>\$91,607</u>	<u>\$43,167</u>	<u>\$172,720</u>
Net Book Value				
At December 31, 2011	<u>\$46,161</u>	<u>\$175,855</u>	<u>\$144,769</u>	<u>\$366,785</u>
At September 30, 2012	<u>\$30,253</u>	<u>\$192,601</u>	<u>\$140,411</u>	<u>\$363,265</u>

4. PATENT RIGHTS

Cost	
Balance at December 31, 2011	\$320,474
Additions	<u>16,498</u>
Balance at September 30, 2012	<u>\$336,972</u>
Amortization & Impairment Losses	
Balance at December 31, 2012	\$125,539
Amortization for the period	16,705
Impairment loss	<u>0</u>
Balance at September 30, 2012	<u>\$142,244</u>
Net Book Value	
At December 31, 2011	<u>\$194,935</u>
At September 30, 2012	<u>\$194,728</u>

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
 Nine Months Ended September 30, 2012 and December 31, 2011

5. SHARE CAPITAL

- a) **Authorized:** unlimited number of common shares, no par value
Issued: 64,669,892 (December 31, 2011: 62,315,337)

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 September 30, 2012 none of these Broker Warrants have been exercised by the Agent.

Held in escrow

All shares previously held in escrow were released from escrow by July 29, 2011.

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, September 30, 2012, 3,724,537 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 September 30, 2012 and December 31, 2011 and changes during the periods ended on those dates is presented in the following table:

	Nine Months Ended September 30, 2012		Year Ended December 31, 2011	
	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
Outstanding, beginning	2,882,404	\$ 0.47	3,220,277	\$ 0.36
Granted	237,848	1.47	282,845	1.40
Exercised	(367,800)	0.34	(620,718)	0.31
Expired	<u>(10,000)</u>	<u>0.64</u>	<u>0</u>	<u>0</u>
Balance, ending	<u>2,742,452</u>	<u>\$ 0.57</u>	<u>2,882,404</u>	<u>\$ 0.47</u>

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
Nine Months Ended September 30, 2012 and December 31, 2011

5. **SHARE CAPITAL** (continued)

The weighted-average remaining contractual life and weighted-average exercise price of options outstanding and of options exercisable as at September 30, 2012 are as follows:

Exercise price	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted-average exercise price	Weighted-average remaining contractual life (years)	Number exercisable	Weighted-average exercise price
\$0.24	628,139	\$0.24	1.8	628,139	\$0.24
\$0.30	892,500	\$0.30	1.4	892,500	\$0.30
\$0.31	315,120	\$0.31	0.8	315,120	\$0.31
\$0.32	151,000	\$0.32	2.8	151,000	\$0.32
\$0.64	85,000	\$0.64	2.8	85,000	\$0.64
\$0.68	50,000	\$0.68	3.0	50,000	\$0.68
\$1.27	160,000	\$1.27	3.3	160,000	\$1.27
\$1.39	47,532	\$1.39	4.6	47,532	\$1.39
\$1.46	25,000	\$1.46	3.8	25,000	\$1.46
\$1.49	190,316	\$1.49	4.4	95,158	\$1.49
\$1.58	65,000	\$1.58	3.8	65,000	\$1.58
\$1.66	32,845	\$1.66	3.9	32,845	\$1.66
\$1.67	<u>100,000</u>	<u>\$1.67</u>	<u>3.0</u>	<u>100,000</u>	<u>\$1.67</u>
	<u>2,742,452</u>	<u>\$0.57</u>	<u>2.9</u>	<u>2,647,294</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.

Stock options granted to non employees, officers or directors are valued using the Black-Scholes 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 employee individuals 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.

Grant date/Person entitled	Number of Options	Vesting Conditions	Contractual life of Options
February 14, 2012, option grants to key employees	<u>190,316</u>	25% every three months from date of option	5 years
May 15, 2012, option grants to Directors	<u>47,532</u>	immediate	5 years

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
 Nine Months Ended September 30, 2012 and December 31, 2011

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
Fair Value at grant date	\$1.105 - \$1.26
Share price at grant date	\$1.39 - \$1.49
Exercise price	\$1.39 - \$1.49
Expected Volatility	111% - 126%
Option Life	5 years
Expected dividends	nil
Risk-free interest rate (based on government bonds)	1.41% - 1.49%

The following is a summary of outstanding warrants as at September 30, 2012 and December 31, 2011 and changes during the periods then ended.

	Number of Warrants September 30, 2012	Amount	Number of Warrants December 31, 2011	Amount
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 8, 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>

6. INCOME TAXES

Losses carried forward

(a) The Company has non-capital losses of approximately \$13,789,871 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	<u>10,023,074</u>
	\$13,789,871

(b) The Company 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.

(c) 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.

Effective August 1, 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.

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 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 September 30, 2012, the Company has issued and outstanding individual purchase orders to this technology and development company which total Cdn. \$1,822,339 (U.S. \$1,852,590).

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
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7. **COMMITMENTS** (continued)

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 minimum periodic payments for the balance of 2012 and beyond.

2012	\$	0
2013	\$	64,000
2014	\$	77,500
2015	\$	80,000
2016	\$	80,000
2017 and thereafter	\$	85,000

8. **RELATED PARTY TRANSACTIONS**

During the period ended September 30, 2012, transactions between the Company and directors, officers and other related parties were in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Officers and Directors of the Company control approximately 16.43% of the Company.

	September 30, 2012		December 31, 2011	
	BASE	%	BASE	%
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	6.62	4,202,411	6.74
Stephen Randall	25,600	0.04	25,600	0.04
Reiza Rayman	4,923,677	7.61	4,848,377	7.78
John Valvo	<u>25,000</u>	<u>0.04</u>	<u>-</u>	<u>-</u>
TOTAL	<u>10,623,688</u>	<u>16.43</u>	<u>10,441,888</u>	<u>16.75</u>
Common Shares Outstanding	<u>64,669,892</u>	<u>100%</u>	<u>62,315,337</u>	<u>100%</u>

TITAN MEDICAL INC.

Notes to the Unaudited Condensed Interim Financial Statements

Nine Months Ended September 30, 2012 and December 31, 2011

9. SEGMENTED REPORTING

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

10. EVENTS AFTER THE REPORTING DATE

On October 15, 2012, the Company announced that it had filed a short form base shelf prospectus with the securities regulatory authorities in each of the provinces of British Columbia, Alberta and Ontario. The short form base shelf prospectus relates to the offering for sale of common shares, warrants, units, preferred shares and debt securities, for gross proceeds of up to an aggregate of CDN \$45,000,000 during the 25 month period that the prospectus remains effective.