



**56 Million**

People in the U.S. suffer from chronic pain and chronic wounds.



[www.theralase.com](http://www.theralase.com)

**Second Quarter Report**  
June 30, 2008

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## ***President's Message***

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### **Highlights**

- Total sales increased 40% to \$604,996, compared to \$431,133 in Q2 2007
- Canadian and U.S. product sales increased 7% and 97%, respectively, compared to Q1 2008
- R&D expenses rose to \$63,589 versus \$22,168 in Q2 2007 due to accelerated spending on TLC-3000 photodynamic technology
- Launched the new Theralase Laser Rehabilitation Centre and appointed a new clinic director
- Appointed a Vice President, Business Development to help expand into Canada and the U.S.

Theralase Technologies Inc. (TSXV: TLT) announces to shareholders its financial results for the three and six months ended June 30, 2008.

The European sale of the beta photodynamic light systems boosted total sales in the second quarter and could lead to further international sales. Product sales, particularly in the U.S., showed strong growth over the prior quarter helped by the hiring of new salespeople in Q1 2008. With the appointment of our new VP, Business Development, Mark Lemieux, we believe we can accelerate our sales and marketing initiatives in Canada and the U.S.

During the quarter, we continued to make progress developing our next generation therapeutic laser, the TLC-2000, which we expect to start selling in the first quarter of 2009. Our planned clinical studies at the Mayo Clinic and the Scripps Institute should demonstrate the efficacy of the new technology. Theralase is also developing a TLC-3000 alpha prototype, which when used with our patented photodynamic compounds, has the ability to destroy cancer cells. This prototype is slated to be delivered to University Health Network for pre-clinical evaluation in the third quarter of 2008.

### **Financial Review**

Revenue for the three months ended June 30, 2008 was \$604,996, an increase of 40% over \$431,133 in the same period in 2007 and a rise of 87% compared to \$324,026 in Q1 2008.

Product and product-related sales increased 41% to \$597,289 from \$423,306 in Q2 2007 mainly due to the sale of photodynamic light systems to a European pharmaceutical company. Canadian product sales decreased by 3% to \$248,961 but increased 7% compared to Q1 2008. Product sales to the U.S. decreased by 2% to \$163,842 but increased 97% from \$83,316 in Q1 2008. The year-over-year decrease is primarily a result of a reduction in smoking cessation product sales and the weakness in the U.S. currency. U.S. product sales are expected to improve as the Company executes on its plans to hire and deploy U.S. regional sales representatives.

Clinic services revenue declined by 1% to \$7,707 compared to \$7,827 in Q2 2007 as the Company's relocation in August 2007 temporarily shut down the Theralase clinic. The Company expects clinic services revenue to increase going forward due to the hiring of a new clinic director and the July 2008 launch of the Theralase Rehabilitation Laser Center; an in-house therapeutic facility, which will be used to treat patients as well as to showcase Theralase's products to its customers.

Gross margin was \$387,078, or 64% of revenue, compared to \$323,535, or 75% of revenue, in the corresponding period in the prior year. The change is primarily due to the addition of production personnel as well as the lower margin achieved on the production of the photodynamic light systems.

Operating expenses rose to \$609,596, or 101% of sales, from \$497,354, or 115% of sales in Q2 2007. The majority of the year-over-year increase related to the addition of new internal sales personnel, increased marketing, accelerated spending on the research and development of the TLC-2000 and TLC-3000 laser systems and administration expenses.

The net loss for the three months ended June 30, 2008 was \$222,581, which included \$49,799 of non-cash expenses (amortization, stock-based compensation expense, foreign exchange gain/loss and lease inducements). This compares to a net loss for the three months ended June 30, 2007 of \$176,463, which included \$173,292 of non-cash expenses.

During the second quarter of 2008, cash and cash equivalents decreased by \$229,445 to \$239,463. The most significant impact to the cash outflow was the net loss for the period and an increase in accounts receivable of \$154,991, of which over 63% has since been received.

### **Key Corporate Developments**

#### **TLC-2000: Biofeedback Laser Technology**

In the second quarter, Theralase designed clinical studies, in conjunction with the Mayo Clinic (Rochester, Minnesota) and the Scripps Institute (La Jolla, California), to demonstrate the efficacy of the new technology in the areas of knee osteoarthritis and diabetic wound healing, respectively. These clinical studies, if proven successful, could secure a new Current Procedural Terminology (CPT) code for reimbursement of laser treatments in the U.S. Theralase expects to start selling the TLC-2000 in the first quarter of 2009.

#### **TLC-3000: Cancer Therapy and Wound Healing**

In preparation for the next round of pre-clinical investigation, Theralase has designed and produced the alpha prototype of the TLC-3000 light source used to activate its patented PDCs in the presence of additional cancer cell lines. The TLC-3000 alpha prototype is slated to be delivered in early September 2008 to University Health Network for pre-clinical evaluation. Published results on the analysis of the PDCs are expected in the third quarter to fourth quarter of 2008.

#### **Photodynamic Therapy (PDT) Light Systems**

In April 2008, Theralase announced that the Company was chosen by a European pharmaceutical company to contract manufacture ten beta prototype photodynamic therapy (PDT) light-based systems for delivery in the second and third quarter of 2008. These PDT light systems have been completed and delivered as per schedule. These systems are to be used in combination with the European pharmaceutical company's proprietary photosensitisers (light sensitive compounds) in clinical studies commencing in the fourth quarter of 2008.

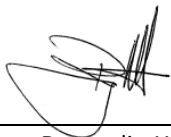
#### **Changes to the Board of Directors**

In June 2008, there were changes to Theralase's Board of Directors: Michel LeBel and H. Dan Routledge resigned from the Board and Andrew Szonyi did not stand for nomination to the Board. All three individuals joined Theralase's Board in May 2006. Frank Ricciuti was appointed to the Company's Board of Directors and granted 100,000 Theralase Technologies Inc. incentive stock options, exercisable for five years, vesting over three years at a strike price of \$0.21.

#### **Outlook**

The Company continues to invest in its future through expanding its U.S sales force for its TLC-1000 laser technology, commercializing its patented TLC-2000 biofeedback technology and researching and developing its TLC-3000 photodynamic compounds aimed at the destruction of cancer. Theralase will also increase its revenue by exploring new vertical medical markets (i.e. dental, veterinarian and physician), introducing a recurring revenue model and a take-home consumer laser system, leveraging its therapeutic laser rehabilitation and training center and partnering with existing medical facilities to create Theralase certified laser centers.

August 21, 2008



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Roger Dumoulin-White  
President & CEO

*This President's Message contains forward-looking statements which reflect the Company's current expectations regarding future events. The forward-looking statements involve risks and uncertainties. Actual results could differ materially from those projected herein. The Company disclaims any obligation to update these forward-looking statements*

## **Management's Discussion and Analysis of Financial Condition and Operations**

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The following Management Discussion and Analysis ("MD&A"), of **Theralase Technologies Inc.** (the "Company" or "Theralase") should be read in conjunction with the Company's unaudited interim consolidated financial statements for the six months ended June 30, 2008 and its audited annual consolidated financial statements for the year ended December 31, 2007. This MD&A has been filed in accordance with the provisions of National Instrument 51-102 (*Continuous Disclosure Regulation*). Copies of the further relevant financial documents, and earlier corporate filings to date, may also be referenced on the regulatory website - SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A is prepared as of August 21, 2008.

The Company's common shares are listed for trading on the TSX Venture Exchange (**Symbol: TLT**).

### **Forward Looking Statements**

*Certain statements contained or incorporated in this MD&A which deal with the Company's financial condition and operating results, include information, analyses and projections as to future corporate developments which are currently in the planning stage, and on the projected operating financial performance of the Company, which constitute forward-looking statements. Such forward-looking statements, made with special reference to the Company's ongoing technologically complex healthcare and medical device research and development efforts, which may include in-house and independent clinical trials, testing new medical technologies and their applications, involve known and unknown risks and uncertainties that could cause actual events and results to differ materially from those estimated or anticipated and which may have been implied or expressed in such forward-looking statements. No conclusions as to the successful outcome of the ongoing and planned research and development projects in which the Company is involved are intended or implied nor can they be foreseen or predicted prior to definitive corporate announcements as to their outcome.*

*Furthermore, the forward-looking statements contained in this MD&A are made as of the date hereof and the Company does not undertake any obligations to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events, or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

### **Company Profile**

**Theralase Technologies Inc.** designs, develops and manufactures patented, super-pulsed laser technology used in a wide range of bio-stimulation and bio-destruction clinical applications. The Theralase technology platform targets several diverse healthcare sectors: firstly, for non-invasive pain management and clinical therapy, in hundreds of neural muscular skeletal conditions including arthritis; secondly, to bio-stimulate and accelerate wound care and healing, including bone fracture regeneration; and thirdly, combining photodynamic compounds with super-pulsed, biofeedback laser technology to attack specifically targeted cancer, bacteria, viruses and fat cells.

### **Advancing the Theralase Technology Platform**

The following summarizes several material technical and business developments that management considers will fuel and accelerate near and longer term Company growth:

#### **TLC-2000: Biofeedback Laser Technology**

During the second quarter of 2008, Theralase made progress on commercializing its next generation therapeutic laser – the patented TLC-2000. The TLC-2000 biofeedback technology targets tissues at depths with higher precision than its competitors enabling exact doses of energy to be delivered to injured tissue at depth for enhanced efficacy and acceleration of healing. The TLC-2000 is also a learning device that remembers the most optimized protocols based on individual patients' optical tissue profiles. In the second quarter, Theralase has designed clinical studies, in conjunction with the Mayo Clinic (Rochester, Minnesota) and the Scripps Institute (La Jolla, California), to demonstrate the efficacy of the new technology in the areas of knee osteoarthritis and diabetic wound healing, respectively. These clinical studies, if

proven successful, could secure a new Current Procedural Terminology (CPT) code for reimbursement of laser treatments in the U.S. Theralase expects to start selling the TLC-2000 in the first quarter of 2009.

### **TLC-3000: Cancer Therapy and Wound Healing**

In February 2008, Theralase announced positive R&D results in the destruction of individual cancer cell lines; specifically brain cancer and colorectal cancer. All three Theralase patented PDCs used in the trials have proven the ability to selectively target cancerous cells over cells derived from healthy tissue. Additional cancer cell lines and various bacterial species will be evaluated in the next stage of the project to determine cell kill by the Photo Dynamic Compounds (PDCs). In preparation for the next round of pre-clinical investigation, Theralase has designed and produced the alpha prototype of the TLC-3000 light source used to activate the PDCs in the presence of additional cancer cell lines. The TLC-3000 alpha prototype is custom designed by Theralase for the Company's patented PDC's and will be instrumental in providing the initial pre-clinical and technical knowledge required to further develop future versions of the TLC-3000 PDC activating light source. The TLC-3000 alpha prototype is slated to be delivered in early September 2008 to University Health Network for pre-clinical evaluation. Published results on the analysis of the PDCs are expected in the third quarter to fourth quarter of 2008.

### **Photo Dynamic Compound (PDC) Light System**

In April 2008, Theralase announced that the Company was chosen by a European pharmaceutical company to contract manufacture ten beta prototype photodynamic therapy (PDT) light-based systems for delivery in the second and third quarter of 2008. These PDT light systems have been completed and delivered as per schedule. These PDT light-based systems are to be used in combination with the European pharmaceutical company's proprietary photosensitisers (light sensitive compounds) in clinical studies commencing fourth quarter 2008.

### **Theralase Announces Changes to Board of Directors**

In June 2005, Theralase announced that Michel LeBel and H. Dan Routledge resigned from the Board of Directors and that Andrew Szonyi did not stand for nomination to the Board of Directors. Mr. LeBel, Mr. Routledge and Mr. Szonyi joined Theralase's Board in May 2006.

In June 2005, Theralase announced that Frank Ricciuti has been appointed to the Company's Board of Directors. Concurrent with Mr. Ricciuti's board appointment, the Company granted Mr. Ricciuti 100,000 Theralase Technologies Inc. incentive stock options, exercisable for 5 years, vesting over 3 years at a strike price of \$0.21.

### **Theralase Launches Laser Rehabilitation Centre**

In July 2008, Theralase announced the launch of a Laser Rehabilitation Centre at its corporate headquarters. The Theralase Laser Rehabilitation Centre is a healthcare facility devoted to the expanding applications of Theralase's laser technology. The Theralase Centre will provide a training facility for practitioners employing the Theralase technology, as well as a rehabilitation clinic treating a variety of pain and tissue conditions, including: nerve, muscle and joint pain, sports medicine injuries, foot and ankle injuries, post surgical pain, dermatological conditions, wound healing, inflamed joints such as arthritis, as well as aesthetic and cosmetic applications and addictions such as smoking.

Theralase has appointed Dr. Rhonda Mostyn, who has been in private chiropractic practice since 1995 as the clinic director. The Theralase Laser Rehabilitation Centre will act as a Centre of Excellence for the expanding applications of the Company's laser technology, educating healthcare practitioners and treating patients wishing to use Theralase's therapeutic laser systems.

### **Theralase Appoints Vice President, Business Development**

In July 2008, Theralase announced that it appointed Mr. Mark Lemieux as Vice President, Business Development to drive the Company forward in expanding sales and distribution of its products into Canada and the United States. Mark Lemieux is a results-oriented business leader with proven skills in sales, marketing, business development and strategic planning in large and small business environments. Mr. Lemieux has over 27 years of sales and marketing experience, including 22

years as a senior business development executive with firms such as Marion Merrell Dow Canada, Warner Lambert Consumer Healthcare and Pfizer Canada Healthcare Canada.

*For further background on Theralase's pain therapy capabilities -- including testimonials on its laser units' role in non-invasive pain management, control and therapy -- please refer to its corporate website at [www.thermalase.com](http://www.thermalase.com).*

## Overview of Financial Performance

During the year under review, the Company's financial performance and its operating results reflected investment in production and sales of the Theralase therapeutic laser system.

## Summary of Quarterly Results (Unaudited)

	2008		2007	
	June 30	March 31	December 31	September 30 (Restated)
Total revenues	604,996	324,026	382,993	347,580
Net loss	(222,518)	(339,348)	(414,890)	(366,418)
Basic and diluted loss per share	\$ (0.0063)	\$ (0.0097)	\$ (0.0114)	\$ (0.0105)
Total assets	3,409,720	3,570,502	3,707,277	3,999,918
Total liabilities	509,663	394,008	335,122	172,656
Deficit	(7,006,800)	(6,784,219)	(6,444,271)	(6,184,983)
Shareholders' Equity	2,900,507	3,115,048	3,372,155	3,827,262

	2007 (Restated)		2006 (Restated)	
	June 30	March 31	December 31	September 30
Total revenues	431,133	398,144	362,709	326,793
Net loss	(176,463)	(155,602)	(551,626)	(6,625)
Basic and diluted loss per share	\$ (0.0053)	\$ (0.0047)	\$ (0.0166)	\$ (0.0002)
Total assets	3,573,587	3,615,249	3,533,586	3,645,768
Total liabilities	297,672	281,359	313,743	119,768
Deficit	(5,818,565)	(5,486,500)	(5,330,898)	(4,779,272)
Shareholders' Equity	3,275,915	3,333,890	3,219,843	3,526,000

Note: The restatement of the interim consolidated financial statements for the six-month period ended June 30, 2008 is explained in note 2 of the financial statements.

## Liquidity and Capital Resources

As at June 30, 2008, current assets aggregated to \$883,963 compared with current liabilities of \$451,953, netting a working capital position of \$432,010 and a current ratio (current assets vs. current liabilities) of approximately 2:1.

The Company's objective is to maintain a sufficient capital base so as to sustain future research and development and business initiatives and to maintain investor, creditor and market confidence. The Company makes every attempt to manage its liquidity to minimize shareholder dilutions when possible.

At the end of June 30, 2008, the Company had cash and cash equivalents on hand of \$239,463. Sales of the TLC-1000, the Company's existing product line, have not been sufficient in and of themselves to enable the Company to fund all its continuing development and commercialization efforts and, accordingly, management is pursuing alternate financing sources to fund the Company's development and commercialization efforts. Similar to the financing secured through the

private placement that took place on August 15, 2007, management believes that the Company will be able to secure the necessary financing through a combination of the issue of new equity or debt instruments, entering into joint venture arrangements and strategic alliances. Nevertheless, there is no assurance that these initiatives will be successful.

## Results of Operations

### Revenue

Revenue increased 40% to \$604,996 for the three-month period ended June 30, 2008, compared to \$431,133 for the same period in 2007.

Product and product-related sales for the three month period ended June 30, 2008 totaled \$597,289 representing a 41% increase over the \$423,306 in product and product-related sales reported for 2007. Product and product-related sales for the three and six month period ended June 30, 2008 and 2007 consist of the following items:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Sales Revenue	\$ 570,271	\$ 398,266	\$ 876,115	\$ 767,420
Service Revenue	13,437	7,310	18,643	16,270
Other Revenue	13,581	17,730	22,584	32,698
	<b>597,289</b>	<b>423,306</b>	<b>917,342</b>	<b>816,388</b>

Product sales increased 43% to \$570,271 for the three-month period ended June 30, 2008, compared to \$398,266 for the same period in 2007. The increase in sales was due primarily to the international sale of the beta Photo Dynamic light systems to the European market. Product sales for the three-month period ended June 30, 2008 declined in Canada by 3% to \$256,668 and in the U.S. by 2% to \$163,842 as compared to the same period in 2007. U.S. product sales are expected to increase going forward as inside sales personnel focus on the U.S. market and a U.S. regional sales team is hired during the latter half of 2008. The Company is currently evaluating augmenting our direct sales force with a leading U.S. healthcare product distributor to market products in the US market.

Clinic services revenue decreased by 1% to \$7,707. The decrease in clinic services is attributed to the Company's corporate relocation in August 2007, which temporarily shut down the Theralase clinic, while the new premises were being commissioned. The new premises provide Theralase with an in-house therapeutic facility that will be used to treat patients as well as showcase Theralase's products to its customers. This facility opened in July 2008 and will be in full operation by September 2008.

### Cost of sales

Cost of sales for the three-month period ended June 30, 2008 was \$217,918, resulting in a gross profit of \$387,078 or 64% of revenue, compared with \$107,598 or 75% for the same period in 2007. The change is primarily due to the addition of production personnel and the lower profit margin related to the production of the beta Photo Dynamic light systems. Cost of sales is represented by the following costs: raw materials, sub-contracting, direct and indirect labour, and the applicable share of manufacturing overhead.

### Operating Expenses

Selling expenses for the three month-period ended June 30, 2008 were \$172,181, representing 29% of product sales, compared with \$122,981 or 29% of product sales for the same period in 2007.

Administrative expenses for the three-month period ended June 30, 2008 were \$329,040, representing a 10% increase from \$298,625 reported for the same period in 2007, and consisted of the following items:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Insurance	\$ 14,705	\$ 15,440	\$ 27,670	\$ 26,917
Professional fees	41,920	6,984	52,926	9,384
Rent	26,400	11,155	52,799	21,297
Advisory and board fees	20,802	23,750	38,227	43,125
Other	54,178	28,368	115,400	50,519
Compensation	163,445	97,994	302,713	190,556
Stock-based compensation	7,590	114,934	90,431	229,866
	<b>329,040</b>	<b>298,625</b>	<b>680,166</b>	<b>571,664</b>

Note: The restatement of the interim consolidated financial statements for the six-month period ended June 30, 2008 is explained in note 2 of the financial statements.

The increase in administrative expenses for the three-month period ended June 30, 2008 is attributed to the following:

- Professional fees increased by 500% due to increased legal and accounting fees.
- Rent increased by 137% due to the relocation of the corporate offices to a 6,500 square foot facility in August 2007.
- Other expense increased by 91% due to personnel recruiting expenses.
- Compensation increased by 67% due to the addition of marketing, accounting and administrative personnel.
- Stock-based compensation decreased by 93% because in June 2008, certain Board Members resigned from the Board or did not stand for re-election and forfeited all non-vested options totaling 200,000 in which \$69,135 of stock-based compensation recognized in prior periods was reversed upon expiry.

#### Research and Development Costs

Research and Development costs expensed totaled \$63,589 for the three-month period ended June 30, 2008, compared to \$22,168 (includes stock-based compensation expense of \$3,573) during the same period in 2007. The increase in Research and Development costs are due to accelerated spending by the Company on its future product pipeline, specifically, the TLC-3000 photodynamic technology.

Research and Development costs capitalized on the Consolidated Balance Sheet during the three-month period ended June 30, 2008 totaled \$10,188, compared to \$15,977 during the same period in 2007. The decrease in capitalized Research and Development costs for the current period under review is due to the completion of the development phase of the TLC-2000 biofeedback technology in 2007.

#### **Assets (other than Cash and Equivalents)**

The Company holds essential and valuable intellectual property rights and assets, including patents, trademarks, development and related costs. The depreciated book value of these assets is \$568,756 to which is added \$1,861,078 in goodwill. Management considers that the value of the Company's intellectual and related property rights and assets is significantly higher than its carrying amount.

## Commitments

As of June 30, 2008, the Company's commitments consist of the following:

	2008	2009	2010	2011	2012	Total
Lease obligations	\$ 23,671	\$ 48,703	\$ 51,968	\$ 53,873	\$ 31,426	\$ 209,641
Research commitments	142,689	65,762	-	-	-	\$ 208,451
<b>Total</b>	<b>\$ 166,360</b>	<b>\$ 114,465</b>	<b>\$ 51,968</b>	<b>\$ 53,873</b>	<b>\$ 31,426</b>	<b>\$ 418,092</b>

- i) Lease obligations under a lease agreement related to its premises which commenced on August 1, 2007 and expires on July 31, 2012. Under the terms of this lease, the Company is required to pay a proportionate share of operating costs, realty taxes and utilities, in addition to the minimum rental payments. The future minimum lease payments are shown in the table above.
- ii) Research commitments under a Research Collaboration Agreement with University Health Network and Ontario Centres of Excellence Photonics Centre of Excellence for the TLC-3000 cancer therapy project. Under the terms of this agreement, the Company is required to pay a total of \$225,250 for the period of July 2007 to June 2009. For the six-month period ended June 30, 2008, the Company paid \$62,484 (\$32,142 – 2007) under this agreement.
- iii) Research commitments under a Research Collaboration Agreement with Virginia Polytechnic Institute and State University for the TLC-3000 cancer therapy project. Under the terms of this agreement the Company is required to pay \$75,686 for the period of May 2007 to August 2008.

The Company indemnifies its directors and officers against any and all costs, charges and expenses, including settlements of claims in respect of any civil, criminal or administrative action incurred in the performance of their service to the Company to the extent permitted by law. The Company maintains liability insurance for its officers and directors.

## Share Capital Analysis

As at June 30, 2008 and at the date of this MD&A, the share capital of the Company consisted of 34,936,725 common shares. Each common share entitles the holder to one vote per share. At June 30, 2008, there were 2,550,000 options outstanding, of which 899,999 were only vested and exercisable into an equivalent number of the Company's common shares at the exercise price of \$0.60. The Company also had 850,000 common share purchase warrants outstanding, entitling its holder to purchase one common share at the price of \$0.75 per share for each warrant held.

To the knowledge of the Directors and senior officers of the Corporation, the only person or persons or companies beneficially owning or controlling, directly or indirectly, common shares carrying more than ten percent(10%) of the voting rights attached to all common shares of the Corporation, is Roger Dumoulin-White who directly holds 4,251,370 (12.2%) of the outstanding common shares of the Corporation (not including 197,756 shares held by his spouse, Kristina Hachey, over which shares Mr. White disclaims any beneficial interest or control), and S. Donald Moore, who directly holds 1,028,430 common shares, and indirectly holds 10,543,025 common shares through his associate, Talent Oil and Gas Ltd., and effectively controls, or exercises direction over, an aggregate of 11,573,455 (33%) of the outstanding common shares of the Corporation.

## Segmented Information

The statements and projections herein are understood to be limited to one reportable operating segment which, for the purposes of this MD&A, comprises the manufacturing and sales of the Company's therapeutic medical laser equipment, largely in the North American market, without any differentiation as to geographic areas or locations. Manufacturing and marketing affiliations are being investigated in the European and Pacific Rim markets, but no firm business arrangements have been concluded to date.

## **Selected Financial Information and Accounting Policies**

The interim Consolidated Financial Statements for three month period ended June 30, 2008, and all other Financial Statements referred to herein, have been prepared in accordance with Canadian generally accepted accounting principles (GAAP), consistently applied, and all amounts and currencies reported therein, and in this MD&A, are in Canadian dollars, unless otherwise noted. The ongoing accounting policies are more particularly described in the Notes to the audited Consolidated Financial Statements for the fiscal year ended December 31, 2007. Please refer to the Company's historic annual and quarterly financial statement filings, including material interim Press Releases, on the regulatory website -- [www.SEDAR.com](http://www.SEDAR.com).

## **Use of Financial Instruments**

The Company's financial instruments consists of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The fair values of cash, accounts receivable, accounts payable and accrued liabilities approximate carrying value because of the short-term nature of these instruments.

(i) Credit risk:

Cash equivalents are held in high-grade, bankers' acceptance and other low risk investments with no exposure to liquidity or other risk associated with Asset-Backed Securities. These financial instruments are classified as held for trading as they may periodically be traded before their maturity date. However, the majority of these financial instruments is held to maturity and would not result in a significant risk of fair value changes if held to maturity. At June 30, 2008 maturities on investments is 30 days.

(ii) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk by continuously monitoring forecasted and actual cash flows, as well as anticipated investing and financing activities. The Company does not have long-term financial liabilities.

(iii) Market risk:

Market risk is the risk that changes in market prices, such as foreign currency exchange rates and interest rates will affect the Company's income or the value of the financial instruments held.

(iv) Foreign currency exchange risk:

The Company's primary risks are exposure to foreign currency exchange risk. These risks arise from the Company's holdings of US dollar denominated cash, accounts receivable and accounts payable. Changes arising from these risks could impact the Company's reported foreign exchange gains or losses. The Company limits its exposure to foreign currency risk by holding US denominated cash in amounts of up to 100% of forecasted twelve month US dollar expenditures, thereby creating a natural hedge against foreign currency fluctuations and limiting foreign currency risk to translation of US dollar balances at the balance sheet date.

The Company has not entered into any conventional or other financial instruments designed to minimize its investment risk, currency risk or commodity risk. No off-balance sheet arrangements have been established nor are there any pending proposals or indicated business requirements to this effect.

## **Disclosure Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures, including adherence to the Disclosure Policy adopted by the Company. The Disclosure Policy requires all staff to keep the Chief Executive Officer and Chief Financial Officer fully apprised of all material information affecting the Company so that they may evaluate and discuss this information and determine the appropriateness and timing for public release. Access to such material information by the Chief Executive Officer and Chief Financial Officer is facilitated by the small size of the Company's senior management and regular communication between them.

The Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures as of June 30, 2008, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its subsidiaries would have been known to them.

The Company's Chief Executive Officer and Chief Financial Officer are also responsible for the design of internal controls over financial reporting. The fundamental issue is ensuring all transactions are properly authorized and identified and entered into a well designed, robust and clearly understood system on a timely basis to minimize risk of inaccuracy, failure to fairly reflect transactions, failure to fairly record transactions necessary to present financial statements in accordance with generally accepted accounting principles, unauthorized receipts and expenditures, or the inability to provide assurance that unauthorized acquisition or dispositions of assets can be detected. The relatively small size of the Company makes the identification and authorization process relatively efficient and a process for reviewing internal controls over financial reporting has been developed. To the extent possible given the Company's small size, the internal control procedures provide for appropriate segregation of duties.

As a result of a thorough review of the Company's prior financial statements, the Company has determined that the previously filed financial statements contained errors requiring restatement as reflected in Note 2 to the December 31, 2007 and 2006 consolidated financial statements. The Company has concluded that there were material weaknesses in the internal control over financial reporting as of December 31, 2007 and that the Company lacked sufficient in-house expertise to ensure compliance with the measurement and recognition requirements under Canadian GAAP for certain transactions.

The Company undertook efforts to improve its internal control over financial reporting and to remediate the material weaknesses identified above. The Company has taken the following actions:

- On-going commitment from Management and the Board of Directors to strengthen internal controls.
- When complex or unusual transactions surface, management has committed to actively seeking a solution in-house and then consulting its actions with third party consultants prior to final resolution.
- Management has committed to updating its Canadian GAAP knowledge and has established a number of control procedures designed to strengthen its capabilities to both identify and address any potential errors before they are reported in the future.

With the implementation of these corrective actions, the Company believes that the above noted actions will address the material weaknesses that were identified in its internal control over financial reporting as of June 30, 2008. However, the proof of the effectiveness of these procedures remains to be tested in 2008 and several fiscal quarters may be required prior to management being able to conclude that the material weaknesses have been remediated. The Company will continue to periodically review its disclosure controls and procedures and internal control over financial reporting and may make additional modifications from time to time as considered necessary or desirable.

## **Critical Accounting Policies and Estimates**

The Company's critical accounting policies and estimates are disclosed in the notes to the annual consolidated financial statements contained in our 2007 Annual Report.

## **Changes in Accounting Policies**

### **Adoption of New Accounting Standards**

Effective January 1, 2008, the Company adopted CICA Handbook Section 1535, *Capital Disclosures*. This section establishes standards for disclosing information about an entity's objectives, policies and processes for managing capital. This standard is effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis.

Effective January 1, 2008, the Company adopted CICA Handbook Section 3862, *Financial Instruments - Disclosures*, and Section 3863, *Financial Instruments - Presentation*. These standards enhance existing disclosures in previously issued Section 3861, *Financial Instruments - Disclosure and Presentation*. Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis.

Effective January 1, 2008, the Company adopted amended CICA Handbook Section 1400, *General Standards of Financial Statement Presentation*. These amendments require management to disclose any uncertainties that cast significant doubt on the entity's ability to continue as a going concern. In assessing whether the going concern assumption is appropriate, management must take into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet date.

The above sections relate to disclosure and presentation only and did not have an impact on the Company's financial results or position. See notes 1, 11 and 12 of the interim consolidated financial statements for the three month period ended June 30, 2008.

Effective January 1, 2008, the Company adopted CICA Handbook Section 3031, *"Inventories"*, which addresses the measurement and disclosure of inventory. The new standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The adoption of this standard did not have a material impact on the Company's financial statements.

#### **Future Accounting Pronouncements**

The potential impact that the application of a new GAAP standard will have on the financial statements in the period of initial adoption is as follows:

- In November 2007, the CICA issued Section 3064, *"Goodwill and Intangible Assets"* ("Section 3064"). Section 3064, which replaces Section 3062 *"Goodwill and Intangibles Assets"*, and Section 3450 *"Research and Development Costs"*, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This standard is effective for the Company for its interim financial statements beginning on October 1, 2008. The Company is currently assessing the impact that this section will have on its financial statements.
- In 2005, the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada for public companies are to converge with IFRS. In May 2007, the CICA published an updated version of its "Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP". This plan includes an outline of the key decisions that the CICA will need to make as it implements the Strategic Plan for publicly accountable enterprises that will converge Canadian GAAP with IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed. The CICA has confirmed the changeover date from current Canadian GAAP to IFRS to be January 1, 2011. The Company is currently assessing the future impact of these new standards on its financial statements.

#### **Risks and Uncertainties**

The Company's operations involve certain risks and uncertainties that are inherent to the Company's industry. The most significant known risks and uncertainties faced by the Company are described below.

##### Capital Resources

In order to achieve its long term development and commercialization strategy for the Company's range of biomedical laser systems and photodynamic compounds, the Company will need to raise additional capital through the issuance of shares, collaboration agreements or partnerships that would allow the Company to finance its activities. Nothing guarantees that additional funds will be available or that they may be acquired according to acceptable terms and conditions. Additional financing may result in dilution of shareholder value.

### Volatility of Share Price

The market price of the Company's shares is subject to volatility. General market conditions as well as differences between the Company's financial, scientific and clinical results and the expectations of investors as well as securities analysts can have a significant impact on the trading price of the Company's shares.

### Regulatory Approvals

The Company is directly and indirectly engaged in the design, manufacture, sale and marketing of biomedical laser equipment, a category of medical device which is subject to regulatory oversights, audits and controls by various national regulatory agencies (FDA, Health Canada, CE) and authoritative quality standards bodies (UL, CSA, ISO and TUV), all with strict quality certification procedures. The Company is in full compliance with all the governing regulatory and quality standards approval requirements pertaining to the medical laser devices it currently designs, manufactures and markets. No assurance can be given that current regulations relating to regulatory approval will not change or become more stringent and it must be noted that product approvals may be withdrawn if compliance with regulatory standards is not maintained.

### Licenses and Patents

The Company's success will depend in part on its ability to obtain licenses and patents, protect its trade secrets and operate without infringing the exclusive rights of other parties. There is no guarantee that any license and patent that will be granted to the Company will bring any competitive advantage to the Company, that its license and patent protection will not be contested by third parties, or that the licenses and patents of competitors will not be detrimental to the Company's commercial activities. It cannot be assured that competitors will not independently develop products similar to the Company's products, that they will not imitate the Company's products or that they will not circumvent or invalidate licenses and patents granted to the Company.

### Currency Risk

The Company is exposed to currency risk through export sales, primarily in U.S. dollars. Changes in exchange rates may result in foreign exchange gains or losses. The Company does not use derivative instruments to reduce our exposure to foreign currency risk and do not anticipate using any hedging strategies in a material way in the immediate future. Management will continue to assess the situation and may, as a result, change its approach to hedging foreign exchange currency fluctuations.

### Credit Risk

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, cash equivalents and accounts receivable. Cash and cash equivalents are in place with major financial institutions. The Company, in the normal course of business, is exposed to credit risk from its customers substantially all of whom are in the Medical industry. These accounts receivable are subject to normal industry credit risks. The Company manages its credit risk through its credit evaluation, approval and monitoring processes.

### Human Resources

The Company's success is dependent upon its ability to attract and retain a highly qualified work force, and to establish and maintain close relationships with research centers. Competition is intense and the Company's success will depend, to a great extent, on its senior executives, scientific staff, and collaborators. The loss of key personnel could compromise the rhythm and success of product development.

### Product Liability


The Company has obtained product liability insurance coverage in the total amount of \$1,000,000. These insurance coverages are a limited guarantee and a product liability claim could potentially be greater than these coverages. The Company's profitability would be adversely affected by a successful product liability claim in excess of its insurance coverage.

### **Outlook**

The Company continues to invest in its future through expanding its U.S sales force for its TLC-1000 laser technology, commercializing its patented TLC-2000 biofeedback technology, and researching and developing its TLC-3000 photodynamic compounds aimed at the destruction of cancer. Theralase will also increase its revenue by exploring new

vertical medical markets (i.e. dental, veterinarian and physician), introducing a recurring revenue model and a take-home consumer laser system, launching its therapeutic laser rehabilitation and training center, and partnering with existing medical facilities to create Theralase certified laser centers.

August 21, 2008

A handwritten signature in black ink, consisting of several overlapping loops and a final vertical stroke on the right side.

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Roger Dumoulin-White  
President & CEO

# THERALASE® TECHNOLOGIES INC.

Consolidated Balance Sheets - Unaudited

As at June 30, 2008 and December 31, 2007

Stated in Canadian Dollars

	2008	2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents (note 4)	\$ 239,463	\$ 507,969
Accounts receivable	383,888	327,851
Inventory	198,383	220,136
Prepaid expenses and other assets	62,229	75,081
	883,963	1,131,037
Property, plant and equipment	95,923	96,939
Intangibles	568,756	618,223
Goodwill	1,861,078	1,861,078
	<b>\$ 3,409,720</b>	<b>\$ 3,707,277</b>
<b>Liabilities</b>		
Current liabilities		
Bank loan	\$ 65,000	\$ -
Accounts payable and accrued liabilities	383,548	291,316
Deferred revenue current	3,405	-
Total current liabilities	451,953	291,316
Deferred revenue	19,400	10,000
Leasehold inducement	38,310	33,806
Total liabilities	509,663	335,122
<b>Shareholders' Equity</b>		
Share capital	7,089,139	7,089,139
Share purchase warrants	103,495	103,495
Contributed surplus (note 7)	2,714,223	2,623,792
Deficit	(7,006,800)	(6,444,271)
	2,900,057	3,372,155
	<b>\$ 3,409,720</b>	<b>\$ 3,707,277</b>

Going Concern (note 1)

Commitments (note 11)

Approved on Behalf of the Board

\_\_\_\_\_

Director

\_\_\_\_\_

Director

# TherAlase® Technologies Inc.

Consolidated Statements of Operations, Comprehensive Loss and Deficit - Unaudited

For the six and three month period ended June 30

Stated in Canadian Dollars

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007 Restated (note 2)	2008	2007 Restated (note 2)
<b>Revenue</b>				
Product sales	\$ 597,289	\$ 423,306	\$ 917,342	\$ 816,388
Clinic services	7,707	7,827	11,680	12,889
	604,996	431,133	929,022	829,277
<b>Cost of Sales</b>				
	217,918	107,598	322,819	202,415
<b>Gross Margin</b>				
	387,078	323,535	606,203	626,862
<b>Operating Expenses</b>				
Selling	172,181	122,981	297,979	245,590
Administrative	329,040	298,625	680,166	571,664
Research and development	63,589	22,168	109,626	43,573
Amortization of property, plant and equipment	6,298	3,699	12,493	7,399
Amortization of intangibles	36,907	37,780	73,812	75,559
(Gain) loss on foreign exchange	1,581	12,101	(1,182)	13,594
	609,596	497,354	1,172,894	957,379
<b>Loss before the following</b>				
	(222,518)	(173,819)	(566,691)	(330,517)
Interest expense	2,652	3,709	3,273	5,153
Interest income	(2,589)	(1,065)	(7,435)	(3,605)
<b>Loss and comprehensive loss for the period</b>				
	(222,581)	(176,463)	(562,529)	(332,065)
<b>Deficit, beginning of period</b>				
	(6,784,219)	(5,486,500)	(6,444,271)	(5,330,898)
<b>Deficit, end of period</b>				
	\$ (7,006,800)	\$ (5,662,963)	\$ (7,006,800)	\$ (5,662,963)
<b>Basic and diluted loss and comprehensive loss per common share (note 6)</b>				
	\$ (0.0064)	\$ (0.0053)	\$ (0.0161)	\$ (0.0100)
<b>Weighted average number of shares outstanding (note 6)</b>				
	34,936,725	33,236,725	34,936,725	33,236,725

Going Concern (note 1)

# THERALASE® TECHNOLOGIES INC.

Statement of Shareholders' Equity - Unaudited

As at June 30

Stated in Canadian Dollars

	Number of Shares	Share Capital	Contributed Surplus	Common Share Purchase Warrants	Deficit	Total Shareholders' Equity
	#	\$	\$	\$	\$	\$
<b>Balance, December 31, 2006</b>	33,236,725	6,403,317	2,147,424	-	(5,330,898)	3,219,843
Stock Options Exercised	-	-	-	-	0	0
Stock Options Expired	-	-	-	-	0	0
Stock-based compensation expense	-	-	476,368	-	0	476,368
Issued pursuant to private placement, net	1,700,000	685,822	-	103,495	0	789,317
Net Loss for the year	-	-	-	-	(1,113,373)	(1,113,373)
<b>Balance, December 31, 2007</b>	34,936,725	7,089,139	2,623,792	103,495	(6,444,271)	3,372,155
Stock-based compensation expense			90,431			90,431
Net Loss for the six-month period ended June 30, 2008					(562,529)	(562,529)
<b>Balance, June 30, 2008</b>	34,936,725	7,089,139	2,714,223	103,495	(7,006,800)	2,900,057

# THERALASE® TECHNOLOGIES INC.

Consolidated Statements of Cash Flows - Unaudited

For the six and three month period ended June 30

Stated in Canadian Dollars

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007 Restated (note 2)	2008	2007 Restated (note 2)
<b>Cash flows from operating activities</b>				
Net loss for the period	\$ (222,581)	\$ (176,463)	\$ (562,529)	\$ (332,065)
Items not involving cash				
Amortization of property, plant and equipment	6,298	3,699	12,493	7,399
Amortization of intangibles	36,907	37,780	73,812	75,559
Stock-based compensation (note 5)	7,590	119,742	90,431	239,484
Foreign exchange (gain) loss	1,581	12,101	(1,182)	13,594
Lease inducements	(2,577)	-	4,504	-
Non-monetary transactions	-	-	-	-
	(172,782)	(3,141)	(382,471)	3,971
Change in operating assets and liabilities other than cash				
Accounts receivable	(154,991)	(38,720)	(54,855)	(8,722)
Inventory	23,250	(12,985)	21,753	(57,199)
Prepaid expenses and other assets	34,065	(19,868)	12,852	(63,419)
Accounts payable and accrued liabilities	(8,213)	1,413	105,037	(41,071)
	(278,671)	(73,301)	(297,684)	(166,440)
<b>Cash flows from investing activities</b>				
Purchase of property, plant and equipment	(4,468)	-	(11,478)	(416)
Investment in development costs	(10,188)	(15,977)	(18,784)	(37,783)
Investment in patents and trademarks	(1,118)	-	(5,560)	(2,630)
	(15,774)	(15,977)	(35,822)	(40,829)
<b>Cash flows from financing activities</b>				
(Repayment) additions of bank loan	65,000	14,900	65,000	25,000
	65,000	14,900	65,000	25,000
Increase (decrease) in cash and cash equivalents during the period	(229,445)	(74,378)	(268,506)	(182,269)
Cash and cash equivalents, beginning of period	468,908	126,707	507,969	234,598
Cash and cash equivalents, end of period	\$ 239,463	\$ 52,329	\$ 239,463	\$ 52,329
<b>Cash and cash equivalents</b>				
Cash	\$ (30,512)	\$ 2,497	\$ (30,512)	\$ 2,497
Cash equivalents	269,975	49,832	269,975	49,832
	\$ 239,463	\$ 52,329	\$ 239,463	\$ 52,329

# **THERALASE<sup>®</sup> TECHNOLOGIES INC.**

## **Notes to Interim Consolidated Financial Statements - Unaudited**

**For the six months ended June 30, 2008**

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### **1. Nature of operations and going concern**

#### **Nature of operations**

Theralase<sup>®</sup> Technologies Inc. ("the Company") designs, develops and manufactures patented, super-pulsed laser technology used in bio-stimulative and bio-destructive clinical applications. The Theralase<sup>®</sup> technology platform targets several healthcare sectors; firstly, for non-invasive pain management and clinical therapy, used in neural muscular skeletal conditions, (including arthritis and osteoarthritis) secondly, wound care and healing, (including: non-healing fractures and bone fracture regeneration) and thirdly, research and development into combining patented photodynamic compounds with patented super-pulsed, biofeedback laser technology to attack specifically targeted cancers, bacteria, viruses and fat cells.

The Company's common shares trade on the Toronto Stock Exchange Venture Exchange ("TSX Venture Exchange") under the symbol "TLT" and on the NASDAQ (OTC BB) under the symbol "TLTFF".

#### **Going concern**

These financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due.

For the six-month period ended June 30, 2008, the Company reported a loss of \$562,529 and an accumulated deficit of \$7,006,800 at that date. The future success of the Company depends primarily upon the Company's ability to produce revenue on a timely basis from the development, commercialization and sale of its current and new therapeutic laser product offerings. These circumstances lend substantial doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

Although the Company has cash and cash equivalents on hand of \$239,463 at June 30, 2008, sales of the TLC-1000, the Company's existing product line, have not been sufficient in and of themselves to enable the Company to fund all its continuing development and commercialization efforts and, accordingly, management is pursuing alternate financing sources to fund the Company's development and commercialization efforts. Similar to the financing secured through the private placement that took place on August 15, 2007, management believes that the Company will be able to secure the necessary financing through a combination of the issue of new equity or debt instruments, entering into joint venture arrangements and strategic alliances. Nevertheless, there is no assurance that these initiatives will be successful.

The Company's ability to continue as a going concern is dependent upon the successful completion of the development and commercialization of its future products and the sale of its current and future product offerings. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary were the going concern assumption inappropriate, and these adjustments could be material.

### **2. Restatement of previously issued financial statements**

The Company has determined that certain adjustments are required to restate the unaudited interim Consolidated Balance Sheet, Consolidated Statements of Operations, Comprehensive Loss and Deficit, and Consolidated Statement of Cash Flows for the six and three month period ended June 30, 2007 to correct errors.

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

For the six months ended June 30, 2008

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The effect of the restatements for the six-month period ended June 30, 2007 is as follows:

Line Item	As Previously Reported (iii)	Restatements	As Restated
<b>Consolidated Statement of Operations and Deficit</b>			
Administrative expense (i)	436,487	121,583	558,070
Research and development expense (i), (ii)	3,349	40,224	43,573
Loss for the year	(170,258)	(161,807)	(332,065)
Deficit, beginning of year (ii)	(5,023,630)	(307,268)	(5,330,898)
Deficit, ending of year	(5,193,888)	(469,075)	(5,662,963)
<b>Consolidated Statement of Cash Flows</b>			
Cash flows from operating activities	(129,976)	(36,464)	(166,440)
Cash flows from investing activities	(77,293)	36,464	(40,829)
<b>Loss per common share</b>			
Basic and fully diluted loss per common share	(0.0051)	(0.0049)	(0.0100)

- (i) The Company has determined that it incorrectly reported stock-based compensation included in administrative and research and development expenses. The fair value of the stock options granted was originally calculated using a volatility rate of 45.0% for each option grant in 2006, whereas the actual volatility rates range from 100.1% to 100.5%. As well, the Company did not correctly account for non-employee stock options granted, which are required to be revalued until the time the awards vest. As a result, administrative and research and development expenses were understated by \$121,583 and \$3,760, respectively, for the six-month period ended June 30, 2007.
- (ii) Development costs and costs relating to patents and trademarks for the TLC-3000 – Cancer Therapy project in the amount of \$219,293 respectively were incorrectly capitalized by management. These costs did not meet the CICA Handbook criteria for deferral at the time of capitalization and as a result, these costs have been expensed. Of these costs, \$182,829 were capitalized prior to 2007 and they have been adjusted to the opening deficit for the year ended December 31, 2007, with the remaining \$36,464 adjusted as an increase in research and development expense for the six-month period ended June 30, 2007.
- (iii) Certain comparative amounts in the financial statements have been reclassified to reflect current year presentation: Stock-based compensation expense was previously presented separately under operating expenses in the amount of \$111,632, where this amount has been reclassified to administrative and research and development expenses in the amounts of \$108,284 and \$3,348 respectively, prior to reflecting the adjustments described above. Expenses relating to advertising, marketing and travel in the amount of \$136,131 were reclassified out of administrative expense and into selling expense, and \$29,700 was reclassified from administrative expense to cost of sales, representing overhead cost on product sales for the six-month period ended June 30, 2007.

### 3. Summary of significant accounting policies

These unaudited interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements ("Canadian GAAP") and are prepared following accounting

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

For the six months ended June 30, 2008

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policies consistent with the Company's annual financial statements and related notes thereto for the year ended December 31, 2007, with the exception of the changes in accounting policies described below.

### Changes to existing accounting policies

#### Revenue recognition

Product sales revenue is recognized when title passes to the customer and collectability is reasonably assured. Clinic services revenue is recognized when the service is delivered to the patient and the collection is reasonably assured.

Deferred revenue consists of unearned revenue from the sale of extended warranty plans and sales with payment terms extending beyond one year.

#### Adoption of new accounting standards

Effective January 1, 2008, the Company adopted CICA Handbook Section 1535, *Capital Disclosures*. This section establishes standards for disclosing information about an entity's objectives, policies and processes for managing capital. This standard is effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis.

Effective January 1, 2008, the Company adopted CICA Handbook Section 3862, *Financial Instruments - Disclosures*, and Section 3863, *Financial Instruments - Presentation*. These standards enhance existing disclosures in previously issued Section 3861, *Financial Instruments - Disclosure and Presentation*. Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis.

Effective January 1, 2008, the Company adopted amended CICA Handbook Section 1400, *General Standards of Financial Statement Presentation*. These amendments require management to disclose any uncertainties that cast significant doubt on the entity's ability to continue as a going concern. In assessing whether the going concern assumption is appropriate, management must take into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet date.

The above sections relate to disclosure and presentation only and did not have an impact on the Company's financial results or position. See notes 1, 8 and 9.

Effective January 1, 2008, the Company adopted CICA Handbook Section 3031, "Inventories", which addresses the measurement and disclosure of inventory. The new standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The adoption of this standard did not have a material impact on the Company's financial statements.

#### Future accounting pronouncements

The potential impact that the application of a new GAAP standard will have on the financial statements in the period of initial adoption is as follows:

- In November 2007, the CICA issued Section 3064, "Goodwill and Intangible Assets" ("Section 3064"). Section 3064, which replaces Section 3062 "Goodwill and Intangibles Assets", and Section 3450 "Research and Development Costs", establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This standard is effective for the Company for its interim financial statements beginning on

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

For the six months ended June 30, 2008

October 1, 2008. The Company is currently assessing the impact that this section will have on its financial statements.

- In 2005, the Accounting Standards Board of Canada (“AcSB”) announced that accounting standards in Canada for public companies are to converge with IFRS. In May 2007, the CICA published an updated version of its “Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP”. This plan includes an outline of the key decisions that the CICA will need to make as it implements the Strategic Plan for publicly accountable enterprises that will converge Canadian GAAP with IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed. The CICA has confirmed the changeover date from current Canadian GAAP to IFRS to be January 1, 2011. The Company is currently assessing the future impact of these new standards on its financial statements.

#### 4. Cash and cash equivalents

The cash and cash equivalents consist of a short-term bankers’ acceptance yielding an interest rate of 2.85% and maturing on June 10, 2008, prime linked guaranteed investment certificate yielding an interest rate of 2.50% and redeemable at any time and cash held and bank indebtedness in bank accounts.

#### 5. Incentive stock options

The Company has a stock option plan reserving for issue under this plan 10% (3,493,672 common shares) of the outstanding common shares. Under the Company's stock option plan, the Board of Directors may grant, at its discretion, options to purchase shares to certain employees, officers, directors and consultants of the Company. Terms and conditions of the option and vesting provisions are at the discretion of the Board of Directors.

A summary of options issued under the Stock Option Plan for the six-month period ended June 30 is provided below.

	2008		2007	
	Number of Options	Exercise Price	Number of Options	Exercise Price
Outstanding beginning of period	2,750,000	\$0.60	2,650,000	\$0.60
Granted during the period <sup>(1)</sup>	100,000	\$0.21	-	-
Exercised during the period	-	-	-	-
Expired or cancelled during the period <sup>(2)</sup>	(200,000)	\$0.60	-	-
<b>Options outstanding at end of year</b>	<b>2,650,000</b>	<b>\$0.60</b>	<b>2,650,000</b>	<b>\$0.60</b>

<sup>(1)</sup> On June 26, 2008, the Company granted a total of 100,000 to a director of the Company

<sup>(2)</sup> On June 26, certain Board Members resigned from the Board or did not stand for re-election and forfeited all non-vested options totaling 200,000.

The following table summarizes information on the stock options outstanding at March 31, 2008:

Options outstanding	Options Outstanding			Options Exercisable	
	Exercise Price	Weighted Average Remaining Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
350,000	\$ 0.60	2.6 years	\$ 0.60	233,333	\$ 0.60
2,100,000	\$ 0.60	2.5 years	\$ 0.60	666,666	\$ 0.60
100,000	\$ 0.60	4.2 years	\$ 0.60	-	-
100,000	\$ 0.21	5 years	\$ 0.21	-	-

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

### For the six months ended June 30, 2008

Under the stock option plan, the options vest in equal installments over a period of three years commencing one year after the grant. As at June 30, 2008, 899,999 of the options were vested. All outstanding options as at June 30, 2008 will be fully vested by June 26, 2011.

The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2008	2007
Risk-free interest rate (%)	2.99%	4.51%
Expected volatility (%)	93.0%	100.1%
Expected life (years)	5	5
Expected dividends	-	-
Weighted average grant date fair value	\$0.152	\$0.345

For the six-month period ended June 30, 2008, the Company recognized a stock-based compensation expense of \$90,431 for options issued to employees and medical scientific and advisory board (2007 - \$239,484 as restated).

#### 6. Loss and comprehensive loss per common share

Basic loss and comprehensive loss per common share has been calculated based on the weighted average number of common shares outstanding during each of the years presented in the consolidated financial statements.

Basic and diluted loss and comprehensive loss per common share for the three and six month periods ended June 30:

	Three months ended June 30		Six months ended June 30	
	2008	2007 Restated (note 2)	2008	2007 Restated (note 2)
Net loss	\$ (222,581)	\$ (176,463)	(562,529)	(332,065)
Weighted average number of common shares	34,936,725	33,236,725	34,936,725	33,236,725
<b>Basic and diluted loss and comprehensive loss per common share</b>	<b>\$ (0.0064)</b>	<b>\$ (0.0053)</b>	<b>\$ (0.0161)</b>	<b>\$ (0.0100)</b>

Options to purchase 2,650,000 common shares and warrants to purchase 850,000 common shares were not included in the computation of diluted loss and comprehensive loss per common share for the six month periods ended June 30, 2008 and 2007 due to their anti-dilutive nature.

#### 7. Contributed surplus

As at June 30, 2008 and 2007, contributed surplus consisted of the following:

	2008	2007 Restated (note 2)
Balance, beginning of period	\$ 2,623,792	\$ 2,147,424
Stock-based compensation expense	90,431	238,184
<b>Balance, end of period</b>	<b>\$ 2,714,223</b>	<b>\$ 2,385,608</b>

# THERALASE<sup>®</sup> TECHNOLOGIES INC.

## Notes to Interim Consolidated Financial Statements - Unaudited

For the six months ended June 30, 2008

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### 8. Financial instruments

The Company's financial instruments consists of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The fair values of cash, accounts receivable, accounts payable and accrued liabilities approximate carrying value because of the short-term nature of these instruments.

(i) Credit risk:

Cash equivalents are held in high-grade, bankers' acceptance and other low risk investments with no exposure to liquidity or other risk associated with Asset-Backed Securities. These financial instruments are classified as held for trading as they may periodically be traded before their maturity date. However, the majority of these financial instruments are held to maturity and would not result in a significant risk of fair value changes if held to maturity. At June 30, 2008 maturities on investments is 30 days.

(ii) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk by continuously monitoring forecasted and actual cash flows, as well as anticipated investing and financing activities. The Company does not have long-term financial liabilities.

(iii) Market risk:

Market risk is the risk that changes in market prices, such as foreign currency exchange rates and interest rates will affect the Company's income or the value of the financial instruments held.

(iv) Foreign currency exchange risk:

The Company's primary risks are exposure to foreign currency exchange risk. These risks arise from the Company's holdings of US and Canadian dollar denominated cash, accounts receivable and accounts payable. Changes arising from these risks could impact the Company's reported foreign exchange gains or losses. The Company limits its exposure to foreign currency risk by holding US denominated cash in amounts of up to 100% of forecasted twelve month US dollar expenditures, thereby creating a natural hedge against foreign currency fluctuations and limiting foreign currency risk to translation of US dollar balances at the balance sheet date.

Accounts exposed to foreign exchange risk as at:

	June 30, 2008			December 31, 2007		
	CDN\$ Balance	USD\$ Balance (1)	Total	CDN\$ Balance	USD\$ Balance (1)	Total
Cash and equivalents	\$ 251,823	\$ (12,360)	\$ 239,463	\$ 501,772	\$ 6,197	507,969
Accounts receivable	\$ 269,999	113,889	383,888	208,622	119,229	327,851
Accounts payable	\$ 271,801	111,747	383,548	259,005	32,311	291,316
<b>Total</b>	<b>\$ 793,623</b>	<b>\$ 213,276</b>	<b>\$ 1,006,899</b>	<b>\$ 969,399</b>	<b>\$ 157,737</b>	<b>\$ 1,127,136</b>

<sup>(1)</sup> All USD balances are shown in Canadian dollar equivalents.

(v) Foreign currency exchange risk sensitivity analysis:

The following table details the Company's sensitivity analysis to a 10% strengthening in the US Dollar on foreign currency denominated monetary items and adjusts their translation at the balance sheet date for a 10% change in foreign currency rates. For a 10% weakening of the US Dollar against the Canadian Dollar, there would be an equal and opposite impact on net and comprehensive loss for the period.

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Change in foreign exchange gain/(loss) resulting from currency fluctuations as at:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	<b>10% Foreign Currency Strengthening</b>	<b>10% Foreign Currency Strengthening</b>
Cash and equivalents	(1,216)	620
Accounts receivable	11,201	12,028
Accounts payable	10,990	3,260
<b>Total</b>	<b>(1,005)</b>	<b>9,388</b>

### 9. Management of Capital

The Company's objective is to maintain a sufficient capital base so as to sustain future research and development and business initiatives and to maintain investor, creditor and market confidence. The Company makes every attempt to manage its liquidity to minimize shareholder dilutions when possible.

For the six-month period ended June 30, 2008, the Company reported a loss of \$562,529 and an accumulated deficit of \$7,006,800 at that date. Although the Company has cash and cash equivalents on hand of \$239,463 at June 30, 2008, sales of the TLC-1000, the Company's existing product line, have not been sufficient in and of themselves to enable the Company to fund all its continuing development and commercialization efforts and, accordingly, management is pursuing alternate financing sources to fund the Company's development and commercialization efforts. Similar to the financing secured through the private placement that took place on August 15, 2007, management believes that the Company will be able to secure the necessary financing through a combination of the issue of new equity or debt instruments, entering into joint venture arrangements and strategic alliances. Nevertheless, there is no assurance that these initiatives will be successful.

The Company is not subject to an externally exposed capital requirements and the Company does not use financial ratios to manage capital.

### 10. Segmented information

The Company is organized and managed as a single reportable business segment. The Company's operations are substantially all related to the research, design, manufacture and sales of therapeutic laser products and services.

The following table displays revenue from product sales by geographic area for the three and six month periods ended June 30:

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Canada	\$ 256,668	\$ 264,258	\$ 497,378	\$ 401,719
International	184,486	-	184,486	-
United States	163,842	166,875	247,158	427,558
	<b>604,996</b>	<b>431,133</b>	<b>929,022</b>	<b>829,277</b>

Revenue from clinic services is all earned in Canada.

As at June 30, 2008 and 2007, the Company's long-lived assets used in operations are all located in Canada.

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### 11. Commitments

The Company's commitments consist of the following:

	2008	2009	2010	2011	2012	Total
Lease obligations	\$ 23,671	\$ 48,703	\$ 51,968	\$ 53,873	\$ 31,426	\$ 209,641
Research commitments	142,689	65,762	-	-	-	\$ 208,451
<b>Total</b>	<b>\$ 166,360</b>	<b>\$ 114,465</b>	<b>\$ 51,968</b>	<b>\$ 53,873</b>	<b>\$ 31,426</b>	<b>\$ 418,092</b>

- i) Lease obligations under a lease agreement related to its premises which commenced on August 1, 2007 and expires on July 31, 2012. Under the terms of this lease, the Company is required to pay a proportionate share of operating costs, realty taxes and utilities, in addition to the minimum rental payments. The future minimum lease payments are shown in the table above.
- ii) Research commitments under a Research Collaboration Agreement with The University Health Network and The Ontario Centres of Excellence for the TLC-3000 cancer therapy project. Under the terms of this agreement, the Company is required to pay a total of \$225,250 for the period of July 2007 to June 2009. For the six-month period ended June 30, 2008, the Company paid \$62,484 (\$32,142 – 2007) under this agreement.
- iii) Research commitments under a Research Collaboration Agreement with Virginia Polytechnic Institute and State University for the TLC-3000 cancer therapy project. Under the terms of this agreement the Company is required to pay \$75,686 for the period of May 2007 to April 2008.

### 12. Comparative figures

Certain comparative figures have been reclassified to conform with the consolidated financial statement presentation adopted in the current quarter.