

# PYNG MEDICAL



Saving Lives in Seconds™

Report for the Three Months and Nine Months Ended June 30, 2011 and 2010

#7-13511 Crestwood Place, Richmond BC V6V 2E9 Canada  
Head Office: 604-303-7964 Fax: 604-303-7987

Investor Relations: 1-800-349-7964 ext. 219  
info@pyng.com

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

**PYNG MEDICAL CORP.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**For the Three Months and Nine Months Ended June 30, 2011 and 2010**

## **NOTICE TO READER**

Under National Instrument 51-102, Part 4, subsection 4.3 (3) (a), if an auditor has not performed a review of interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of Pyng Medical Corp. have been prepared by, and are the responsibility of, the Company's management. The accompanying unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in Canada, consistent with previous periods.

Pyng Medical Corp.'s independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

**PYNG MEDICAL CORP.****Consolidated Balance Sheets**

As at June 30, 2011 and September 30, 2010

(Expressed in Canadian Dollars)

<b>ASSETS</b>	<b>June 30 - 2011</b>	<b>September 30 - 2010</b>
Current		
Cash	\$ 305,743	\$ 282,993
Accounts receivable	1,191,844	1,211,408
Other receivables	54,011	69,435
Inventories (Note 7)	698,018	441,063
Prepaid expenses	144,806	68,325
	<b>2,394,422</b>	<b>2,073,224</b>
Deferred product development costs (Note 8)	3,387,015	3,023,044
Property and equipment (Note 10)	143,686	151,734
Website development costs (Note 11)	30,335	48,537
Patents (Note 12)	288,236	262,281
Intellectual property rights (Note 13)	2,551,436	2,520,567
	<b>\$ 8,795,130</b>	<b>\$ 8,079,387</b>
<b>LIABILITIES</b>		
Current		
Bank line of credit (Note 14)	\$ 107,031	\$ 258,081
Accounts payable	624,936	422,626
Accrued liabilities	245,784	350,011
Loan payable (Note 15)	233,355	281,251
	<b>1,211,106</b>	<b>1,311,969</b>
Loan payable (Note 15)	-	204,058
Convertible debentures (Note 16)	349,519	306,454
Other long-term liabilities (Note 13)	614,952	656,587
Future income tax liabilities	461,000	461,000
	<b>2,636,577</b>	<b>2,940,068</b>
<b>SHAREHOLDERS' EQUITY</b>		
Equity portion of convertible debentures (Note 16)	191,825	191,825
Share capital (Note 17)	8,444,724	7,844,724
Contributed surplus (Note 17)	624,061	624,963
Deficit	(3,102,057)	(3,522,193)
	<b>6,158,553</b>	<b>5,139,319</b>
	<b>\$ 8,795,130</b>	<b>\$ 8,079,387</b>

Nature and continuance of operations (Note 1)

Commitments (Note 20)

Approved on behalf of the board

"L.J. (Bud) Evans"  
Director

"Herbert A. Toms III"  
Director

See accompanying notes to the consolidated financial statements

**PYNG MEDICAL CORP.**

**Consolidated Statements of Operations, Comprehensive Income and Deficit**

*For the Three Months and Nine Months Ended June 30, 2011 and 2010  
(Expressed in Canadian Dollars, except number of shares)*

	Three Months Ended June 30		Nine Months Ended June 30	
	2011	2010	2011	2010
<b>Sales</b>	\$ 1,723,803	\$ 1,290,643	\$ 5,054,810	\$ 4,455,042
<b>Cost of goods sold</b>	602,467	458,519	1,725,322	1,414,447
<b>Gross margin</b>	1,121,336	832,124	3,329,488	3,040,595
<b>Expenses</b>				
Advertising and promotion	15,008	5,245	47,043	24,258
Amortization of deferred product development costs	95,476	75,416	245,371	255,304
Amortization of website development costs	6,067	-	18,201	-
Amortization - other	34,755	34,388	99,082	101,851
Consulting fees	107,674	97,477	278,174	282,893
Foreign exchange loss	(6,026)	(1,057)	58,711	10,621
Interest and bank charges	8,608	8,964	23,792	23,529
Interest on convertible debenture	24,679	24,678	77,624	73,719
Interest on long-term debt	7,812	15,406	30,578	50,544
Licenses and insurance	41,471	35,372	121,885	119,342
Meals and entertainment	4,191	7,283	18,183	36,289
Office and telephone	33,148	49,570	128,747	133,330
Quality assurance regulatory requirements	523	4,677	1,447	30,520
Professional fees	39,573	54,380	133,374	255,604
Rent and utilities	28,601	30,927	83,516	83,493
Repairs and maintenance	9,146	8,729	32,487	26,868
Research & development	9,506	3,950	22,112	5,890
Royalties	5,057	(311)	14,401	5,676
Stock based compensation (Note 17(e))	3,330	16,673	21,484	56,004
Transfer agent & shareholder information	9,266	2,065	24,063	22,633
Travel	39,478	63,471	116,740	240,465
Wages and benefits	393,436	387,811	1,312,335	1,539,090
	910,781	925,114	2,909,352	3,377,924
<b>Income (loss) from operations</b>	210,555	(92,990)	420,136	(337,329)
Other comprehensive income (loss)	-	-	-	28
	-	-	-	28
<b>Net income (loss) and comprehensive income (loss) for the period</b>	210,555	(92,990)	420,136	(337,301)
<b>Deficit, beginning of period</b>	(3,312,612)	(4,049,919)	(3,522,193)	(3,805,608)
<b>Deficit, end of period</b>	(3,102,057)	(4,142,909)	(3,102,057)	(4,142,909)
<b>Earnings (loss) per share</b>				
Basic	\$ 0.01	\$ (0.01)	\$ 0.03	\$ (0.03)
Diluted	0.01	(0.01)	0.03	(0.03)
<b>Weighted average number of shares outstanding</b>				
Basic	15,001,583	12,001,583	14,012,572	12,001,583
Diluted	15,428,997	12,001,583	16,751,878	12,001,583

See accompanying notes to the consolidated financial statements

**PYNG MEDICAL CORP.**

**Consolidated Statements of Cash Flows**

*For the Three Months and Nine Months Ended June 30, 2011 and 2010  
(Expressed in Canadian Dollars)*

	Three Months Ended June 30		Nine Months Ended June 30	
	2011	2010	2011	2010
Cash provided from (used for)				
<b>Operating activities</b>				
Net income (loss) for the year	\$ 210,555	\$ (92,990)	\$ 420,136	\$ (337,301)
Items not involving cash				
Amortization of deferred product development costs	95,476	75,416	245,371	255,304
Amortization of website development costs	6,067	-	18,201	-
Amortization - other	34,755	34,388	99,082	101,851
Accreted interest on convertible debentures	8,838	8,103	26,514	24,310
Stock-based compensation	3,330	16,673	21,484	56,004
Accrued interest	-	-	-	-
Income tax expense	-	-	-	-
Unrealized foreign exchange loss	3,739	(26,973)	38,492	6,480
	<b>362,761</b>	<b>14,616</b>	<b>869,280</b>	<b>106,648</b>
Net change in non-cash working capital items				
Accounts receivable	(725,343)	32,174	(35,701)	260,299
Other receivable	(27,641)	-	15,424	-
Inventories	166,947	(25,736)	(368,938)	(126,304)
Prepaid expenses	(55,683)	(86,931)	(76,481)	(70,646)
Accounts payable and accrued liabilities	120,625	(63,518)	(43,502)	14,323
	<b>(158,334)</b>	<b>(129,395)</b>	<b>360,082</b>	<b>184,319</b>
<b>Financing activities</b>				
Drawn down from bank line of credit	107,031	259,608	(151,050)	447,313
Repayment on loan payable	(72,361)	(64,364)	(251,955)	(188,766)
Proceeds from issuance of common shares	-	-	600,000	-
Share issue cost	-	-	(22,385)	-
	<b>34,670</b>	<b>195,244</b>	<b>174,610</b>	<b>258,547</b>
<b>Investing activities</b>				
Deferred product development costs incurred	(264,485)	(81,005)	(351,420)	(366,855)
Patent costs incurred	(11,172)	(8,901)	(22,755)	(47,524)
Website development cost incurred	-	-	(23,497)	-
Acquisition of property and equipment	(1,301)	-	(36,860)	(7,654)
Additions to intellectual property rights	-	(283)	(30,870)	(19,574)
	<b>(276,958)</b>	<b>(90,189)</b>	<b>(465,402)</b>	<b>(441,607)</b>
<b>Effect of exchange rate changes on cash</b>	<b>(2,309)</b>	<b>7,151</b>	<b>(46,539)</b>	<b>(6,890)</b>
<b>Increase (decrease) in cash</b>	<b>(402,931)</b>	<b>(17,190)</b>	<b>22,750</b>	<b>(5,631)</b>
<b>Cash, beginning of period</b>	<b>708,674</b>	<b>164,090</b>	<b>282,993</b>	<b>152,531</b>
<b>Cash, end of period</b>	<b>\$ 305,743</b>	<b>\$ 146,900</b>	<b>\$ 305,743</b>	<b>\$ 146,900</b>
<b>Supplemental information</b>				
Interest paid	\$ 23,652	\$ 31,685	\$ 84,957	\$ 83,102

See accompanying notes to the consolidated financial statements

**PYNG MEDICAL CORP.**

*Notes to Consolidated Financial Statements*

*For the Three Months and Nine Months Ended June 30, 2011 and 2010*

*(Expressed in Canadian Dollars)*

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**1. NATURE AND CONTINUANCE OF OPERATIONS**

Pyng Medical Corp., (the Company or Pyng) is a public company incorporated under the British Columbia Business Corporations Act. Its shares are listed on the TSX Venture Exchange (“TSX-V”) under the symbol PYT. The Company is in the business of producing and selling the **FASTI®** Intraosseous Infusion System, **FASTx™** Sternal Intraosseous Device, **TPOD®** Pelvic Stabilizer, **MAT®** Tourniquet, and **CRIC™** Cricothyrotomy System.

On June 9, 2008, the Company incorporated its wholly-owned subsidiary, Pyng Medical USA Corp., in the State of Washington in the U.S.A. to enhance the distribution of its products and opened an office in Kirkland, Washington in February 2010.

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for the next twelve months. The Company’s ability to continue as a going concern is dependent upon its ability to achieve future profitable operations and to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they become due. Management plans to secure the necessary financing through the combination of renewal of existing credit facilities and issuance of new equity or debt instruments. There can be no assurance that these initiatives will be successful.

As at June 30, 2011, the Company has cash in the amount of \$305,743 (September 30, 2010 - \$282,993) and working capital in the amount of \$1,183,316 (September 30, 2010 - \$761,255). The Company’s working capital, together with the credit facilities as described in Note 14 are expected to be sufficient to fund anticipated cash requirements over the next twelve months.

These interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements of the Company as at and for the year ended September 30, 2010. Amounts in these interim consolidated financial statements are unaudited and presented in Canadian dollars.

**2. SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates which have been made using careful judgment.

The consolidated financial statements have, in management’s opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

**PYNG MEDICAL CORP.**

*Notes to Consolidated Financial Statements*

*For the Three Months and Nine Months Ended June 30, 2011 and 2010*

*(Expressed in Canadian Dollars)*

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**a) Basis of Presentation**

These consolidated financial statements include the accounts of the parent and its wholly-owned subsidiary, Pyng Medical USA Corp. All material inter-company transactions and balances have been eliminated on consolidation.

**b) Use of Estimates**

The presentation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the period. Significant areas requiring the use of estimates include the rates of amortization for property and equipment, impairment of long-lived assets, estimates of accounts payable and accrued liabilities, the assumptions used in the determination of fair value of stock-based compensation, and the determination of valuation allowance for future income tax assets. Actual results may differ from those estimates and these differences could have a significant impact on the financial statements.

**c) Cash and Cash Equivalents**

Cash includes cash on hand and demand deposits. Cash equivalents comprise short-term, highly liquid investments that are readily convertible to known amounts of cash which are subject to insignificant risk of change and have maturities of three months or less from the date of acquisition, held for the purpose of meeting short-term cash commitments rather than for investing or other purposes. As at June 30, 2011 and September 30, 2010, the Company did not have any cash equivalents.

**d) Inventories**

Raw materials, work-in-progress and finished goods are measured at the lower of the cost, determined on a weighted average basis and net realizable value.

The net realizable value of inventory is generally considered to be the selling price in the ordinary course of business less the estimated costs of completion and estimated costs to make the sale.

The amount of any write-down of inventories to net realizable value and all loss of inventories is recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

**e) Property and Equipment**

Property and equipment are recorded at cost less amortization provided for over the estimated useful lives of the assets at the following annual rates and methods:

**PYNG MEDICAL CORP.**

Notes to Consolidated Financial Statements

For the Three Months and Nine Months Ended June 30, 2011 and 2010

(Expressed in Canadian Dollars)

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**e) Property and Equipment (Continued)**

<b>Assets</b>	<b>Annual Rate</b>	<b>Basis</b>
Furniture and office equipment	20%	Declining balance
Medical equipment	20%	Declining balance
Computer equipment	30%	Declining balance
Leasehold improvements	30%	Straight-line
Software	100%	Straight-line

**f) Research and Development Costs**

The Company has been in the process of researching and developing a medical device on the **FASTI**<sup>TM</sup> Intraosseous Infusion System. All product development and related administrative costs, incurred prior to and after commencement of commercial production, that meet the criteria of the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3064 – “Goodwill and Intangible Assets”, have been capitalized. All other expenditures for research and improvement of the **FASTI**<sup>TM</sup> Intraosseous Infusion System are expensed as incurred. The accumulated capitalized costs are being amortized on a per unit basis based on the sales volume projection for the next 4 years. The unamortized deferred product development costs are reviewed annually and should the review indicate that the basis of amortization requires modification, the change will be applied prospectively.

During the fiscal year 2008, the Company took over the process of developing a medical device on the **CRIC**<sup>TM</sup> Cricothyrotomy System as part of an asset acquisition, and began the development of **FASTx**<sup>TM</sup> Sternal Intraosseous Device. All the development costs incurred that meet the criteria of intangible assets per CICA Handbook Section 3064 have been capitalized and will be amortized upon commercial production.

**g) Website Development Costs**

Website development costs are stated at acquisition cost less accumulated amortization. Amortization is calculated over the estimated useful life of three years using the straight line method. Website hosting and maintenance costs are charged to operations.

**h) Patents**

Patents are recorded at cost and comprised of costs associated with preparing, filing and obtaining patents. Technology license costs are recorded at the fair value of consideration paid.

Patents are amortized using the straight-line method over 10 years. The amounts shown for patents do not necessarily reflect present or future values and the ultimate amount recoverable will be dependent upon the successful development and commercialization of products based on these rights. If management determines that such costs exceed estimated net recoverable value based on future cash flows, the excess of such costs is charged to operations.

## **2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

### **i) Intellectual Property Rights**

All the costs incurred to acquire patents, trademarks, and other intellectual and industrial property rights related to TPOD®, MAT®, FastInfo and CRIC™ have been capitalized. The costs are not amortized since the Company considers them to have an indefinite life.

### **j) Government Assistance**

Government grants are recognized only when there is reasonable assurance that the Company will comply with any conditions attached to the grant and that the grant will be received. Grant amounts resulting from government assistance programs on research and development costs are reflected as reductions to the cost of the assets or to the expenses to which they relate at the time the assistance becomes receivable.

### **k) Stock Based Compensation**

The Company follows the recommendations of CICA Handbook Section 3870 – “Stock Based Compensation and Other Stock Based Payments” to account for stock based transactions with officers, directors, employees, and outside consultants. Accordingly, the fair value of stock options is charged to operations as appropriate, with an offsetting credit to contributed surplus. The fair value of stock options which vest immediately is recorded at the date of grant; the fair value of options which vest in the future is recognized on a straight-line basis over the vesting period. Stock options issued to outside consultants that vest over time are valued at the grant date and subsequently re-valued on each vesting date as services are rendered. Any considerations received on exercise of stock options, together with the related portion of contributed surplus, are credited to share capital.

The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate.

### **l) Fair Value of Warrants**

Proceeds from unit placements are allocated between shares and warrants issued according to their relative fair value using the residual method to determine the fair value of warrants issued. The value of warrants issued to brokers and creditors is determined by using the Black-Scholes model.

### **m) Earnings Per Share**

Basic and diluted earnings per share amounts are computed using the weighted average number of common shares outstanding during the year.

**PYNG MEDICAL CORP.**

*Notes to Consolidated Financial Statements*

*For the Three Months and Nine Months Ended June 30, 2011 and 2010*

*(Expressed in Canadian Dollars)*

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**m) Earnings Per Share (Continued)**

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only instruments with exercise amounts less than market prices impact the diluted calculations. This method assumes that common shares are issued for the exercise of warrants and options and that the assumed proceeds from the exercise of warrants and options are used to purchase common shares at the average market price during the period. The difference between the number of shares assumed issued and the number of shares assumed purchased is then added to the basic weighted average number of shares outstanding to determine the fully diluted number of common shares outstanding.

**n) Income Taxes**

The Company uses the asset and liability method of accounting for income taxes whereby future income tax assets are recognized for deductible temporary differences and operating loss carry-forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

**o) Revenue Recognition**

Revenue from sales of the Company's products is recognized at the time of shipment, at which point risks and rewards over ownership and title of transfer have been passed to the customer, provided that collection of the proceeds of sale is reasonably assured.

**p) Impairment of long-lived assets**

On an annual basis and when impairment indicators arise, the Company evaluates the future recoverability of its long-lived assets, including deferred product development costs, property and equipment, website development costs, patents and intellectual property rights. If the changes in circumstances indicate that the carrying amount of an asset may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated. If the undiscounted amount of the future cash flows is less than the carrying amount of the assets, an impairment is recognized for the difference between the carrying amount of the asset and its estimated fair value based on discounted net future cash flow or quoted market prices.

Intangible assets with indefinite useful lives are not amortized and are tested for impairment annually, or more frequent, if events or changes in circumstances indicate that the asset may be impaired. The impairment test compares the carrying amount of the intangible asset with its fair value, and an impairment loss is reorganized in income for the excess, if any.

As at June 30, 2011 and September 30, 2010, there has been no impairment loss recognized.

## **2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

### **q) Foreign Currency Translation**

The Company's functional and reporting currency is the Canadian dollar. The transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the rate of exchange in effect at the balance sheet date.

Financial statements of integrated subsidiaries, denominated in foreign currencies, are translated using the temporal method as follows:

- Monetary assets and liabilities at the rate prevailing at the balance sheet date
- Non-monetary assets and liabilities at historical rates
- Revenue and expenses at the rate of exchange in effect at the date of the transaction.

Any gains or losses resulting from translation have been included in the determination of income.

### **r) Deferred Financing Costs**

Financing costs for convertible debentures are capitalized and amortized on a straight-line basis, which approximates the effective-interest rate method, to interest expense over the life of the debt instruments.

### **s) Comprehensive Income**

The Company adopts CICA Handbook Section 1530, "Comprehensive Income", which establishes standards for reporting and presenting comprehensive income, defined as the change in equity from transactions and other events from non-owner sources. Comprehensive income includes both net earnings and other comprehensive income. Other comprehensive income ("OCI") includes holding gains and losses on available-for-sale investments, gains and losses on certain derivative financial instruments and foreign currency gains and losses relating to self-sustaining foreign operations, all of which are not included in the calculation of net earnings until realized. The cumulative changes in other comprehensive loss are included in accumulated other comprehensive loss, which is a separate category within shareholders' equity in the consolidated balance sheet.

### **t) Financial Instruments**

All financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured on the trade date at fair value upon initial recognition. Subsequent measurement depends on the initial classification of the instrument. Held-for-trading financial assets are measured at fair value, with changes in fair value recognized in net earnings (loss). Available-for-sale financial instruments are measured at fair value, with changes in fair value recorded in OCI until the instrument is derecognized or impaired. Loans and receivables, held-to-maturity investments and other financial liabilities are

**PYNG MEDICAL CORP.**

*Notes to Consolidated Financial Statements*

*For the Three Months and Nine Months Ended June 30, 2011 and 2010*

*(Expressed in Canadian Dollars)*

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in the statement of operations. Transaction costs on the acquisition of financial assets and liabilities that are classified as other than held-for-trading are expensed. The Company's financial assets and liabilities are initially recorded at fair value and subsequently measured based on their assigned classifications as follows:

<b>Asset/Liability</b>	<b>Category</b>	<b>Measurement</b>
Cash	Held-for-trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Other receivable	Loans and receivables	Amortized cost
Bank line of credit	Other liabilities	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Loan payable	Other liabilities	Amortized cost
Convertible debentures	Other liabilities	Amortized cost
Other long-term liabilities	Other liabilities	Amortized cost

**u) Variable Interest Entities**

The CICA issued Accounting Guideline 15, "Consolidation of Variable Interest Entities", to provide accounting guidance related to variable interest entities ("VIE"). A VIE exists when the entity's equity investment is at risk. When a VIE is determined to exist, the guidance requires the VIE to be consolidated by the primary beneficiary. The Company has determined that it does not have a primary beneficiary interest in VIE's.

**v) Comparative Figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

**3. CHANGES IN ACCOUNTING POLICIES**

**a) Financial Instruments – Disclosures**

In June 2009, the CICA amended Handbook Section 3862, "Financial Instruments – Disclosures". The amendments provide for additional fair value measurements for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements:

Level 1 – observable inputs such as quoted price in active markets;

Level 2 – inputs, other than the quoted market prices in active markets, which are observable, either directly or indirectly,

Level 3 – unobservable inputs for the assets or liabilities in which little or no market data exists, therefore require an entity to develop its own assumptions.

### **3. CHANGES IN ACCOUNTING POLICIES (Continued)**

#### **a) Financial Instruments – Disclosures (Continued)**

The Company adopted this standard in 2010 and the required disclosures have been inserted in Note 6.

#### **b) Capital Disclosures**

The CICA issued a new accounting standard, Section 1535, “Capital Disclosures”, which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity’s objectives, policies and processes for managing capital. This new section was effective for the Company beginning October 1, 2008.

#### **c) General Standards of Financial Statement Presentation**

The CICA approved amendments to CICA Handbook Section 1400, “General Standards of Financial Statement Presentation”. These amendments require management to assess an entity’s ability to continue as a going concern. When management is aware of material uncertainties related to events or conditions that may cast doubt on an entity’s ability to continue as a going concern, those uncertainties must be disclosed. In assessing the appropriateness of the going concern assumption, the standard requires management to consider all available information about the future, which is at least, but not limited to, twelve months from the balance sheet date. The new requirements of the standard are applicable for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

#### **d) Goodwill and Intangible Assets**

On January 8, 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets”. Section 3064 establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Section 3064 is effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. This section had no material impact on the Company’s financial position or results of operations.

### **4. FUTURE ACCOUNTING PRONOUNCEMENTS**

#### **a) Business Combinations**

Section 1582, “Business Combinations”, applies prospectively to the Company’s business combinations on or after January 1, 2011. Early adoption of this recommendation is permitted. This section replaces Section 1581, “Business Combinations”, and harmonizes the Canadian accounting standards with International Financial Reporting Standards (“IFRS”). Under the new guidance, the purchase price used in a business combination will be the new fair value of the shares exchanged at their market price on the date of the exchange.

Currently, when shares are issued, they are valued based on the market price for a reasonable period before and after the date the acquisition is agreed upon and announced. Under the new guidelines, all acquisition costs are expensed where currently they are capitalized as part of the acquisition costs. There are also a number of other differences between the new guidelines and

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*Notes to Consolidated Financial Statements*

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**4. FUTURE ACCOUNTING PRONOUNCEMENTS (Continued)**

**a) Business Combinations (Continued)**

current GAAP. The Company does not expect the adoption of this pronouncement to impact the financial statements.

**b) Consolidated Financial Statements and Non-controlling Interests**

Section 1601, “Consolidated Financial Statements”, and 1602, “Non-Controlling Interests”, change the accounting and reporting of ownership in interests in subsidiaries held by parties other than the parent. Non-controlling interests are to be presented in the consolidated statement of financial position (balance sheet) within equity, but separately from the parent’s equity. The amount of consolidated net income attributable to the parent and to the non-controlling interest is to be clearly identified and presented on the face of the consolidated statement of operations. In addition, these pronouncements establish standards for a change in a parent’s ownership interest in a subsidiary and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. They also establish reporting requirements for providing sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interest of the non-controlling owners. The Company does not expect the adoption of these pronouncements to impact its financial statements in fiscal 2011.

**c) Multiple Deliverable Revenue Arrangements**

In February 2010, the Emerging Issues Committee of the CICA issued EIC-175, Multiple Deliverable Revenue Arrangements (“EIC-175”). EIC-175 provided guidance on how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and addressed how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. This section applies to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. The Company does not expect the adoption of this standard to have an impact on its financial statements.

**d) International Financial Reporting Standards (“IFRS”)**

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that January 1, 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada’s own GAAP. For the companies with calendar year end, the date of transition to IFRS is January 1, 2010. The first interim and annual financial statements for fiscal year beginning January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010.

Since the Company has a fiscal year end September 30, the transition date is October 1, 2010. The Company will report interim and annual financial statements, with comparatives, in accordance with IFRS beginning with the quarter ending December 31, 2011. The Company has developed a three-phase implementation plan to facilitate the transition and has completed the

#### **4. FUTURE ACCOUNTING PRONOUNCEMENTS (Continued)**

##### **d) International Financial Reporting Standards (“IFRS”) (Continued)**

phase one on the assessment of the accounting and reporting differences under IFRS as compared to Canadian GAAP. However, management has not yet finalized the impact of these differences on the financial statements. In the period leading to the changeover, the AcSB will continue to issue accounting standards that are converged with IFRS. The Company will also continue to monitor and assess the impact of the convergence of IFRS on its internal control over financial reporting and the information system.

#### **5. CAPITAL MANAGEMENT**

The Company’s objectives when managing capital are to safeguard its ability to continue as a going concern, to provide an adequate return to shareholders, to meet external capital requirements on credit facilities and to support any growth plans.

In the management of its capital, the Company includes its cash and cash equivalent balances. The Company monitors capital based on the debt to debt-plus-equity ratio. Debt is total debt shown on the balance sheet, less cash and cash equivalents. Debt-plus-equity is calculated as debt shown on the balance sheet, plus total shareholders’ equity, which includes share capital, contributed surplus and deficit.

The Company’s policy is to keep its debt to debt-plus-equity ratio at a manageable level consistent with the current business cycle and the business opportunities outlook foreseen by the Company. As a general guideline, the Company’s policy will be to keep its debt to debt-plus-equity ratio to a minimal level, except in unusual circumstances such as major acquisition. Currently, the Company is in full compliance with its capital risk management policies. The Company’s Board of Directors approves management’s annual capital expenditures plans and reviews and approves any material debt borrowing plans proposed by the Company’s management.

To effectively manage the entity’s capital requirements, the Company has a planning and budgeting process in place to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives.

#### **6. FINANCIAL INSTRUMENTS AND RISKS**

As at June 30, 2011 and September 30, 2010, the Company's financial instruments recognized on the balance sheet consist of cash and cash equivalents, accounts receivable, other receivables, accounts payable and accrued liabilities, bank credit facility, loan payable and convertible debentures.

In accordance with CICA Section 3862, “Financial Instruments – Disclosures”, the Company has classified fair value measurement using three-level hierarchies. Pursuant to Section 3862, fair value of assets and liabilities measured on a recurring basis include cash determined based on Level 1 inputs, which consist of quoted prices in active markets for identical assets. The recorded values of all of the other financial instruments approximate their current fair values because of their nature and respective maturity dates or durations.

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**6. FINANCIAL INSTRUMENTS AND RISKS (Continued)**

The fair value of the Company's cash, accounts receivable, other receivables accounts payable and accrued liabilities and the current portion of the bank loan, approximate the carrying amounts due to their short-term nature. The fair value of the variable interest rate long-term portion of the bank loan is equivalent to the carrying value as the loan bears interest at a rate which varies according to the market rate. The fair value of the liability component of the convertible debenture was estimated by discounting future cash flow at the current market interest rates for agreements covering similar investments. The fair value as at June 30, 2011 was determined to be \$416,579 (September 30, 2010 - \$390,065), compared to the carrying amount of \$349,519 (September 30, 2010 - \$306,454). For the fair value of other long-term liabilities, it is impractical to estimate due to the nature of the financial instruments and the absence of the information needed.

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board of Directors approves and monitors the risk management process. The overall objective of the Board is to set policies that seek to reduce risk as far as possible without unduly affecting the Company's competitiveness and flexibility. The type of risk exposure and the way in which such exposure is managed is provided as follows:

**a) Credit Risk**

The Company is exposed to credit risk from accounts receivable. The Company performs certain credit evaluation procedures and does not require collateral for financial instruments subject to credit risk. The Company believes that credit risk is limited because the Company assesses the financial strength of its customers, and based upon factors surrounding the credit risk of its customers, establishes an allowance for uncollectible accounts and, as a consequence, believes that its account receivable credit risk beyond such allowances is limited. The maximum exposure to credit risk is the net carrying value of accounts receivable.

Credit risk also arises from cash with banks and financial institutions. This risk is limited because the counterparties are mainly Canadian banks with high credit rating. To minimize the risk, cash has been deposited in major financial institutions in Canada (subject to deposit insurance up to \$100,000). The Company also acquires accounts receivable insurance coverage to mitigate collection risks.

The Company's credit risk for accounts receivable is concentrated, as the Company presently derives a substantial amount of its revenues from one distributor which contributed approximately 80% (2010 - 64%) of revenues for the three months ended June 30, 2011. The sales are made to the distributor under a distributorship agreement. The non-renewal or cancellation of the contract could have a material adverse short-term impact on the Company.

Amounts owing from one distributor comprised 85% (September 30, 2010 - 56%) of the accounts receivable balance as at June 30, 2011.

**b) Foreign Exchange Risk**

The Company uses the Canadian dollar as its reporting currency for these consolidated financial statements. The Company's revenues are dominated primarily in U.S. dollars, giving rise to the exposure to market risks from changes in foreign exchange rates. The Company is exposed to

**PYNG MEDICAL CORP.***Notes to Consolidated Financial Statements**For the Three Months and Nine Months Ended June 30, 2011 and 2010**(Expressed in Canadian Dollars)***6. FINANCIAL INSTRUMENTS AND RISKS (Continued)****b) Foreign Exchange Risk (Continued)**

foreign currency fluctuation on its cash, accounts receivable, accounts payable, accrued liabilities as well as certain operating expenses and its other long-term liabilities. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. The significant change in the exchange rate between the Canadian dollar and U.S. dollar could have an effect on the Company's results of operations, financial position and cash flows.

If the Canadian dollar appreciated one percent against U.S. dollar, with all other variables remain constant, the net income would have been decreased by approximately \$7,017 (2010 - \$5,860). If the Canadian dollar depreciated one percent against US dollar, there would be an equal and opposite impact on the net income.

**c) Liquidity Risk**

Liquidity risk is the risk the Company may not be able to meet its contractual obligations and financial liabilities as they become due. The Company is exposed to liquidity risk as its continued operations are dependent upon the Company realizing its accounts receivable, line of credit, bank loan and convertible debenture to satisfy its liabilities as they become due. To manage the Company's liquidity risk, customer credit evaluations are conducted based on trade references, bank reports, and periodic review of customers' payment patterns to ensure irregularities are addressed promptly. As at June 30, 2011, the Company has cash of \$305,743 (September 30, 2010 - \$282,993) and working capital of \$1,183,316 (September 30, 2010 - \$761,255).

The following is an analysis of the contractual maturities of the Company's financial liabilities as at June 30, 2011:

	Due by period						
	Total	<1 year	1-2 year	2-3 year	3-4 year	4-5 year	>5 year
Accounts payable and accrued liabilities	870,720	870,720	-	-	-	-	-
Bank line of credit	107,031	107,031	-	-	-	-	-
Loan payable	233,355	233,355	-	-	-	-	-
Convertible debenture	349,519	-	-	-	349,519	-	-
Operating lease	13,371	13,371	-	-	-	-	-
	\$ 1,573,996	\$ 1,224,477	\$ -	\$ -	\$ 349,519	\$ -	\$ -

**d) Interest Rate Risk**

Bank line of credit, loan payable and convertible debentures are subject to interest rate cash flow risk as the required cash flow to service the debt will fluctuate as a result of the changing prime interest rate. The Company has estimated that one percent increase or decrease in the prime rate would have caused the net income decrease or increase by approximately \$3,786 (2010 - \$2,962).

**PYNG MEDICAL CORP.**

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**7. INVENTORIES**

	<b>June 30 - 2011</b>		<b>September 30-2010</b>	
Raw materials and work in progress	\$	591,472	\$	407,003
Inventory in transit		-		1,425
Finished goods		106,547		32,635
	<b>\$</b>	<b>698,018</b>	<b>\$</b>	<b>441,063</b>

**8. DEFERRED PRODUCT DEVELOPMENT COSTS**

	<b>June 30 - 2011</b>		<b>September 30-2010</b>	
Deferred product development costs	\$	6,185,268	\$	5,575,926
Less: accumulated amortization		(2,798,253)		(2,552,882)
	<b>\$</b>	<b>3,387,015</b>	<b>\$</b>	<b>3,023,044</b>

As of June 30, 2011, the deferred development costs related to *CRIC*<sup>TM</sup> and *FASTx*<sup>TM</sup> in the amount of \$2,415,986.74 (September 30, 2010 - \$1,810,410) have not been amortized.

**9. GOVERNMENT ASSISTANCE**

Under an agreement through the Industrial Research Assistance Program ("IRAP"), the National Research Council of Canada ("NRC") agreed to reimburse certain of the Company's allowable direct expenditures on the development of *FASTx*<sup>TM</sup>. In fiscal 2009, the Company received a total reimbursement of \$8,100 and the amount was recorded as a reduction of deferred product development costs in 2009.

During the fiscal year 2009, the Company entered into an agreement with the U.S. Army Medical Research Acquisition Activity ("USAMRAA") to receive reimbursement for certain direct expenditures on the development of *CRIC*<sup>TM</sup>. In fiscal 2009, the Company received a total reimbursement of \$300,364 (US\$253,162); and an amount of \$38,136 (US\$35,568) was receivable as of September 30, 2009. These amounts were recorded as reduction of deferred product development costs in 2009. During the fiscal year 2010, the Company received the outstanding amount of \$38,136 (US\$35,368).

**10. PROPERTY AND EQUIPMENT**

	<b>June 30 - 2011</b>		<b>September 30 - 2010</b>	
	<b>Cost</b>	<b>Amortization</b>	<b>Net Book Value</b>	
Furniture and office equipment	179,150	127,670	51,480	
Medical equipment	312,722	274,283	38,439	
Computer equipment	121,799	74,486	47,313	
Leasehold improvements	108,190	102,714	5,476	
Software	221,210	220,232	978	
	<b>\$</b>	<b>943,071</b>	<b>\$</b>	<b>799,385</b>
			<b>\$</b>	<b>143,686</b>

**PYNG MEDICAL CORP.**

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**10. PROPERTY AND EQUIPMENT (Continued)**

<b>September 30-2010</b>	<b>Cost</b>	<b>Amortization</b>	<b>Net Book Value</b>
Furniture and office equipment	179,150	118,585	60,565
Medical equipment	312,722	267,500	45,222
Computer equipment	87,935	66,402	21,533
Leasehold improvements	108,190	86,288	21,902
Software	218,214	215,702	2,512
	<b>\$ 906,211</b>	<b>\$ 754,477</b>	<b>\$ 151,734</b>

**11. WEBSITE DEVELOPMENT COSTS**

	<b>June 30 - 2011</b>	<b>September 30-2010</b>
Website development costs	\$ 58,244	\$ 58,244
Less: accumulated amortization	(27,909)	(9,707)
	<b>\$ 30,335</b>	<b>\$ 48,537</b>

**12. PATENTS**

	<b>June 30 - 2011</b>	<b>September 30-2010</b>
Patents	\$ 527,693	\$ 464,114
Less: accumulated amortization	(239,457)	(201,833)
	<b>\$ 288,236</b>	<b>\$ 262,281</b>

**13. INTELLECTUAL PROPERTY RIGHTS**

	<b>June 30 - 2011</b>	<b>September 30-2010</b>
Balance, beginning of the period	\$ 2,520,567	\$ 2,507,184
Addition	30,869	13,383
Reversal of accrued liabilities	-	-
Balance, end of the period	<b>\$ 2,551,436</b>	<b>\$ 2,520,567</b>

On May 31, 2008, the Company completed the acquisition of the trauma assets of Bio Cybernetics International (“BCI”) (dba “Cybertech Medical”), including Trauma Pelvic Orthotic Device (*TPOD*®), Mechanical Advantage Tourniquet (*MAT*®), and Cricothyrotomy Kit (*CRIC*™). The purchase price was \$2,737,913, of which \$1,784,003 was paid in cash on closing and the balance of \$953,910, recorded in accrued liabilities are the contingent payments subject to achievement of certain milestones.

In order to partially fund the acquisition, the Company obtained a bank loan in the amount of \$1,000,000. As part of that financing, the Company also issued 110,000 common share purchase

**PYNG MEDICAL CORP.**

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**13. INTELLECTUAL PROPERTY RIGHTS (Continued)**

warrants to the bank at an exercise price of \$0.55. Each warrant is exercisable to purchase one common share of the Company until the date the loan is repaid or no later than June 6, 2013.

The acquisition has been accounted for as a purchase of assets, and the consideration of \$2,737,913 was allocated to the assets acquired based on the estimated fair values on the date of acquisition as set out below:

<b>Assets acquired</b>	<b>Amount</b>	
Accounts receivable	\$	73,223
Inventories		113,904
Intellectual property rights *		2,550,786
	<b>\$</b>	<b>2,737,913</b>
<b>Consideration</b>		
Cash	\$	1,784,003
Contingent payments **		953,910
	<b>\$</b>	<b>2,737,913</b>

\* Intellectual property rights include patents, trademarks, and other intellectual and industrial property rights related to *TPOD*®, *MAT*®, and *CRIC*™.

\*\* In February 2009, the Company became aware that the achievement of certain milestones will most likely not occur within the next twelve months. As a result, US\$637,586 was classified as other long term liabilities as at September 30, 2010 and 2009. During the first nine months of fiscal 2011, there has been no change on these liabilities and the Canadian equivalent of \$614,952 (September 30, 2010 - \$ 656,587) was reported as at June 30, 2011.

**14. BANK CREDIT FACILITY**

The Company has established credit facilities for up to \$1,000,000 under a line of credit with its bank. The line of credit bears interest at prime plus 2% per annum, is due on demand and secured under the general security agreement over all assets of the Company. The line of credit is subject to financial covenants pertaining to certain ratios. As at June 30, 2011, \$107,031 has been drawn down from this credit facility (September 30, 2010 - \$258,081).

**15. LOAN PAYABLE**

	<b>June 30 - 2011</b>	<b>September 30-2010</b>
Promissory note payable in Canadian dollars, interest at prime plus 8% per annum, monthly blended payments of \$26,724 until March 15, 2012, secured by a general security agreement over all assets of the Company, subject to financial covenants pertaining to certain ratios, common share purchase warrants of 110,000 attached, (Notes 13 and 17)	\$ 233,355	\$ 485,309
Less: current portion	(233,355)	(281,251)
	<b>\$ -</b>	<b>\$ 204,058</b>

**PYNG MEDICAL CORP.**

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**15. LOAN PAYABLE (Continued)**

The required future principal and interest repayments on loan payable are as follows:

1 - 12 months	\$	244,359
13 - 23 months		-
	\$	<b>244,359</b>

**16. CONVERTIBLE DEBENTURES**

	June 30 - 2011		September 30-2010	
Convertible debentures issued	\$	545,000	\$	545,000
Equity portion of convertible debentures		(191,825)		(191,825)
		353,175		353,175
Deferred financing costs (net of amortization)		(67,060)		(83,611)
Interest accretion		63,404		36,890
Debt portion of convertible debentures	\$	<b>349,519</b>	\$	<b>306,454</b>

On August 10, 2009, the Company issued convertible debentures in the amount of \$545,000, which are due and payable on August 10, 2014. The amount of \$495,000 out of \$545,000 was issued to directors and officers of the Company. The debentures are convertible into common shares of the Company at \$0.20 per share. The Company issued 2,725,000 common share purchase warrants at \$0.001 per warrant as part of the convertible debt financing agreement. Each warrant is exercisable to purchase one common share of the Company at \$0.22 per share until the date the loan is repaid or no later than August 10, 2014.

Interest on the debentures is calculated at prime plus 10% per annum. The interest is payable quarterly in Canadian dollars. The debentures are secured by all assets of the Company, subordinated to the Company's bank credit facility and loan payable.

The liability component of the convertible debt is calculated as the present value of the principal, discounted at a rate approximating the interest rate that was estimated would have been applicable to non-convertible debt at the time the debt was issued. This portion of the convertible debt is accreted over its term to the full face value by charges to interest expense. The accretion is a non-cash transaction and has been excluded from the statement of cash flows.

The equity element of the convertible debt comprises the value of the conversion option, being the difference between the face value of the convertible debt and the liability component.

**17. SHARE CAPITAL**

**a) Authorized**

100,000,000 common shares without par value

**PYNG MEDICAL CORP.***Notes to Consolidated Financial Statements**For the Three Months and Nine Months Ended June 30, 2011 and 2010**(Expressed in Canadian Dollars)***17. SHARE CAPITAL (Continued)****b) Issued and Outstanding**

	Number of Shares	Amount	Contributed Surplus
<b>Balance, September 30, 2008</b>	<b>12,001,583</b>	<b>\$ 7,844,724</b>	<b>\$ 474,395</b>
Fair value of options issued	-	-	75,361
Fair value of warrants issued	-	-	2,725
<b>Balance, Septemebr 30, 2009</b>	<b>12,001,583</b>	<b>\$ 7,844,724</b>	<b>\$ 552,481</b>
Fair value of options issued	-	-	72,482
<b>Balance, September 30, 2010</b>	<b>12,001,583</b>	<b>\$ 7,844,724</b>	<b>\$ 624,963</b>
Common shares issued	3,000,000	600,000	
Share issue cost			(22,385)
Fair value of options issued			21,484
<b>Balance, June 30, 2011</b>	<b>15,001,583</b>	<b>8,444,724</b>	<b>\$ 624,061</b>

On December 30, 2010, the Company closed a non-brokered private placement and issued 3,000,000 common shares at \$0.20 per share for net proceeds of \$600,000 to a single investor. There was no finder's fees payable in connection with the placement. All securities issued in connection with the placement were subject to a statutory hold period of four months plus a day from the date of issuance in accordance with applicable securities legislation. The proceeds of the placement were used for general working capital and to pursue international sales opportunities.

**c) Escrow Shares**

In March 2011, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

In September 2010, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

In March 2010, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

In September 2009, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

In March 2009, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

In October 2008, 300,000 shares held in escrow were released in accordance with TSX Venture Exchange policies.

**PYNG MEDICAL CORP.***Notes to Consolidated Financial Statements**For the Three Months and Nine Months Ended June 30, 2011 and 2010**(Expressed in Canadian Dollars)***17. SHARE CAPITAL (Continued)**

As at June 30, 2011, all the shares held in escrow have been released in accordance with TSX Venture Exchange policies (September 30, 2010 – 300,000).

**d) Warrants**

On August 10, 2009, the Company issued 2,725,000 common share purchase warrants at \$0.001 per warrant as part of the convertible debt financing agreement. Each warrant is exercisable to purchase one common share of the Company at \$0.22 per share until the date the loan is repaid or no later than August 10, 2014.

A summary of warrant activities for the period presented is as follows:

	June 30 - 2011		September 30-2010	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of period	2,835,000	\$ 0.23	2,835,000	\$ 0.23
Issued	-	-	-	0.00
Outstanding, end of period	<b>2,835,000</b>	<b>\$ 0.23</b>	<b>2,835,000</b>	<b>\$ 0.23</b>

As at June 30, 2011, the following warrants were outstanding:

Number of Warrants	Exercise Price	Expiring Date
110,000	\$ 0.55	6-Jun-13
2,725,000	\$ 0.22	10-Aug-14
<b>2,835,000</b>		

**e) Stock Options**

The Company has a rolling stock option plan, which follows the policies of the TSX Venture Exchange (“TSXV”) regarding stock option awards granted to employees, directors and consultants. The stock option plan allows a maximum of 10% of the issued shares to be reserved for issuance under the plan. As at June 30, 2011, a total of 461,200 (September 30, 2010 – 1,166,200) stock options have been granted out of the 1,500,158 pool under this plan, with the balance of 1,038,958 (September 30, 2010 – 33,958) stock options available to grant.

The Company’s stock options vest as follows: 1/3 six months after the date of grant, 1/3 twelve months after the date of grant, and 1/3 eighteen months after the date of grant.

A summary of stock option activities for the years presented is as follows:

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	June 30 - 2011		September 30-2010	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of period	1,166,200	\$ 0.31	1,066,200	\$ 0.35
Granted	-	-	230,000	0.20
Forfeited	(705,000)	0.25	(130,000)	0.43
Outstanding, end of period	<b>461,200</b>	<b>\$ 0.41</b>	<b>1,166,200</b>	<b>\$ 0.31</b>

As at June 30, 2011, the following stock options were outstanding:

Options Outstanding			Options Exercisable
Number of Options	Exercise Price	Expiring Date	Number of Options
20,000	\$ 0.42	14-Aug-11	20,000
10,000	\$ 0.34	21-Aug-11	10,000
30,000	\$ 0.35	12-Dec-11	30,000
81,200	\$ 0.23	10-May-13	81,200
60,000	\$ 0.56	12-Jun-13	60,000
60,000	\$ 0.41	8-Sep-13	60,000
50,000	\$ 0.20	18-May-14	50,000
150,000	\$ 0.20	9-Mar-15	100,000
<b>461,200</b>			<b>411,200</b>

As at June 30, 2011, 411,200 (September 30, 2010 – 879,133) stock options were vested and exercisable, and the fair value of \$3,330 (2010 - \$16,673) has been expensed as stock based compensation during the quarter.

On March 10, 2010, the Company granted 150,000 stock options exercisable for a period of five years until March 9, 2015 at a price of \$0.20 per share.

On November 16, 2009, the Company granted 80,000 stock options exercisable for a period of five years until November 15, 2014 at a price of \$0.20 per share.

On August 11, 2009, the Company granted 30,000 stock options exercisable for a period of five years until August 10, 2014 at a price of \$0.17 per share.

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**17. SHARE CAPITAL (Continued)**

**e) Stock Options (Continued)**

On July 20, 2009, the Company granted 300,000 stock options exercisable for a period of five years until July 19, 2014 at a price of \$0.23 per share.

On May 19, 2009, the Company granted 50,000 stock options exercisable for a period of five years until May 18, 2014 at a price of \$0.20 per share.

On May 19, 2009, the Company granted 81,200 stock options exercisable for a period of four years until May 10, 2013 at a price of \$0.23 per share.

The fair value of stock options granted was estimated on the date of the grant using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options with the following weighted-average assumptions used for options granted:

	<b>2010</b>	<b>2009</b>
Dividend yield	<b>Nil</b>	<b>Nil</b>
Expected volatility	82% - 83%	86% - 87%
Risk-free interest rate	3.72%	3.72%
Expected life	<b>4 - 5 years</b>	<b>4 - 5 years</b>

**18. RELATED PARTY TRANSACTION**

Related party transactions are 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.

**a) Payment to directors**

During the quarter ended June 30, 2011, consulting fees of \$43,907 (2010 - \$7,571) and directors fees of \$31,000 (2010 - \$19,000) were paid or accrued to the directors and officers of the Company.

As at June 30, 2011, \$8,875 (September 30, 2010 - \$9,393) was owing to directors for consulting fees and expense reimbursements. The amount is included in accounts payable.

**b) Contractual commitments with directors**

As at June 30, 2011, the Company did not have contractual commitments with directors.

**19. SEGMENTED INFORMATION**

The Company's operations are in Canada and U.S.A. and it operates in one industry segment. Sales by geographic region are as follows:

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*(Expressed in Canadian Dollars)*

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**19. SEGMENTED INFORMATION (Continued)**

	<b>June 30 - 2011</b>		<b>June 30-2010</b>	
	<b>Percentage</b>	<b>Amount</b>	<b>Percentage</b>	<b>Amount</b>
U.S.A.	85%	\$ 4,281,379	92%	\$ 4,095,473
Other	15%	773,431	8%	\$ 359,569
	<b>100%</b>	<b>\$ 5,054,810</b>	<b>100%</b>	<b>\$ 4,455,042</b>

**20. COMMITMENTS**

The Company has a five-year lease commitment on its Richmond production premises. The Company is required to pay base rent of \$4,337 per month for the first two years and \$4,457 per month for the last three years. The lease expires on September 30, 2011.

**21. SUBSEQUENT EVENT**

Subsequent to the quarter ended June 30, 2011, the Company has made an arrangement to renew the lease for one more year to September 30, 2012 at \$4,577 per month.