

TITAN MEDICAL INC.
Unaudited Condensed Interim Financial Statements
Three and Nine Months Ended September 30, 2013 and 2012

TITAN MEDICAL INC.
Unaudited Condensed Interim Balance Sheets
As at September 30, 2013 and December 31, 2012

	September 30, <u>2013</u>	December 31, <u>2012</u>
ASSETS		
CURRENT		
Cash and cash equivalents	\$4,373,160	\$4,617,016
Amounts receivable	39,507	70,188
Deposits (Note 7)	419,824	294,161
Prepaid expenses	<u>50,244</u>	<u>202,848</u>
Total Current Assets	4,882,735	5,184,213
Furniture and Equipment (Note 3)	258,936	335,398
Patent Rights (Note 4)	<u>247,390</u>	<u>201,520</u>
	<u>\$5,389,061</u>	<u>\$5,721,131</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	<u>\$1,460,203</u>	<u>\$1,098,658</u>
SHAREHOLDERS' EQUITY		
Share Capital (Note 5(a))	31,925,239	26,682,137
Contributed Surplus	2,064,346	1,978,154
Warrants (Note 5 (b))	8,532,233	7,593,119
Deficit	<u>(38,592,960)</u>	<u>(31,630,937)</u>
Total Equity	<u>3,928,858</u>	<u>4,622,473</u>
TOTAL LIABILITIES & EQUITY	<u>\$5,389,061</u>	<u>\$5,721,131</u>

Commitments (Note 7)
See accompanying notes to financial statements

Approved on behalf of the Board:

John T. Hargrove
Director

Martin Bernholtz
Director

TITAN MEDICAL INC.
Unaudited Condensed Interim Statements of Shareholders' Equity and Deficit
For the Periods ended September 30, 2012 and 2013

	Share Capital Number	Share Capital Amount	Contributed Surplus	Warrants	Deficit	Total Equity
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				3,000,000
Share issue expense		(444,968)				(444,968)
Warrants issued during the period		(615,894)		615,894		-
Options exercised	367,800	212,160	(88,117)			124,043
Stock based compensation expense			306,361			306,361
Net and comprehensive loss for the period					(5,893,142)	(5,893,142)
Balance – September 30, 2012	<u>64,669,892</u>	<u>\$ 26,643,399</u>	<u>\$ 1,965,741</u>	<u>\$ 7,593,119</u>	<u>\$ (29,766,835)</u>	<u>\$ 6,435,424</u>
Balance - December 31, 2012	64,744,892	\$ 26,682,137	\$ 1,978,154	\$ 7,593,119	\$ (31,630,937)	\$ 4,622,473
Issued pursuant to agency agreement	6,260,763	6,573,801				6,573,801
Share issue expense		(806,360)				(806,360)
Warrants issued during the period		(939,114)		939,114		-
Options exercised	794,005	414,775	(180,643)			234,132
Stock based compensation expense			266,835			266,835
Net and comprehensive loss for the period					(6,962,023)	(6,962,023)
Balance – September 30, 2013	<u>71,799,660</u>	<u>\$ 31,925,239</u>	<u>\$ 2,064,346</u>	<u>\$ 8,532,233</u>	<u>\$ (38,592,960)</u>	<u>\$ 3,928,858</u>

See accompanying notes to financial statements.

TITAN MEDICAL INC.
Unaudited Condensed Interim Statements of Operations
For the Three and Nine Months ended September 30, 2013 and 2012

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
REVENUE	\$ _____ -	\$ _____ -	\$ _____ -	\$ _____ -
EXPENSES				
Amortization	29,329	74,933	32,376	98,806
Consulting fees	43,432	288,156	45,226	168,641
Stock based compensation (Note 5(b))	243,826	286,335	57,587	306,361
Insurance	11,223	32,993	10,859	32,366
Management salaries and fees	243,639	1,136,017	162,666	1,021,434
Marketing and investor relations	26,858	94,883	15,615	107,842
Office and general	19,924	198,583	48,113	279,000
Professional fees	42,575	238,631	95,722	304,609
Rent	84,039	151,499	37,494	129,954
Research and development	1,382,521	4,377,558	601,625	3,354,874
Travel	52,890	135,605	26,045	159,393
	2,180,256	7,015,193	1,133,328	5,963,280
OTHER INCOME				
Interest	15,858	53,170	20,950	70,138
NET AND COMPREHENSIVE LOSS FOR THE PERIOD	\$(2,164,398)	\$(6,962,023)	\$(1,112,378)	\$(5,893,142)
BASIC AND DILUTED LOSS PER SHARE	\$(0.03)	\$(0.10)	\$(0.01)	\$(0.09)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES, Basic and Diluted	71,716,271	69,760,809	64,499,321	63,867,583

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, 2013 and 2012

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
OPERATING ACTIVITIES				
Net loss for the period	\$(2,164,398)	\$(6,962,023)	\$(1,112,378)	\$(5,893,142)
Items not involving cash:				
Amortization	29,329	74,933	32,376	98,806
Stock based compensation - vested	224,326	266,835	57,587	306,361
Changes in non-cash working capital items				
Amounts receivable, prepaid expenses and deposits	(3,097)	57,622	(28,524)	659,487
Accounts payable and accrued liabilities	53,437	361,545	10,843	(1,333,235)
Cash used in operating activities	(1,860,403)	(6,201,088)	(1,040,096)	(6,161,723)
FINANCING ACTIVITIES				
Net proceeds from issuance of common shares and warrants	83,739	6,001,573	56,700	2,679,074
Cash provided by financing activities	83,739	6,001,573	56,700	2,679,074
INVESTING ACTIVITIES				
(Purchase) Disposal of Furniture and Equipment	300	(1,371)	-	(78,580)
Costs of Patents	(13,066)	(42,970)	(2,375)	(16,498)
Cash used in investing activities	(12,766)	(44,341)	(2,375)	(95,078)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,789,430)	(243,856)	(985,771)	(3,577,727)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,162,590	4,617,016	7,146,866	9,738,822
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$4,373,160	\$4,373,160	\$6,161,095	\$6,161,095
CASH AND CASH EQUIVALENTS COMPRISE:				
Cash	\$ 353,768	\$ 353,768	\$ 392,927	\$ 392,927
Term Deposits	4,019,392	4,019,392	5,768,168	5,768,168
	\$4,373,160	\$4,373,160	\$6,161,095	\$6,161,095

See accompanying notes to financial statements

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, 2013 have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34").

These condensed interim financial statements should be read in conjunction with the Company's 2012 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 and methods of computation consistent with those used in the Company's 2012 annual financial statements as well as any amendments, revisions and new IFRS, which have been issued subsequently and are appropriate to the Company.

Changes in Accounting Policy and Disclosure:

None of these new standards, interpretations and amendments, effective for the first time from January 1, 2013 have had a material effect on the financial statements.

IFRS 7 Transfers of Financial Assets

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

(b) Basis of Measurement

These condensed interim financial statements have been prepared on the historical cost basis.

(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 5, 2013.

1. **DESCRIPTION OF BUSINESS** (continued)

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 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 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.

Standards, Amendments and Interpretations Not Yet Effective

Following is a listing of amendments, revisions and new IFRSs, which has been issued and is effective for annual periods beginning after January 1, 2013. Management continues to assess the effect on the Company's future results and Financial Position as a result of this amendment.

IAS 32 Financial Instruments presentation effective January 1, 2014

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

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
 Nine Months Ended September 30, 2013

3. FURNITURE AND EQUIPMENT

	Computer Equipment	Furniture and Fixtures	Leasehold Improvements	Total
Cost				
Balance at December 31, 2012	\$68,123	\$284,208	\$183,579	\$535,910
Additions	<u>1,371</u>	<u>-</u>	<u>-</u>	<u>1,371</u>
Balance at September 30, 2013	<u>\$69,494</u>	<u>\$284,208</u>	<u>\$183,579</u>	<u>\$537,281</u>
Amortization & Impairment Losses				
Balance at December 31, 2012	\$43,628	\$108,174	\$48,710	\$200,512
Amortization for the period	15,322	45,883	16,628	77,833
Impairment loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at September 30, 2013	<u>\$58,950</u>	<u>\$154,057</u>	<u>\$65,338</u>	<u>\$278,345</u>
Net Book Value				
At December 31, 2012	<u>\$24,495</u>	<u>\$176,034</u>	<u>\$134,869</u>	<u>\$335,398</u>
At September 30, 2013	<u>\$10,544</u>	<u>\$130,151</u>	<u>\$118,241</u>	<u>\$258,936</u>

4. PATENT RIGHTS

Cost	
Balance at December 31, 2012	\$349,135
Additions	<u>42,970</u>
Balance at September 30, 2013	<u>\$392,105</u>
Amortization & Impairment Losses	
Balance at December 31, 2012	\$147,615
Amortization and other adjustments for the period	(2,900)
Impairment loss	<u>-</u>
Balance at September 30, 2013	<u>\$144,715</u>
Net Book Value	
At December 31, 2012	<u>\$201,520</u>
At September 30, 2013	<u>\$247,390</u>

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
Nine Months Ended September 30, 2013

5. **SHARE CAPITAL**

a)	<i>Authorized:</i>	unlimited number of common shares, no par value
	<i>Issued:</i>	71,799,660 (December 31, 2012: 64,744,892)

On March 13, 2013 Titan completed an offering of securities pursuant to an agency agreement. The offer consisted of 6,260,763 units at \$1.05 for gross proceeds of \$6,573,801. (\$5,767,441 net of closing costs including 7% cash commission of \$460,166 paid in accordance with the terms of the agency agreement). Each unit comprises one common share of Titan and one warrant. Each warrant entitles its holder to purchase one additional common share of Titan for \$1.25 and will expire March 13, 2018. The warrants were valued at \$939,114 using a proportionate fair value method and the balance of \$5,634,687 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 438,253 common shares at a price of \$1.05 per share for a period of 24 months following the closing date. As at September 30, 2013 none of these Broker Warrants have been exercised by the Agent.

On March 14, 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, 2013 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 September 30, 2013, 4,377,375 common shares (December 31, 2012: 3,872,037) 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, 2013 and September 30, 2012 and changes during the periods ended on those dates is presented in the following table:

	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
Balance, beginning	2,602,452	\$0.55	2,882,404	\$ 0.47
Granted	1,073,144	\$0.57	237,848	1.47
Exercised	(794,005)	\$0.29	(367,800)	0.34
Expired	<u>(75,000)</u>	<u>\$0.31</u>	<u>(10,000)</u>	<u>0.64</u>
Balance, ending	<u>2,806,591</u>	<u>\$0.64</u>	<u>2,742,452</u>	<u>\$ 0.57</u>

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
 Nine Months Ended September 30, 2013

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, 2013 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	346,754	\$0.24	0.8	346,754	\$0.24
\$0.30	600,000	\$0.30	1.7	600,000	\$0.30
\$0.32	126,000	\$0.32	1.8	126,000	\$0.32
\$0.56	1,023,553	\$0.56	4.8	215,656	\$0.56
\$0.64	55,000	\$0.64	1.8	55,000	\$0.64
\$0.68	50,000	\$0.68	2.0	50,000	\$0.68
\$0.83	49,591	\$0.83	4.5	49,591	\$0.83
\$1.27	160,000	\$1.27	2.3	160,000	\$1.27
\$1.39	47,532	\$1.39	3.6	47,532	\$1.39
\$1.46	25,000	\$1.46	2.8	25,000	\$1.46
\$1.49	190,316	\$1.49	3.4	190,316	\$1.49
\$1.66	32,845	\$1.66	2.9	32,845	\$1.66
\$1.67	<u>100,000</u>	<u>\$1.67</u>	<u>2.0</u>	<u>100,000</u>	<u>\$1.67</u>
	<u>2,806,591</u>	<u>\$0.64</u>	<u>2.6</u>	<u>1,998,694</u>	<u>\$0.67</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
March 21, 2013, option grants to Director and Officer	<u>49,591</u>	Immediate	5 years
August 2, 2013, option grants to Directors and Officer	<u>215,656</u>	Immediate	5 years
August 2, 2013, option grants to Officers and Employees	<u>807,897</u>	25% every three months from date of option	5 years

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
Nine Months Ended September 30, 2013

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	
	2013	2012
Fair Value at grant date	\$0.45 - \$0.66	\$1.11 - \$1.26
Share price at grant date	\$0.56 - \$0.83	\$1.39 - \$1.49
Exercise price	\$0.56 - \$0.83	\$1.39 - \$1.49
Expected Volatility	110% - 114%	111% - 126%
Option Life	5 years	5 years
Expected dividends	nil	nil
Risk-free interest rate (based on government bonds)	1.34% - 1.82%	1.41% - 1.49%

The following is a summary of outstanding warrants as at September 30, 2013 and December 31, 2012 and changes during the periods then ended.

	Number of Warrants	Amount	Number of Warrants	Amount
	September 30, 2013		September 30, 2012	
Opening Balance	17,444,255	\$7,593,119	15,457,500	\$6,977,225
Issued March 14, 2012 Exercise Price of \$1.77 Expires March 14, 2017	-	-	1,986,755	615,894
Issued March 13, 2013 Exercise Price of \$1.25 Expires March 13, 2018	<u>6,260,763</u>	<u>939,114</u>	<u>-</u>	<u>-</u>
Ending Balance	<u>23,705,018</u>	<u>\$8,532,233</u>	<u>17,444,255</u>	<u>\$7,593,119</u>

In addition to the warrants listed above, the Company has issued and outstanding 918,926 Broker Warrants from previous financings.

As at September 30, 2013 none of these Broker Warrants have been exercised by the Agent.

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
Nine Months Ended September 30, 2013

6. INCOME TAXES

Losses carried forward

(a) The Company has non-capital losses of approximately \$20,721,839 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>6,931,968</u>
	<u>\$20,721,839</u>

(b) The Company has accumulated Qualifying Research and Development expenses of \$10,039,811 (December 31, 2012: \$8,880,330) 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 2013, the Company received the amount of \$179,416 (\$147,570 net after commission) with regards to the amount claimed as Ontario Investment Tax Credit (OITC) for the year ended December 31, 2013.

7. COMMITMENTS

Effective July 15, 2011, the Company entered into a lease in Ancaster, Ontario, 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.

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. As of August 22, 2013 the initial sublease was replaced with a new sublease that expires January 31, 2019.

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 its robotic 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, 2013, the Company has issued and outstanding individual purchase orders to this technology and development company which total Cdn. \$667,295 (U.S. \$648,804). The Company also has on deposit with this same U.S. supplier Cdn. \$412,000 to be applied against future invoices.

TITAN MEDICAL INC.
Notes to the Unaudited Condensed Interim Financial Statements
 Nine Months Ended September 30, 2013

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 robotic surgical system. These agreements require Titan to make minimum periodic payments for 2014 and beyond.

2014	\$ 77,500
2015	\$ 80,000
2016	\$ 80,000
2017	\$ 80,000
2018	\$ 5,000

8. **RELATED PARTY TRANSACTIONS**

During the period ended September 30, 2013, 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 9.04% of the Company.

	September 30, 2013		December 31, 2012	
	BASE	%	BASE	%
John Barker	149,000	0.21	74,000	0.11
Martin Bernholtz	1,291,500	1.80	1,291,500	2.00
John Hargrove	56,200	0.08	6,200	0.01
Craig Leon	-	-	4,277,711	6.61
Stephen Randall	45,600	0.06	25,600	0.04
Reiza Rayman	4,923,917	6.85	4,923,677	7.60
John Valvo	<u>25,000</u>	<u>0.04</u>	<u>25,000</u>	<u>0.04</u>
TOTAL	<u>6,491,217</u>	<u>9.04</u>	<u>10,623,688</u>	<u>16.41</u>
Common Shares Outstanding	<u>71,799,660</u>	<u>100%</u>	<u>64,744,892</u>	<u>100%</u>

9. MANAGEMENT CHANGES

Effective March 19, 2013 the then current CEO of the Company stepped down as Chairman and CEO. Included in Accounts payable and accrued liabilities is the amount of \$136,140 with regards to his separation package.

10. SEGMENTED REPORTING

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