Consolidated Financial Statements of

avVaa World Health Care Products Inc.

(a development stage company)

FOR THE THREE MONTHS ENDING AUGUST 31, 2010

AVVAA World Health Care Products, Inc.
(A Development Stage Company)

Index

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

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

The Company'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.

AVVAA World Health Care Products, Inc.
(A Development Stage Company)
Consolidated Balance Sheets
(expressed in U.S. Dollars)
(unaudited)

	August 31, 2010 $	May 31, 2010 $
Assets		
Current Assets		
Cash	3,170	31,918
Accounts receivable, net of allowance of $Nil	10,807	9,178
Prepaid expenses and deposits	–	1,500
Total Current Assets	13,977	42,596
Property and Equipment (Note 3)	3,544	4,140
Total Assets	17,521	46,736
Liabilities and Stockholders' Deficit		
Current Liabilities		
Accounts payable	922,205	826,250
Accrued liabilities (Note 4)	3,961,121	3,953,336
Convertible notes, less unamortized discount of $Nil (Note 5)	4,284,253	3,984,253
Derivative liabilities (Note 5 and 7)	4,709,846	4,279,006
Due to related parties (Note 8)	2,129,219	2,112,060
Other advances (Note 9)	212,164	213,448
Total Current Liabilities	16,218,808	15,368,353
Deferred gain (Note 3)	48,408	51,742
Total Liabilities	16,267,216	15,420,095
Commitments and Contingencies (Notes 1, 13, and 14)		
Stockholders' Deficit		
Preferred Stock – 400,000,000 shares authorized, at $0.001 par value; 1,250,000 shares issued and outstanding (Note 10)	1,250	1,250
Common Stock – 4,000,000,000 shares authorized, at $0.001 par value; 1,672,151,784 shares issued and outstanding (Note 10)	1,672,151	1,672,151
Additional Paid-in Capital	15,805,219	15,805,219
Accumulated Other Comprehensive Loss	(199,139)	(220,816)
Deficit Accumulated During the Development Stage	(33,529,176)	(32,631,163)
Total Stockholders' Deficit	(16,249,695)	(15,373,359)
Total Liabilities and Stockholders' Deficit	17,521	46,736

(The accompanying notes are an integral part of these consolidated financial statements.)

AVVAA World Health Care Products, Inc.
(A Development Stage Company)
Consolidated Statements of Operations
(expressed in U.S. Dollars)
(unaudited)

	Accumulated from March 25, 1999 (Date of Inception) to August 31, 2010 $	For the Three Months Ended August 31 2010 $	For the Three Months Ended August 31 2009 $
Sales	240,321	2,676	1,834
Cost of Sales	174,765	1,008	1,392
Provision for Obsolete Inventory	337,237	–	–
Gross Profit (Loss)	(271,681)	1,668	442
Operating Expenses			
Depreciation and amortization	93,568	518	485
Impairment loss on assets	310,898	–	–
Research and development	1,308,492	–	–
Selling, general and administrative	12,907,243	157,323	94,346
Total Operating Expenses	14,620,201	157,841	94,831
Net Loss from Operations	(14,891,882)	(156,173)	(94,389)
Debt Issue Costs	(722,076)	–	(48,760)
Write-off of Accounts Payable	202,938	–	–
Interest Expense	(5,996,789)	(316,363)	(460,475)
Liquidated Damages	(9,393,045)	–	–
Gain on Sales of Assets	62,235	5,363	5,016
Other Income	81,895	–	–
Gain on Restructure of Convertible Debt	6,666,531	–	–
Unrealized (Loss) Gain on Fair Value of Derivatives	(9,071,285)	(430,840)	(14,760,298)
Inducement Expense	(372,698)	–	–
Net Loss	(33,434,176)	(898,013)	(15,358,906)
Preferred Stock Dividend	(95,000)	–	–
Net Loss Available to Common Shareholders	(33,529,176)	(898,013)	(15,358,906)
Other Comprehensive Income (Loss):			
Net Loss	(33,529,176)	(898,013)	(15,358,906)
Foreign currency translation (loss) gain	(199,139)	21,677	(45,194)
Comprehensive Loss	(33,728,315)	(876,336)	(15,404,100)
Net Loss Per Share – Basic and Diluted		(0.00)	(0.02)
Weighted Average Common Shares Outstanding – Basic and Diluted		1,672,151,784	920,627,690

(The accompanying notes are an integral part of these consolidated financial statements.)

AVVAA World Health Care Products, Inc.
(A Development Stage Company)
Consolidated Statements of Cash Flows
(expressed in U.S. Dollars)
(unaudited)

	Accumulated from March 25, 1999 (Date of Inception) to August 31, 2010 $	For the Three Months Ended August 31, 2010 $	2009 $
Operating Activities			
Net loss	(33,434,176)	(898,013)	(15,358,906)
Adjustments to reconcile net loss to net cash used in operating activities:			
Allowance for obsolete inventory	337,237	–	–
Amortization of deferred compensation and other stock-based compensation	5,694,760	–	(50,750)
Deferred debt expense	317,906	–	6,360
Depreciation and amortization	93,568	518	485
Gain on restructure of convertible debt	(6,666,531)	–	–
Gain on sale of assets	(112,985)	(5,363)	(5,016)
Write off of accounts payable	(195,642)	–	–
Impairment loss on assets	310,898	–	–
Non-cash interest and debt issue costs	5,737,939	300,000	392,824
Recapitalization costs	(115,730)	–	–
Unrealized loss (gain) on derivative liabilities	9,071,285	430,840	14,760,298
Unrealized foreign exchange	(221,532)	(16,141)	(534)
Liquidated damages	9,393,045	–	–
Inducement expense	372,698	–	–
Changes in non-cash working capital items:			
Accounts receivable	(2,996)	(1,871)	(978)
Prepaid expenses and deposits	–	1,500	(2,246)
Due to related parties	333,563	58,710	29,449
Accrued management fees	725,819	8,358	40,409
Accounts payable and accrued liabilities	2,123,968	111,416	62,817
Net Cash Used In Operating Activities	(6,236,906)	(10,046)	(125,778)
Investing Activities			
Website development costs	(7,798)	–	–
Patent protection costs	(11,378)	–	–
Purchase of property and equipment	(51,588)	–	–
Proceeds from sale of assets (net)	406,312	–	–
Advance royalty deposits	(220,000)	–	–
Net Cash Provided By Investing Activities	115,548	–	–
Financing Activities			
Advances from others	250,468	–	130,013
Advances from related parties	2,767,048	–	–
Repayments to related parties	(809,966)	(18,460)	–
Proceeds from convertible notes	3,550,250	–	–
Debt issue costs	(387,018)	–	–
Repayment of mortgage	(377,043)	–	–
Proceeds from issuance of common stock	1,235,637	–	–
Net Cash Provided by (Used in) Financing Activities	6,229,376	(18,460)	130,013
Effects of Exchange Rate Changes on Cash	(104,848)	(242)	281
Change in Cash	3,170	(28,748)	4,516
Cash – Beginning of Period	–	31,918	4,269
Cash – End of Period	3,170	3,170	8,785

Supplementary cash flow information (Note 15)

(The accompanying notes are an integral part of these consolidated financial statements.)

1. Nature of Operations and Continuance of Business

AVVAA World Health Care Products, Inc. (the "Company") was incorporated on June 3, 1998 in the State of Nevada.

On June 28, 2002 the Company completed the acquisition of 100% of the common shares of Mind Your Own Skin Products Inc. ("MYOSP"), a company incorporated under the Company Act of the Province of British Columbia, Canada. The purchase transaction consisted of the issuance of 121,125 common shares. This share issuance resulted in a reverse takeover of the Company by the shareholders of MYOSP. Certain directors and officers of MYOSP became directors and officers of the Company. The consolidated financial statements include the accounts of the Company since the reverse takeover and the historical accounts of MYOSP since the date of its inception, March 25, 1999.

The Company is a global biotechnology company specializing in providing all-natural, therapeutic skin care products. The Company intends to manage the manufacturing, distribution, marketing and sale of health-care products to the countries specified in its distribution agreement. The specified regions for which the Company has the exclusive distribution rights are as follows: North America, Central America, South America, India, South East Asia, West Indies, Greater Antilles, Australia, Africa, China and Great Britain. The Company's mission is to provide to the public medically safe, natural, non-toxic health-care products and specifically products that treat skin abnormalities as well as enhance the natural clarity and texture of healthy skin. The Company has the exclusive distribution rights for patented European skin care products, which are scientifically developed to treat the symptoms of skin diseases including eczema, psoriasis and acne. The Company intends to manufacture and market over-the-counter the Neuroskin line of products through mass marketing food and drug channels initially in the United States. The three flagship core products of the Neuroskin lines are FDA compliant. The Company has developed a business plan and conducted research with respect to marketing the products.

The Company is considered a development stage company in accordance with Accounting Standards Codification ("ASC") 915, *Development Stage Entities*. These consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. As at August 31, 2010, the Company has not recognized significant revenue, has a working capital deficiency of $16,204,831 and has accumulated losses of $33,529,176 since its inception. The continuation of the Company is dependent upon the continuing financial support of creditors and stockholders and obtaining short-term and long-term financing, generating significant revenue and achieving profitability. These conditions raise substantial doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments that might arise from this uncertainty.

2. Summary of Significant Accounting Principles

(a) Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Mind Your Own Skin Products Inc., AVVAA World Health Care Products (Canada) Ltd. and 648311 B.C. Ltd. All inter-company accounts and transactions have been eliminated.

(b) Recent Accounting Pronouncements

The Company has implemented all new accounting pronouncements that are in effect. These pronouncements did not have any material impact on the financial statements unless otherwise disclosed, and the Company does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its financial position or results of operations.

(expressed in U.S. dollars)

3. Property and Equipment

	Cost $	Accumulated Depreciation $	August 31, 2010 Net Carrying Value $	May 31, 2010 Net Carrying Value $
Office equipment	24,643	21,099	3,544	4,140

On October 31, 2007 the Company sold its land and building located in Lumby, BC, Canada for gross proceeds of $406,312 and realized a gain of $111,708. The Company subsequently entered into an agreement to lease the office space back for a period of 5 years. The Company deferred the gain in accordance with ASC 840-40 *Sale-Leaseback Transactions* and will recognize the gain over the life of the lease. During the three months ended August 31, 2010, the Company recognized a gain of $5,363 (2009 - $5,016). The terms of the new lease agreement are described in Note 13(d).

4. Accrued Liabilities

	August 31, 2010 $	May 31, 2010 $
Penalties on convertible debt	3,193,045	3,193,045
Accrued interest	419,824	449,891
Other	348,252	310,400
	3,961,121	3,953,336

5. Convertible Notes

	August 31, 2010 $	May 31, 2010 $
a) Convertible notes ("April 2005 Financing") interest rate 15% per annum; due one year from issuance; convertible at 50% of the average three lowest closing prices of the Company's common stock for the 20 days prior to conversion.	294,253	294,253
b) Convertible notes ("March 2007 Financing") interest rate 15% per annum; due three years from issuance; convertible at 50% of the average three lowest closing prices of the Company's common stock for the 20 days prior to conversion.	90,000	90,000
c) Principle amount of settlement agreement due immediately, non-interest bearing	3,900,000	3,600,000
Convertible notes	4,284,253	3,984,253

(a) *April 2005 Financing*

On April 5, 2005, the Company completed Financing Agreements totalling $1,100,000 and issued $1,100,000 in convertible notes. The convertible notes bear interest at 8% per annum, are due one year from issuance, and bear default interest at 15% thereafter. Any accrued interest is payable upon each conversion and on the due date. The notes are convertible into common shares of the Company at a conversion price based on 80% of the average of the three lowest closing prices of the Company's stock for the thirty days prior to conversion; for a maximum of $20 per split-adjusted share; and a minimum of $8 per split-adjusted share for eight months after issuance, and no minimum conversion price thereafter. The timing of the conversion is at the option of the holder. The notes are secured by a grant of a general security interest in all of the Company's tangible and intangible assets.

5. Convertible Notes (continued)

(a)(i) The Company is to issue four series of share purchase warrants as follows: Class A warrants equivalent to the number of shares issued on the convertible note exercisable at $20 per split-adjusted share; Class B warrants equivalent to 75% of the number of shares issued on the convertible note exercisable at $25 per split-adjusted share; Class C warrants equivalent to 75% of the number of shares issued on the convertible note exercisable at $30 per split-adjusted share; and Class D warrants equivalent to 50% of the number of shares issued on the convertible note exercisable at $45 per split-adjusted share. The warrants will expire five years after the date the warrants are issued and are callable by the Company when the market price is 200% of the exercise price.

(a)(ii) On April 5, 2005, the Company received $660,000 under the terms of the convertible notes and was to receive the balance of $440,000 once the Company filed an S-1 Registration Statement ("S-1") with the United States Securities and Exchange Commission ("SEC") that is declared effective (met and received). If the S-1 is not declared effective within ninety days after April 5, 2005, the Company must pay a penalty of 2% (subsequently amended to 5%) for each thirty-day period of the convertible notes remaining unconverted. The S-1 was declared effective in December 2005.

(a)(iii) On April 5, 2005, the Company issued 41,250 split-adjusted Class A warrants, 30,938 split-adjusted Class B warrants, 30,938 split-adjusted Class C warrants, and 20,625 split-adjusted Class D warrants pertaining to the $660,000 in convertible notes issued.

(a)(iv) On March 30, 2006, the Company agreed to change the conversion terms of the convertible notes described above in Note 5(a). The conversion price was changed from 80% to 50% of the average of the three lowest closing prices of the Company's shares for the twenty trading days prior to conversion.

(a)(v) There are specific provisions for use of proceeds and penalties should the Company vary more than 5% for each individual item specified on the use of proceeds. The Company was also committed to paying a due diligence fee of 9% of the total convertible notes issued (50% or $49,500 of which was paid in cash and the other 50% was paid in the form of $49,500 in convertible notes with the same terms as above and without warrants).

(a)(vi) On August 2, 2005, the Financing Agreements were amended and the Company issued an additional $140,000 in convertible notes. The terms and conditions of the original Financing Agreements were unchanged except that the maximum conversion price for the convertible notes was reduced from a split-adjusted price of $20 per share to $16 per share and there is no minimum conversion price. The Company issued 11,297 split adjusted Class A warrants exercisable at $20 per share, 8,473 split-adjusted Class B warrants exercisable at $25 per share, 8,473 split-adjusted Class C warrants exercisable at $30 per share, and 5,649 split-adjusted Class D warrants exercisable at $45 per split adjusted share, pertaining to the $140,000 in convertible notes issued. The warrants expire five years after the date the warrants are issued and are callable by the Company when the market price is 200% of the exercise price.

(a)(vii) On January 17, 2006, the Financing Agreements were completed and the Company received an additional $300,000. The Company issued $493,200 in convertible notes for the additional funding of $300,000 and for liquidated damages amounting to $193,200 as outlined in Note 5(a)(ii). The Company issued 47,847 split-adjusted Class A warrants exercisable at $20 per split adjusted share, 35,885 split-adjusted Class B warrants exercisable at $25 per share, 35,885 split-adjusted Class C warrants exercisable at $30 per share, and 23,923 split-adjusted Class D warrants exercisable at $45 per share.

(a)(viii) The warrants are detachable from the convertible notes and have been accounted for separately in accordance with ASC 815, *Derivatives and Hedging*. The warrants do not meet the necessary qualifications for equity as outlined in ASC 815. As a result, the warrants and conversion feature were classified as liabilities pursuant to ASC 815 at fair value with changes in fair value recorded in the consolidated statements of operations.

5. Convertible Notes (continued)

The Company classified the conversion features and warrants as derivative liabilities pursuant to ASC 815. The Company recorded derivative liabilities (Refer to Note 7) on the convertible notes equal to the fair value of the conversion feature and warrants. At August 31, 2010, $1,048,447 of the $1,342,700 convertible notes had been converted into common shares leaving outstanding principal of $294,253 with a carrying value of $294,253.

(b) *March 2007 Financing*

On March 1, 2007, the Company completed financing agreements for $250,000 with private investors (the "Investors") and issued callable secured convertible notes totalling $250,000 with a 6% interest rate, 15% interest rate upon default and a maturity of three years (the "Notes"). The Notes are convertible into shares of common stock at 50% of the average of the lowest three closing prices for the Company's shares during the twenty trading days prior to conversion. The Notes are secured with a secondary position on all of the Company's assets pursuant to the Security Agreement and the Intellectual Property Security Agreement entered into with the Investors. In addition, the Company granted the Investors warrants with a seven-year maturity, to purchase 100,000 split-adjusted shares of the Company's common stock at an exercise price of $0.20 per split adjusted share. Pursuant to the terms of a Registration Rights Agreement, the Company is required to register the shares underlying the Notes, as well as the shares to be issued pursuant to the Warrant, within 45 days from the Closing Date and is required to have the registration statement declared effective within 120 days from the Closing Date. The underlying shares have not been registered and the Company has defaulted on the convertible notes. The Company must make default payments at the borrower's option in cash or stock.

(b)(i) The warrants are detachable from the convertible notes and have been accounted for separately in accordance with ASC 815, *Derivatives and Hedging*. The warrants do not meet the necessary qualifications for equity as outlined in ASC 815. As a result, the warrants and conversion feature were classified as liabilities pursuant to ASC 815 at fair value with changes in fair value recorded in the consolidated statements of operations.

(b)(ii) There are liquidated damages or cash penalty payable to the warrant holder if the Company cannot register the shares underlying the warrants. The Company must file an S-1 to register the warrant shares within 45 days from the closing date and have the S-1 declared effective within 120 days. If the Company fails to file by the 45th day, there is a 2% penalty payable as of that date. Then on the 30th day thereafter there is another 2% penalty, prorated if the default is cured during the 30 day period. If the S-1 is not declared effective by the 120th day, then on the 30th day after that day there is a 2% penalty and on each 30th day after that another 1% penalty, again prorated to a maximum of 6%. The penalties commenced April 14, 2007 at 2% of $250,000 and continue at 6% per month for each month thereafter until the Notes mature in March 2010. The maximum penalty payable is $15,000. At May 31, 2009, the Company had recorded $15,000 in accrued liabilities for the penalties that have accrued.

(b)(iii) The Company evaluated the conversion feature under the guidance of ASC 815, *Derivative and Hedging*, Pursuant to ASC 815, the embedded conversion feature was separated from the host contract and the conversion feature was classified as liabilities pursuant to ASC 815 at fair value with changes in fair value recorded in the consolidated statements of operations.

(b)(iv) On March 26, 2010, the Company entered into a settlement agreement to settle $160,000 the notes and 64,000 warrants issued pursuant to the March 2007 financing. Refer to Note 5(c). For the three months ended August 31, 2010, the Company recorded $Nil (2009 - $12,591) as the accretion of interest expense on the convertible notes. At August 31, 2010, the carrying value of the convertible notes was $90,000 (May 31, 2010 - $90,000).

5. Convertible Notes (continued)

(c) *Loan Settlement*

On March 26, 2010, as a result of legal action initiated by the holders of the convertible notes the Company entered into a settlement agreement. Pursuant to the agreement, the Company settled convertible notes with a carrying value of $2,116,530 and 724,000 warrants issued with convertible notes.

Pursuant to the agreement, in exchange for forgiving all amounts owing pursuant to the March 2006 and July 2007 financings, $160,000 of the notes issued pursuant to the March 2007 financings and all interest and penalties owing on those notes, the Company owes the note holders a principal amount of $3,600,000 which is payable immediately, non-interest bearing and will be reduced by weekly payments of the Company's common stock.

The Company is currently subject to a cease trade order. For the six months following the revocation of the cease trade order, the Company will issue twenty percent (20%) of the Company's prior week's total trading volume. Thereafter the weekly share issuances will equal the greater of 17,500,000 shares or twenty percent (20%) of the prior week's total trading volume as reported on Bloomberg. The Principal Amount shall be reduced by the net proceeds from any sales of the Company's shares and by such other cash payments as the Company may decide to make front time to time.

Upon the revocation of the cease trade order, the Company must place 35,000,000 shares in escrow. However, the Company cannot execute or implement the terms of the agreement without the consent of the British Columbia Securities Commission or the revocation of the cease trade order.

The agreement originally contemplated that if the cease trade order was not revoked by June 30, 2010, the note holders would be entitled to enter into a judgment against the Company for the Principal Amount. The Company was entitled to three thirty day extensions in consideration for the increase in the principal of $100,000 per extension. The Company exercised all three extensions and has recorded $300,000 as additional interest expense.

Subsequent to August 31, 2010, the Company began negotiating a revised settlement agreement, subject to the revocation of the cease trade order or British Columbia Securities Commission approval, whereby the creditor has agreed to waive the $300,000 extension fee contemplated by the original version of the settlement agreement and to maintain the Principal Amount at $3,600,000. In addition, pursuant to this revised settlement agreement, the Company would have until November 30, 2010 to have the cease trade order revoked and would have the ability to request three thirty day extensions to the November deadline for an extension fee of $100,000 per extension.

In the event that the Company fails to deliver any shares of stock when such shares are due, the balance of the settlement amount shall be immediately due and payable and shall bear interest at 12% per annum, from the date of default. In addition, note holders shall be entitled to entry of a judgment against the Company without notice or delay, in the principal amount, plus default interest. The note holders are also entitled to include in the judgment an amount equal to the greater of 15% of the foregoing amount or $25,000 as their reasonable legal fees and costs of collection. The judgment shall bear interest at 12% per annum until paid in full.

Pursuant to ASC 470-60, *Troubled Debt Restructurings by Debtor*s the Company recorded a gain of $5,272,473 equal to the difference between the carrying value of the debt of $2,116,530, accrued interest of $555,943 and penalties of $6,200,000 and the settlement amount of $3,600,000. As the principal amount of the settlement would still be classified as a derivative liability pursuant to ASC 815, *Derivatives and Hedging,* and ASC 710, *Compensation,* the Company also recorded a gain on the settlement of debt of $1,394,058 equal to the difference between the fair value of the derivative immediately prior to the settlement agreement and after.

(expressed in U.S. dollars)

5. Convertible Notes (continued)

(d) During the three months ended August 31, 2010, interest of $14,528 (2009 - $66,956) was accrued on the convertible notes During the three months ended August 31, 2010, convertible notes with a principal amount of $Nil (2009 – $51,500) were converted into Nil (2009 - 30,791,667) shares of common stock. Pursuant to ASC 470-20, *Debt with Conversion and Other Options*, the Company recognized inducement expense of $372,698, resulting from the difference between the fair value of the shares of common stock issued and the fair value of the shares of common stock issuable under the original conversion terms of the agreement.

6. Debt Wrap Agreements

As August 31, 2010, the Company had entered into seven debt wrap agreements of $50,000 each and one debt wrap agreement of $12,500 for a total of $362,500. Pursuant to the agreements the President of the Company, the wife of the President of the Company, and the Chief Financial Officer of the Company each assigned $100,000 of amounts owing to them to third parties. Two shareholders also assigned a total of $62,500 of amounts owing to them to a third party. These amounts were then secured by the Company issuing convertible notes to the third parties.

These notes were converted by the third parties into 165,394,272 shares of common stock on the date of issuance. The third parties will sell the shares on the open market. Of the proceeds received from the sale of the shares $280,000 will be loaned back to the Company, $25,625 will be used for legal fees and $56,875 will be kept by the original debt holder. As at August 31, 2010, $237,600 of proceeds has been loaned back to the Company.

The Company recorded the excess value of the common stock issued over the note settled as interest expense. The fair value of the common stock was determined based upon the closing market price of the Company's common stock on the date of conversion. During the three months ended August 31, 2010, the Company recorded interest expense of $Nil (2009 - $292,473).

7. Derivatives

The Company evaluated the application of ASC 815, *Derivatives and Hedging,* for the convertible notes issued to investors as outlined in Note 5. Based on the guidance in ASC 815, the Company concluded all of these instruments were required to be accounted for as derivatives. ASC 815 requires the Company to bifurcate and separately account for the conversion features of the notes as embedded derivatives. Pursuant to ASC 815, the Company bifurcated the conversion feature from the notes because the economic characteristics and risks of the conversion features were determined to not be clearly and closely related to the economic characteristics and risks of the debentures.

In addition, the number of shares issuable pursuant to the conversion features was variable and the Company determined that the conversion features met the attributes of a liability and therefore recorded the fair value of the conversion features as current liabilities. The Company also determined that as a result of being unable to determine the number of shares issuable upon the conversion of notes, the Company’s warrants and stock options granted to non-employees also should be classified as derivative liabilities. The Company is required to record the derivatives on its balance sheet at fair value with changes in the values of these derivatives reflected in the statement of operations. The impact of the application of ASC 815 on the balance sheet is as follows:

	August 31, 2010 $	August 31, 2009 $
Derivative liabilities	4,709,846	4,279,006

(expressed in U.S. dollars)

7. Derivatives (continued)

The Company uses a binomial valuation model for calculation of the fair value of the conversion feature and the Black Scholes valuation model for calculation of stock option and warrant derivative liabilities. The Company uses volatility rates based upon the closing stock price of its common stock. The Company uses a risk free interest rate which is the U.S. Treasury bill rate for securities with a maturity that approximates the estimated expected life of a derivative. The Company uses the closing market price of the common stock on the date of issuance of a derivative or at the end of a quarter when a derivative is valued at fair value. The volatility has ranged from 718% to 177% during the three months ending August 31, 2010 and 2009.

The following table shows the weighted average volatility, risk free rate and market price used in the calculation of the call value for the notes.

	Volatility	Risk Free Rate	Dividend Yield	Term in Years
At Issuance Date for:				
April 2005 Financing	192%	4.10%	–	1.00
March 2006 Financing	169%	4.66%	–	3.00
March 2007 Financing	187%	4.42%	–	3.00
July 2007 Financing	211%	4.65%	–	3.00
Average rates at Period End:				
August 31, 2010	563%	0.72%	–	3.00
May 31, 2010	564%	1.48%	–	3.00

The following table shows the weighted average volatility, risk free rate and market price used in the calculation of the Black Scholes valuation of the detachable warrants.

	Volatility	Risk Free Rate	Dividend Yield	Term in Years
At Issuance Date for:				
April 2005 Financing	111%	4.07%	–	5.00
March 2006 Financing	164%	4.75%	–	7.00
March 2007 Financing	187%	4.42%	–	7.00
July 2007 Financing	188%	4.78%	–	7.00
Average rates at Period End:				
August 31, 2010	247%	0.26%	–	1.13
May 31, 2010	377%	1.41%	–	2.88

As a result of the debt settlement agreement described in Note 5(c), the Company eliminated $4,994,058 of derivative liabilities previously outstanding relating to convertible notes settled and incurred a $3,600,000 derivative liability relating to the amount owing pursuant to the settlement agreement. During the three months ended August 31, 2010, the Company recorded a loss on derivatives of $430,840 (2009 – $14,760,298) equal to the difference in the fair value of the derivatives at August 31, 2010 (2009) and the previous year end. During the three months ended August 31, 2010, the Company reclassified $nil (2009 - $285,665) of derivative liabilities to additional paid-in capital upon the conversion of convertible notes.

(expressed in U.S. dollars)

8. Related Party Balances/Transactions

	August 31, 2010 $	August 31, 2009 $
(a) Balances		
(i) Shield-Tech Products Inc.	524,402	535,980
(ii) Directors and/or officers, current and former	1,604,817	1,576,080
	2,129,219	2,112,060

b) Shield-Tech Products Inc., a company in which the former President of the Company has a significant influence on, conducted research and incurred development expenditures on the Company's behalf. The advances are without interest, unsecured and due on demand.

c) The advances from directors and/or officers are without interest, unsecured, and due on demand.

d) The remaining amount of $58,288 (May 31, 2010 - $59,575) owing to a former officer in connection with the failed acquisition of 5943609 B.C. Ltd. (dba Mystic Mountain Body and Spa Products) ("Mystic") in fiscal 2004 are secured by promissory notes, non-interest bearing and due on demand. The Company and Mystic decided to terminate the acquisition agreement in fiscal 2004 but have not yet settled the terms.

e) Three directors/officers were paid/accrued $57,612 for the three months ended August 31, 2010 (2009 – $40,420) for consulting services rendered.

9. Other Advances

(a) The Company received advances from a non-related party totalling $114,000 to assist in research and development. The advances are due on demand, unsecured and accrued interest at prime plus 1% per annum until May 31, 2005. As at May 31, 2005, $40,033 of interest had been accrued on these advances and included in other advances. Subsequent to May 31, 2005, the amount became non-interest bearing.

(b) On December 22, 2003, the Company entered into a Letter of Commitment to participate in a Joint Venture with a First Nations Band (the "Band"). The Joint Venture was to be 51% owned by the Band and 49% by the Company. The Company was to contribute all the property and equipment, including all intellectual property and intangible assets, and inventory of Mystic. The Company was also to provide its management expertise to supervise the construction of a manufacturing facility on the Band's land, purchase and install suitable equipment, and prepare a business plan. The band was to contribute a total of Cdn$5,000,000 to be used to construct the manufacturing facility, to purchase manufacturing equipment and to fund start up and operating costs. In fiscal 2004 the Company received Cdn$102,000 from the Band to assist the Company in developing a business and start-up plan for the Joint Venture. The advance was non-interest bearing, unsecured and repayable only if the Band did not approve the start-up plan. The Company and the Band have decided not to proceed with the Joint Venture and the Company will repay the promissory note to the Band. On July 27, 2004, the Band demanded repayment and interest at the rate of 12% per annum began accruing on the outstanding balance on August 10, 2004. During fiscal 2005, the Company repaid Cdn$30,000 and during the year ended May 31, 2007, the Company repaid Cdn$10,000, leaving a balance of $58,125 (Cdn$62,000) remaining as at August 31, 2010 (May 31, 2010 - $59,415).

(expressed in U.S. dollars)

10. Common Stock, Preferred Stock and Deferred Compensation Cost

(a) Authorized Shares

The Company's authorized common stock is 4,000,000,000 shares. The holders of common stock are entitled to equal dividends and distributions when, as, and if declared by the Board of Directors from funds legally available therefore. Each share of common stock is entitled to one vote.

The Company's authorized preferred stock is 400,000,000 shares. The preferred shares are convertible into shares of common stock at the option of the holder at a ratio of 2 common shares for 1 preferred share and have liquidation rights at 8 common shares per 1 preferred share. The preferred shares have a voting ratio of 5 votes for 1 preferred share.

The Company has evaluated the preferred shares to determine if there are any embedded derivatives and determined that the preferred shares have more characteristics of equity than debt as they are not redeemable and carry voting rights. As such the preferred shares are considered perpetual and the option to convert into shares of the Company's common stock is clearly and closely related to the host contract, they do not need to be separated.

(b) Non-cash Consideration

Shares issued for non-cash consideration were valued (1) based on the fair value of the services and/or goods provided when these amounts were more readily determinable than the value of the shares at the date of issue; and (2) based on the fair market value of the shares at the date of issue when their value was more readily determinable than the value of the services provided.

11. Stock Options

The Company adopted a Stock Option Plan dated June 1, 2004 under which the Company is authorized to grant stock options to acquire up to a total of 30,000 shares of common stock. The Company also adopted a Stock Option Plan dated March 1, 2005 under which the Company is authorized to grant stock options to acquire up to a total of 20,000 shares of common stock. The Company also adopted a Stock Option Plan in 2006 under which the Company is authorized to grant stock options to acquire up to a total of 100,000 shares of common stock. Pursuant to the plans, no options shall be issued under either stock option plan at a price per share less than the fair market value. The vesting term will be determined at the time of grant by the Board of Directors.

A summary of the changes in the Company's stock options is presented below:

	Number of Options	Weighted Average Exercise Price $	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value $
Outstanding, May 31, 2009	76,992,500	0.02		
Expired	(41,000)	23.90		
Outstanding and Exercisable, May 31, and August 31, 2010	76,951,500	0.01	3.55	38,000

(expressed in U.S. dollars)

11. Stock Options (continued)

Additional information regarding stock options outstanding as at August 31, 2010 is as follows:

	Outstanding and Exercisable	
Exercise prices $	Number of options	Remaining contractual life (years)
0.0005	76,000,000	3.56
0.03	850,000	2.77
1.90	2,500	1.12
2.60	1,000	1.07
3.20	89,000	0.90
6.50	9,000	0.23
	76,951,500	

At August 31, 2010 and 2009, the Company had no unvested options.

12. Share Purchase Warrants

A summary of the changes in the Company's share purchase warrants is presented below:

	Three Months Ended August 31, 2010		Year Ended May 31, 2010	
	Number	Weighted Average Exercise Price $	Number	Weighted Average Exercise Price $
Balance, beginning of period	213,433	23.24	1,061,183	13.00
Forfeited/Expired	(33,893)	27.92	(847,750)	10.92
Balance, end of period	179,540	22.36	213,433	23.24

As at August 31, 2010, the following share purchase warrants were outstanding:

Number of Warrants	Exercise Price $	Expiry Date
47,847	20.00	January 17, 2011
35,885	25.00	January 17, 2011
35,885	30.00	January 17, 2011
23,923	45.00	January 17, 2011
36,000	0.20	March 1, 2014
179,541		

(expressed in U.S. dollars)

13. Commitments

(a) On July 23, 2004, the Company entered into a Stock Purchase Agreement with Seaside Investments PLC ("Seaside"), a private London investment company, for the purchase by Seaside of $1,177,970 of the Company's common shares at $46 per share, in exchange for shares of Seaside. At that time, Seaside entered into a "lock-up" agreement with the Company pursuant to which it has agreed not to trade the Company's shares for a period of one year from the closing date. The Company agreed to file a registration statement with the SEC allowing the public resale of the common shares by Seaside, commencing at the expiration of the "lock-up" period. Seaside was to issue its shares to the Company equivalent to $1,177,970 as full payment for the Company's shares. Thirty percent of Seaside's shares were to be held in escrow for one year following their issuance and in the event the per share market price of the Company's common stock at such time was less than the per share value of the Company's stock at the time of the closing, Seaside was to be entitled to receive out of escrow a percentage of the shares equal to the percentage of such decline. The remaining shares held in escrow were to be released to the Company at such time.

The closing of this transaction was subject to certain contingencies, including the listing of Seaside shares on the London Stock Exchange on or before September 30, 2004 (extended to March 31, 2005).

The Company delivered 26,775 split-adjusted shares to its legal counsel to be held in escrow pending closing of this transaction at which time these shares were to be recorded as issued common shares. As the transaction did not close, on September 20, 2005 the Company terminated the agreement. At August 31, 2010, the Company intends to cancel the 26,775 split-adjusted shares.

(b) On February 16, 2006, the Company entered into a structuring agreement relating to placement agent services rendered in connection with the $2,000,000 financing agreement, as discussed in Note 5(b). The Company agreed to pay $100,000 in cash (paid), and to issue warrants worth $200,000. As at August 31, 2010, $200,000 has been accrued for structuring fees incurred.

(c) On April 17, 2007, the Company entered into a consulting agreement for 5 years of public relations services in consideration for $24,000 per year. As at August 31, 2010, the Company has accrued $66,000 (August 31, 2010 - $60,000).

(d) On October 31, 2007, the Company entered into a five year lease agreement for office space. Pursuant to the agreement the Company is to pay $3,586 ($3,825 CDN) per month. The Company's remaining minimum lease payments over the next 2 years are as follows:

Fiscal Year	$
2011	32,274
2012	17,930
	50,204

14. Contingent Liability and Legal Proceedings

The former Vice President of Sales and Marketing (former Vice President) of the Company, wrongfully registered certain of the Company's internet domain names in the name of E-Clarity Consulting Inc. a consulting company controlled by her, during the time she worked for the Company. The Company was able to recover registered ownership of some of its domain names. On September 30, 2005, the Company commenced legal proceedings in the Supreme Court of British Columbia against the former Vice President and E-Clarity Consulting Inc. alleging that breach of fiduciary and contractual duties to the Company on a number of grounds, including wrongfully registering the Company's internet product property and by failing to deliver them to the Company when requested to do so. On September 30, 2005, the Company obtained an interim Court Order requiring the former Vice President and E-Clarity Consulting Inc. to deliver the internet property to the Company within two days of being served with the Court Order. The Court Order was served and complied with. On October 17, 2005, the Company obtained a judgment against the former Vice President and E-Clarity Consulting Inc. for damages to be assessed plus costs to be assessed. The Company has not since taken any steps in the proceedings to assess costs or damages.

In September 2005, the Company received an invoice from E-Clarity Consulting Inc. seeking payment of $240,137 with a threat of legal proceedings if the amount was not paid. The Company denies the amount claimed is owed, has not paid any of the amount claimed, and intends to vigorously defend its position when required to do so. The Company has recorded an amount owing to the former Vice President of $131,458 in its books as at May 31, 2009. The former Vice President has issued further invoices unilaterally adding further interest charges to the amount allegedly owing, but she has taken no steps in the Courts to attempt to collect it. The Company denies the obligation to pay the invoiced amounts and interest as claimed. Aside from rendering invoices, the former Vice President has not taken any steps in the existing legal proceedings nor initiated any other legal proceedings to advance claims for payment from the Company. If steps are taken in legal proceedings to collect the amounts allegedly due, the Company will defend the claim and proceed to assess damages and costs in its legal proceedings and seek to set off those amounts from the amount, if any, which might be found by a court to be payable by the Company. If the Company's damage claim exceeds the amount which may be payable, the Company plans to collect the excess of such damages and costs from the former Vice President and E-Clarity Consulting Inc.

On May 9, 2007, the former CFO of the Company commenced legal proceedings against the Company seeking judgement for unpaid services totalling $73,312 plus costs and on May 25, 2007 filed an application for summary judgement.

The amount claimed is included in accrued liabilities at August 31, 2010.

(expressed in U.S. dollars)

15. Supplementary Cash Flow Information

	Accumulated from March 25, 1999 (Date of Inception) to August 31, 2010 $	For the Three Months Ended August 31, 2010 $	2009 $
Non-cash Investing and Financing Activities			
Advance royalty deposits payable	25,000	–	–
Deferred financing fees payable	200,000	–	–
Promissory notes issued to acquire assets	73,346	–	–
Shares issued to settle debt	1,356,053	–	492,473
Shares issued for consulting fees and services	4,233,138	–	–
Shares issued to purchase inventory	120,000	–	–
Shares issued to settle related party debt	430,113	–	–
Accrued interest converted into convertible notes payable	49,500	–	–
Derivative liability relieved by conversion	6,612,377	–	285,665
Shares issued for conversion of notes payable and accrued interest	1,958,091	–	66,500
Deemed dividends on preferred shares	95,000	–	–
Supplemental Disclosures			
Interest paid	–	–	–
Income taxes paid	–	–	–

16. Segmented Information

The Company reports in one reportable operating segment, which is the provision of skin products. The Company operates primarily from Vernon, British Columbia, Canada.