

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
**(A company in the development stage)**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF JUNE 30, 2009**

**IN US DOLLARS**

**MEDGENICS, INC., AND ITS SUBSIDIARY**  
**(A company in the development stage)**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF JUNE 30, 2009**

**IN US DOLLARS**

**(UNAUDITED)**

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**MEDGENICS, INC. AND ITS SUBSIDIARY**  
**(A company in the development stage)**

**CONSOLIDATED BALANCE SHEETS**

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**In US Dollars**

	<b>June 30, 2009 Unaudited</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$53479	\$1043338
Accounts receivable and prepaid expenses	116325	121794
<u>Total</u> current assets	169804	1165132
LONG TERM ASSETS:		
Restricted lease deposit	22432	22607
Prepaid lease payments	22443	22443
Severance pay fund	203010	171048
<u>Total</u> long term assets	247885	216098
PROPERTY AND EQUIPMENT, NET	361365	400214
<u>Total</u> assets	\$779054	\$1781444

The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
**(A company in the development stage)**

**CONSOLIDATED BALANCE SHEETS**

**In US Dollars**

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
	<b>Unaudited</b>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Short – term bank credit	\$12281	\$52886
Trade payables	977617	889002
Other accounts payable and accrued expenses	1397748	1068518
<u>Total</u> current liabilities	2387646	2010406
<b>LONG-TERM LIABILITIES:</b>		
Accrued severance pay	904913	818639
Convertible debentures	273130	-
<u>Total</u> long term liabilities	1178043	818639
<u>Total</u> liabilities	3565689	2829045
<b>SHAREHOLDERS' DEFICIENCY:</b>		
Common shares - \$0.0001 par value; 500,000,000 shares authorized at June 30, 2009 and December 31, 2008; 117,754,028 and 106,728,195 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively		
Additional paid-in capital	11775	10672
Receipts on account of shares	29606783	28968015
Deficit accumulated during the development stage	-	150000
	(32405193)	(30176288)
Total shareholders' deficiency	(2786635)	(1047601)
Total liabilities and shareholders' deficiency	\$779054	\$1781444

The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
**(A company in the development stage)**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**In US Dollars (except for share data)**

	<b>Six months ended June 30, 2009</b>	<b>June 30, 2008</b>	<b>Year ended December 31, 2008</b>	<b>From date of inception (January 27, 2000) through June 30, 2009</b>
	<b>Unaudited</b>			<b>Unaudited</b>
Research and development expenses	\$1282669	\$1632531	\$3435538	\$20010032
Less – Participation by the Office of the Chief Scientist	(292893)	-	(1336446)	(3532600)
Research and development expenses, net	989776	1632531	2099092	16477432
General and administrative expenses	1198690	1388281	2761008	15349557
Loss from disposal of property and equipment	-	-	-	325,842
Operating loss	2188466	3020812	4860100	32152831
Financial (income) expenses, net	37247	(51343)	(11457)	609328
Loss before taxes on income	2225713	2969469	4848643	32762159
Taxes on income	-	1839	3615	70294
Net loss	2225713	2971308	4852258	32832453
Dividend in respect of reduction in exercise price of certain warrants	3192	-	6745	9937
Net loss attributable to common shareholders	\$2228905	\$2971308	\$4859003	\$32842390
Basic and diluted net loss per share	<u>\$0.02</u>	<u>\$0.03</u>	<u>\$0.05</u>	

Weighted average number of shares used in per share calculation	<u>111249104</u>	<u>106204484</u>	<u>106447604</u>
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The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
(A company in the development stage)

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Old Common shares		Preferred shares Series A		Preferred shares Series B		Additional Paid-in Capital	Deferred Stock Compensation	Deficit Accumulated During the Development Stage	Total Shareholders' Equity (Deficiency)
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount				
	Balance as of January 27, 2000 (inception)	-	\$ -	-	\$ -	-				
Issuance of Old Common shares in January 2000 at par value	2,000,000	2	-	-	-	-	-	-	2	
Issuance of Old Common shares in March 2000 at par value	69,677	-	-	-	-	-	-	-	-	
Issuance of Old Common shares in August 2000 at \$1.14 per share, net	437,936	-	-	-	-	499,997	-	-	499,9	
Issuance of Old Common shares in respect of license agreement in August 2000 at par value	940,950	1	-	-	-	-	-	-	1	
Net loss	-	-	-	-	-	-	-	(681,216)	(681	
Balance as of December 31, 2000	3,448,563	3	-	-	-	499,997	-	(681,216)	(181,	
Stock split effected as stock	-	342	-	-	-	(342)	-	-	-	
Dividend	-	-	-	14	-	-	-	-	-	
Issuance of Preferred shares in January 2001 at \$1.41 per share, net	-	-	138,502	-	-	195,122	-	-	195,1	
Issuance of Preferred shares in March and June 2001 at \$1.67 per share, net	-	-	4,085,837	408	-	6,805,968	-	-	6,806	
Deferred stock compensation	-	-	-	-	-	248,165	(248,165)	-	-	
Amortization of deferred stock compensation	-	-	-	-	-	-	40,880	-	40,88	

Stock based compensation expense related to options to consultants	-	-	-	-	-	-	510,869	-	-	510,8
Net loss	-	-	-	-	-	-	-	-	(3243701)	(324
Balance as of December 31, 2001	3,448,563	\$345	4,224,339	\$422	-	\$	\$8,259,779	(\$207285)	(\$3924917)	\$412

The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
(A company in the development stage)

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Old Common shares		Preferred shares Series A		Preferred shares Series B		Addition al Paid-in Capital	Deferred Stock Compensation	Deficit Accumulated During the Development Stage	Total Share Equity (Deficiency)
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount				
Balance as of December 31, 2001	3448563	\$345	4224339	\$422	-	\$	\$8259779	(\$207285)	(\$3924917)	\$412
Issuance of Preferred shares					268					
In October 2002 at - \$1.97 per share, net	-	-	-	-	2,676,674		5,264,352	-	-	5,264,352
Deferred stock compensation	-	-	-	-	-	-	63855	(63855)	-	-
Amortization of deferred stock compensation	-	-	-	-	-	-	-	66,937	-	66,937
Stock based compensation expenses related to options to consultants	-	-	-	-	-	-	371,560	-	-	371,560
Net loss	-	-	-	-	-	-	-	-	(5049391)	(5049391)
Balance as of December 31, 2002	3448563	\$345	4224339	\$422	2676674	\$268	\$1395954	(\$204203)	(\$8974308)	\$478

The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**

(A company in the development stage)

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Old Common shares		Preferred shares Series A		Preferred shares Series B		Additional Paid-in Capital	Deferred Stock Compensation	Deficit Accumulated During the Development Stage	Total Shareholders' Equity (Deficiency)
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount				
Balance as of December 31, 2002	3448563	\$345	4224339	\$422	2676674	\$268	\$1395954	(\$204203)	(\$8974308)	\$478,000
Exercise of stock options	19443	2	-	-	-	-	193	-	-	195
Issuance of Preferred shares in April 2003 at \$ 2.00 per share, net	-	-	-	-	216,507	-	432,994	-	-	433,000
Issuance of Preferred shares in May 2003 at \$ 2.00 per share, net	-	-	-	-	850,490	-	1,603,783	-	-	1,603,783
Deferred stock compensation	-	-	-	-	-	-	440811	(440811)	-	-
Amortization of deferred stock compensation	-	-	-	-	-	-	-	105,213	-	105,213
Stock based compensation expenses related to options to consultants	-	-	-	-	-	-	475,469	-	-	475,469
Net loss	-	-	-	-	-	-	-	-	(5038272)	(5038272)
Balance as of December 31, 2003	<u>3468006</u>	<u>\$347</u>	<u>4224339</u>	<u>\$422</u>	<u>3743671</u>	<u>\$375</u>	<u>\$1691279</u>	<u>(\$539801)</u>	<u>(14012580)</u>	<u>\$236,000</u>

The accompanying notes are an integral part of the consolidated financial statements

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
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**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Old Common shares		Preferred shares Series A		Preferred shares Series B		Addition al Paid-in Capital	Deferred Stock Compensation	Deficit Accumulated During the Development Stage	Total Shareholders' Equity (Deficiency)
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount				
Balance as of December 31, 2003	3468006	\$347	4224339	\$422	3743671	\$375	\$1691279	(\$539801)	(\$1401258)	\$236
Exercise of stock options	12750	1	-	-	-	-	126	-	-	127
Stock based compensation related to shares to consultants	33333	3	-	-	-	-	9997	-	-	10000
Amortization of deferred stock compensation - Stock based compensation expense related to options to consultants	-	-	-	-	-	-	-	539801	-	539801
Net loss	-	-	-	-	-	-	346762	-	-	346762
	-	-	-	-	-	-	-	-	(4515829)	(4515829)
Balance as of December 31, 2004	3514089	\$351	4224339	\$422	3743671	\$375	\$1726968	\$-	(\$1852840)	(\$1252840)
Net loss	-	-	-	-	-	-	-	-	(776129)	(776129)
Balance as of December 31, 2005	3514089	\$351	4224339	\$422	3743671	\$375	\$1726968	\$-	(\$1930453)	(\$2030453)

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**MEDGENICS, INC. AND ITS SUBSIDIARY**  
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**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Common shares		Old Common shares		Preferred shares Series A		Preferred shares Series B		Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Shareholders' Equity (Deficiency)
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount			
	Balance as of December 31, 2005	-	\$ -	4E+06	\$351	4E+06	\$422	4E+06			
Conversion of Old Common shares, Series A and Series B Preferred shares into New Common shares	1E+07	46	-4E+06	(351)	-4E+06	(422)	-4E+06	(375)	(436095)	437197	-
Conversion of convertible Note into New Common shares	1E+07	56	-	-	-	-	-	-	1795016	-	179
Issuance of Common shares in settlement of due debt in March 2006	3E+06	12	-	-	-	-	-	-	96004	-	960
Issuance of Common shares and warrants in March 2006 at \$0.07 per share and warrant, net	1E+07	66	-	-	-	-	-	-	828197	-	828
Issuance of Common shares and warrants in April 2006 at \$0.07 per share and warrant, net	513396	2	-	-	-	-	-	-	30133	-	301
Issuance of Common shares and warrants in June 2006 at \$0.07 per share and warrant, net	2E+06	8	-	-	-	-	-	-	93538	-	935
Issuance of Common shares and warrants in November 2006 at \$0.12 per share and warrant, net	5E+06	25	-	-	-	-	-	-	521752	-	521
Issuance of Common shares and warrants in December 2006 at \$0.12 per share and warrant, net	1E+07	53	-	-	-	-	-	-	1092916	-	109
Stock based compensation expense related to options and warrants granted to consultants and employees	-	-	-	-	-	-	-	-	1161287	-	116
Net loss	-	-	-	-	-	-	-	-	-	(2598605)	(2598605)
Balance as of December 31, 2006	6E+07	\$268	-	-	-	-	-	-	\$22452425	(\$2146594)	\$20305831

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**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	<u>Common shares</u>		<u>Additional Paid-in Capital</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Shareholders' Equity</u>
	<u>Number of Shares</u>	<u>Amount</u>			
	Balance as of December 31, 2006	57405326			
Issuance of Common shares and warrants in January 2007 at \$0.12 per share and warrant, net	427402	2	33318	-	333
Issuance of Common shares and warrants in May 2007 at \$0.16 per share and warrant, net	5347851	25	583636	-	5836
Issuance of Common shares in July 2007 at \$0.13 per share, net	771612	3	84211	-	842
Exercise of warrants in July 2007	451939	2	-	-	-
Issuance of Common shares to consultant in August 2007, net	122232	1	(1)	-	-
Issuance of Common shares and warrants in August 2007 at \$0.16 per share and warrant, net	1527973	7	166753	-	1667
Stock split effected as stock dividend in December 2007	-	6297	(6297)	-	-
Conversion of convertible Note into Common shares and issuance of warrants in December 2007, at \$0.16 per share and warrant, net	6417447	642	699751	-	7003
Issuance of Common shares and warrants in December 2007 at \$0.19 - \$0.21 per share and warrant, net	28537213	2853	3778659	-	37815
Issuance of Common shares and warrants to consultants in December 2007, net	3008033	301	(301)	-	-
Issuance of Common shares for arrangement of security for Letter of Credit in December 2007, net	76389	8	15740	-	15748
Issuance cost due to obligation to issue 142,609 Common shares for consultant, net	-	-	(31449)	-	(31449)
Stock based compensation expense related to options granted to consultants and employees	-	-	346802	-	346802
Beneficial conversion feature embedded in Convertible Note.	-	-	511391	-	511391
Net loss	-	-	-	(3851339)	(3851339)
Balance as of December 31, 2007	<u>1.04E+08</u>	<u>\$10409</u>	<u>\$28634642</u>	<u>(\$2531728)</u>	<u>\$332776</u>

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**MEDGENICS, INC. AND ITS SUBSIDIARY**

(A company in the development stage)

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	Common shares		Additional Paid-in Capital	Receipts on account of shares	Deficit Accumulated During the Development Stage	Total Shareholders' Equity (Deficiency)
	Number of Shares	Amount				
Balance as of December 31, 2007	1.04E+08	\$10409	\$28634642	\$ -	(\$2531728)	\$332776
Exercise of warrants in January 2008	2462050	246	(246)	-	-	-
Issuance of Common shares to consultant in April 2008	142609	14	31435	-	-	314
Exercise of warrants in December 2008	30119	3	(3)	-	-	-
Stock based compensation expense related to options granted to consultants and employees	-	-	295442	-	-	295442
Receipts on account of shares in respect to exercise of warrants in January 2009	-	-	-	150000	-	150000
Dividend in respect of reduction in exercise price of certain warrants	-	-	6745	-	(6745)	-
Net loss	-	-	-	-	(4852258)	(4852258)
Balance as of December 31, 2008	<u>1.07E+08</u>	<u>\$10672</u>	<u>\$28968015</u>	<u>\$150000</u>	<u>(\$3017628)</u>	<u>(\$10476)</u>

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**MEDGENICS, INC. AND ITS SUBSIDIARY**

(A company in the development stage)

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIENCY)**

**In US Dollars (except for share data)**

	<u>Common shares</u>		<u>Additional Paid-in Capital</u>	<u>Receipts on account of shares</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Shareholders' Equity (Deficiency)</u>
	<u>Number of Shares</u>	<u>Amount</u>				
Balance as of December 31, 2008	1.07E+08	\$10672	\$28968015	\$150000	(\$30176288)	(\$104760)
Exercise of warrants	11025833	1103	404902	(150000)	-	2560
Stock based compensation expense related to options granted to consultants and employees	-	-	230674	-	-	230674
Dividend in respect of reduction in exercise price of certain warrants	-	-	3192	-	(3192)	-
Net loss	-	-	-	-	(2225713)	(2225713)
Balance as of June 30, 2009 (Unaudited)	<u>1.18E+08</u>	<u>\$11775</u>	<u>\$29606783</u>	<u>\$-</u>	<u>(\$32405192)</u>	<u>(\$278662)</u>

The accompanying notes are an integral part of the consolidated financial statements.

**MEDGENICS, INC. AND ITS SUBSIDIARY**  
(A company in the development stage)

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**In US Dollars**

	<b>Six months ended June 30,</b>		<b>Year ended December 31,</b>	<b>From date of inception (January 27, 2000) through June 30,</b>
	<b>2009</b>	<b>2008</b>	<b>2008</b>	<b>2009</b>
	<b>Unaudited</b>			<b>Unaudited</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net loss	(\$2225713)	(\$2971308)	(\$4852258)	(\$32832453)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation	60250	36912	96497	804214
Exchange differences on long term loan	-	-	-	2950
Loss from disposal of property and equipment	-	-	-	325842
Interest on Convertible debentures	8130	-	-	8130
Issuance of shares in consideration for providing security for letter of credit	-	-	-	15,748
Stock based compensation related to options and warrants granted to consultants and employees	230674	219345	295442	4501697
Interest and amortization of beneficial conversion feature of convertible note	-	-	-	759197
Purchase of short-term investment, net	-	(47278)	-	(47278)
Gain from short term investment	-	(53690)	-	(53690)
Capital loss	2859	-	-	2859
Accrued severance pay, net	54312	120314	77035	701903
Increase in trade payables	88615	163161	439036	969525
Decrease (increase) in other accounts receivable and pre-paid expenses	5469	(39893)	261354	(116325)
Increase in other accounts payable and accrued expenses	329230	212494	564055	1493764
Net cash used in operating activities	(1446174)	(2359943)	(3118839)	(23362949)

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Proceeds from disposal of property and equipment	-	-	-	172869
Increase in prepaid lease payments	-	-	(10939)	(22443)
Decrease (increase) in restricted lease deposit	175	-	(22607)	(22432)
Purchase of property and equipment	(24260)	(363607)	(371622)	(1659017)
Net cash used in investing activities	(24085)	(363607)	(72991)	(1531023)

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**MEDGENICS, INC. AND ITS SUBSIDIARY**  
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**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**In US Dollars**

	<b>Six months ended</b>		<b>Year ended</b>	<b>From date</b>
	<b>June 30,</b>		<b>December 31,</b>	<b>of</b>
	<b>2009</b>	<b>2008</b>	<b>2008</b>	<b>inception</b>
	<b>Unaudited</b>			<b>(January 27,</b>
				<b>2000)</b>
				<b>through</b>
				<b>June 30,</b>
				<b>2009</b>
				<b>Unaudited</b>
 <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Proceeds from issuance of shares, net	-	-	(309741)	21669890
Exercise of Warrants	256005	-	-	256005
Repayment of issuance expenses	-	(309741)	-	(309741)
Repayment of long-term loan	-	-	-	(73080)
Proceeds from long term loan	-	-	-	70130
Receipts on account of shares	-	-	150000	150000
Proceeds from Convertible Note	265000	-	-	2862225
Increase (decrease) in short-term bank credit	(40605)	(9714)	43172	12281
Net cash provided by (used in) financing activities	480400	(319455)	(116569)	24947451
Increase (decrease) in cash and cash equivalents	(989859)	(3043005)	(3640576)	53479
Balance of cash and cash equivalents at the beginning of the period	1043338	4683914	4683914	-
Balance of cash and cash equivalents at the end of the period	\$53479	\$1640909	\$1043338	\$53479
<b>Supplemental disclosure of cash flow information:</b>				
Cash paid during the period for:				
Interest	(\$35)	(\$7145)	\$833	(\$45571)
Taxes	\$3660	(\$1839)	\$12420	(\$57982)

**Supplemental disclosure of non cash flow information:**

Accrued issuance expenses	\$ -	\$ -	\$ -	(\$460739)
Issuance of Common shares upon conversion of a Convertible Note	\$ -	\$ -	\$ -	\$2845072
Issuance of shares in settlement of debt	\$ -	\$ -	\$ -	\$96016
Issuance cost due to obligation to issue Common shares to consultant	\$ -	\$ -	(\$31449)	(\$31449)
Issuance of Common shares to consultant	\$ -	\$31449	\$ -	\$31449
Purchase of property and equipment	\$ -	\$ -	\$8092	\$17243
Issuance of common shares upon conversion of a warrants	\$150000	\$ -	\$ -	\$150000

The accompanying notes are an integral part of the consolidated financial statements.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**In US Dollars**

**NOTE 1:- GENERAL**

- a.** Medgenics, Inc. (“the Company”) was incorporated in January 2000 in Delaware, and is a holding company with one wholly-owned subsidiary Medgenics Medical Israel Ltd. (formerly Biogenics Ltd.) (“The subsidiary”) which was incorporated in Israel in March 2000. The Company and its subsidiary are engaged in the research and development of products in the field of biotechnology and associated medical equipment and are thus considered development stage companies as defined in Statement of Financial Accounting Standards No. 7 "Accounting and Reporting by Development Stage Enterprises ("SFAS No. 7").

On December 4, 2007 the Company's Common shares were admitted for trading on the London Stock Exchange's Alternative Investment Market (AIM).

- b.** The Company and its subsidiary are in the development stage. The subsidiary ceased operating in 2004 and in 2006 renewed its research and development activities after having raised additional funds.

As reflected in the accompanying financial statements, the Company's operations for the six months ended on June 30, 2009, resulted in a net loss of \$ 2,228,905 and the Company's balance sheet reflects a net shareholders' deficiency of \$ 2,786,635, accumulated deficit of \$ 32,405,193 and a working capital deficiency of \$ 2,217,841.

The Company and its subsidiary have not yet generated revenues and have negative cash flows from operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Management's plans in this regard include, among others, seeking additional capital to continue the operations of the Company and its subsidiary. However, there is no assurance that the Company will be successful in its efforts to raise the necessary capital to continue its planned research and development activities.

The consolidated financial statements do not include any adjustments with respect to the carrying amounts of assets and liabilities and their classification that might result from the outcome of this uncertainty.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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In US Dollars

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies applied in the annual financial statements as of December 31, 2008 are applied consistently in these financial statements.

**Recently issued Accounting Standards:**

FSP FAS 157-4:

In April 2009 the FASB issued FASB staff position 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly". This FSP applies to all assets and liabilities within the scope of accounting pronouncements that require or permit fair value measurements, except as discussed in paragraphs 2 and 3 of statement 157. The FSP is Effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively.

FSP FAS 157-4 relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms what Statement 157 states is the objective of fair value measurement—to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive.

FSP FAS 157-4 provides guidance on (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased and (2) identifying transactions that are not orderly. The adoption of this standard did not have any impact on the consolidated results of operations or financial position of the Company.

SFAS 165:

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS No. 165"). SFAS No. 165 establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, this statement sets forth: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS No. 165 is effective for the interim or annual financial periods ending after June 15, 2009. The adoption of this standard did not have any impact on the consolidated results of operations or financial position of the Company.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**In US Dollars**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)**

SFAS 166:

In June 2009 the FASB issued SFAS No.166 "Accounting for Transfers of Financial Assets" ("SAFS No. 166"). SAFS No. 166 is a revision to Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and will require more information about transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures. SFAS No. 166 enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and a company's continuing involvement in transferred financial assets. SFAS No. 166 will be effective at the start of a company's first fiscal year beginning after November 15, 2009. The Company is currently examining this new standard; the adoption of this standard is not expected to have a material impact on the Company's condensed consolidated financial statements.

**NOTE 3:- UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

**NOTE 4:- SHAREHOLDERS' EQUITY**

**Issuance of shares:**

Pursuant to Note 10d (25) to the Company's annual report regarding the Warrant Repricing Program of the Company to encourage existing warrant holders to exercise their warrants, during January and February 2009, 11,025,833 warrants were exercised into 11,025,833 Common shares of the Company in consideration for a reduced price of \$ 406,048 and issuance of 1,218,144 new warrants as a bonus. The bonus warrants are exercisable immediately for a period of three years from the issuance date at an exercise price of \$0.25 per share. The consideration was paid partly in the year ended December 31, 2008 (\$ 150,000) and the balance was paid in 2009. The benefit resulting to the warrant holders from the reduction of the exercise price and the bonus warrants in the amount of \$6,745 and \$3,192 as of December 31, 2008 and June 30, 2009, respectively, was recorded as a preferred dividend to the warrant holders.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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In US Dollars

### NOTE 5:- CONVERTIBLE DEBENTURES

Commencing May 2009, the Company offered to accredited investors only, in a private placement, convertible debentures in multiples of \$50,000 each (the "Debentures"), together with warrants (the "Warrants") to purchase a number of Common shares, par value \$0.0001 per share, of the Company, equal to 35% of the number of shares of Common shares issued upon conversion of the Debentures. The Debentures issued in the private placement will mature two years after the date of issuance. The Debentures will automatically be converted into Common shares upon the closing of a Qualified Transaction, as defined in the Securities Purchase Agreement entered into by the Company in connection with the private placement.

On June 16, 2009, the Company closed the first series of the private placement. The Company announced at that date, that it has raised \$265,000 in gross proceeds through the issuance of Debentures.

The Debentures bear interest at a rate of 10% per annum. Interest will accrue on the Debentures quarterly from the date of issue and shall be paid on a quarterly basis. In the event of default, the interest rate shall increase 2% per month for every month the Debentures are in default to a maximum of 18% per annum. The Company shall repay the principal and any accrued interest at the two-year anniversary of the date the Debentures were issued. The Debentures are unsecured and the Company has no right to redeem the Debentures. If the Company is liquidated, the holders of the Debentures will participate pari passu with all general creditors of the Company with no seniority or preference. The interest due on June 30, 2009 has been paid.

Until such time the Debentures are repaid, the Debentures (including any accrued interest) shall automatically convert into Common shares at the closing of a Qualified Transaction at the following valuation:

- In the event that the per share price paid in the Qualified Transaction (or per share value of merger consideration in a merger transaction) (the "**Qualified Transaction Price**") is \$0.12 per share or greater, the conversion price shall be the lesser of \$0.12 per share or a 40% discount from the Qualified Transaction Price.
- In the event that the Qualified Transaction Price is at least \$0.07 but less than \$0.12 per share, the conversion price shall be \$0.07 per share.
- In the event that the Qualified Transaction Price is less than \$0.07 per share, the conversion price shall be the Qualified Transaction Price; provided, however, that the holder of the Debenture shall receive 100% more Warrants than such holder would have otherwise been entitled to receive upon conversion.

The share prices referenced above shall be adjusted to reflect any stock splits, stock combinations, stock dividends, reorganizations and the like.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**In US Dollars**

**NOTE 5:- CONVERTIBLE DEBENTURES (CONT.)**

The Warrants exercisable for a number of shares of Common Stock equal to 35% of the number of shares which will be issued upon conversion of the Debentures are for Common Stock. Warrants shall not be issued unless and until the conversion of the Debentures. The Warrants shall be immediately exercisable upon issuance and shall expire five years from the date of issuance. The exercise price shall be 110% of the Qualified Transaction Price.

The Company irrevocably elected to initially and subsequently measure the Debentures entirely at fair value (with changes in fair value recognized in earnings) in accordance with par. 16 of SFAS 133 (as amended by SFAS 155), thus the Company will not separate the embedded derivative instrument from the host contract and account for it as a derivative instrument pursuant to SFAS 133.

This election was made only in respect to the Debentures, as permitted by SFAS 155, which states that this election may be made on an instrument-by-instrument basis.

Subsequent to the balance sheet date, and in conjunction with this private placement, the Company issued additional Debentures for gross proceeds of \$ 305,000 under the same terms.