# LED MEDICAL DIAGNOSTICS INC.

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

**For the Three and Six Months ended June 30, 2012**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis has been prepared by management as of August 14, 2012 and should be read in conjunction with the unaudited interim condensed consolidated financial statements and related notes of LED Medical Diagnostics Inc. (the "Company" or "LED") as at and for the three and six months ended June 30, 2012 and with the audited consolidated financial statements and related notes thereto of the Company for the year ended December 31, 2011 (both prepared in accordance with International Financial Reporting Standards or "IFRS"). All amounts are presented in Canadian dollars unless otherwise noted. All referenced materials as well as additional disclosures are available at www.sedar.com.

## DISCLAIMER FOR FORWARD-LOOKING STATEMENTS

The following Management's Discussion and Analysis contains statements which, to the extent that they are not recitations of historical fact, may constitute forward-looking information under applicable Canadian securities legislation. Such forward-looking statements or information includes financial and other projections as well as statements regarding the Corporation's future plans, objectives, performance, revenues, growth, profits, operating expenses or the Corporation's underlying assumptions and the Company's intention to expand its technology beyond dental applications. The words "may", "would", "could", "will", "likely", "expect", "anticipate", "intend", "plan", "forecast", "project", "estimate" and "believe" or other similar words and phrases may identify forward-looking statements or information. Persons reading this Management's Discussion and Analysis are cautioned that such statements or information are only predictions, and that the Corporation's actual future results or performance may be materially different. Factors that could cause actual events or results to differ materially from those suggested by these forward-looking statements include, but are not limited to: economic conditions; dilution; limited history of profits and operations; operational risk; distributor risks; working capital; potential conflicts of interest; speculative investment; volatility of stock price; intellectual property risks; disruptions in production; reliance on key personnel; seasonality; management's estimates; competitors; regulatory requirements; reliance on few suppliers; reliance on subcontractors; technological milestones; operating cost fluctuations; fluctuations in exchange rates; product liability and medical malpractice claims; access to credit; taxation; potential unknown liabilities; the possibility of development or deployment difficulties or delays; the dependence on its customers' satisfaction; the timing of entering into significant contracts; the performance of the global economy; market acceptance of the Corporation's products and services; customer and industry analyst perception of the Corporation and its technology vision and future prospects; the success of certain business combinations engaged in by the Corporation or by its competitors; possible disruptive effects of organizational or personnel changes; technological change, new products and standards; risks related to acquisitions and international expansion; reliance on large customers; concentration of sales; international operations and sales; management of growth and expansion; dependence upon key personnel and hiring; reliance on a limited number of suppliers; risks related to the Corporation's competition; the Corporation not adequately protecting its intellectual property; risks related to product defects and product liability; currency exchange rate risk; and including, but not limited to, other factors described in the Corporation's reports filed on SEDAR, including its financial statements and management's discussion and analysis for the year ended December 31, 2011. In drawing a conclusion or making a forecast or projection set out in the forward-looking information, the Corporation takes into account the following material factors and assumptions in addition to the above factors: the Corporation's ability to execute on its business plan; the acceptance of the Corporation's products and services by its customers; the timing of execution of outstanding or potential customer contracts by the Corporation; the sales opportunities available to the Corporation; the Corporation's subjective assessment of the likelihood of success of a sales lead or opportunity; the Corporation's historic ability to generate sales leads or opportunities; and that sales will be completed at or above the Corporation's estimated margins. This list is not exhaustive of the factors that may affect the Corporation's forward-looking information. These and other factors should be considered carefully and readers should not place undue reliance on such forward-looking information. All forward-looking statements made in this AIF are qualified by this cautionary statement and there can be no assurance that actual results or developments anticipated by the Corporation will be realized. The Corporation disclaims any intention or obligation to update or revise forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

## OVERVIEW

LED was incorporated under the BCBCA on July 17, 2002 as 651195 B.C. Ltd. and changed its name to LED Medical Diagnostics Inc. on August 20, 2003. LED's head office is located at 235 – 5589 Byrne Road, Burnaby, B.C. V5J 3J1. LED's registered and records office is located at 2500 – 700 West Georgia Street, Vancouver, B.C. V7Y 1B3. LED maintains a warehouse facility at 119 – 5589 Byrne Road, Burnaby, B.C. V5J 3J1. The Company is listed on the TSX Venture Exchange (TSX-V) under the trading symbol LMD.

LED has two wholly-owned operating subsidiaries, LED Dental (US) Ltd., which was incorporated under the laws of Washington State, and LED Dental Inc., which was incorporated under the BCBCA.

### General Development of the Business

Headquartered in Burnaby, B.C., LED was founded in 2003 by current CEO and director Peter Whitehead. LED's first product, the VELscope®, is a first step towards LED's goal of becoming a global leader in developing advanced, affordable technology targeted to dental and medical healthcare providers for the detection, diagnosis, and treatment of disease.

### Description of the Business

The VELscope tissue fluorescence visualization technology is backed by over $50 million in funding by the National Institutes of Health ("NIH") and other US and Canadian government and private organizations. The NIH, part of the U.S. Department of Health and Human Services, is the primary Federal agency for conducting and supporting medical research in the US. The technology for the VELscope system was developed by LED in partnership with the British Columbia Cancer Agency ("BCCA").

In 2006, VELscope received U.S. FDA and Health Canada clearances. The clearances were pertinent to the VELscope's use of tissue fluorescence visualization technology as a new standard of screening for mucosal abnormalities, potentially malignant tissue and cancerous disease, and for surgical margin delineation. VELscope is the only device on the market indicated for use to discover cancerous and precancerous lesions that might not be apparent to the naked eye, and for use to help determine appropriate surgical areas when excision is required.

The first-generation VELscope device was introduced in 2006. Since then, LED has sold over 9,000 devices, which have been used to conduct over 10 million oral soft tissue exams worldwide. Currently, VELscope fluorescence visualization technology is used to conduct more oral exams than any other adjunctive detection technology in the world.

Since its inception, LED has grown from a research and development, pre-commercial product development company, to its current status as a fast-growing sales and marketing-focused growth-stage company.

Pursuant to an agreement dated November 30, 2010, Henry Schein Dental became the exclusive distributor of the VELscope Vx Enhanced Oral Assessment system in North America. Henry Schein Dental is the U.S. dental business of Henry Schein, Inc. a world leader in the provision of healthcare products and services to office-based practitioners.

Since the VELscope was launched in 2006, LED has introduced first the VELscope Vantage, and, in 2011, the VELscope Vx. The VELscope Vx is portable, rechargeable, and significantly more affordable than previous models. Its increased functionality and lower production costs improve LED's prospects as it moves into other countries and other healthcare markets.

LED markets its products, in conjunction with its distribution partners, directly to dental practitioners. Such direct marketing includes direct mail/e-mail and advertising in industry journals, and personal visits. In most cases, direct marketing activities are oriented towards convincing dental practitioners to attend an education seminar or trade show event in which LED is a participant. LED has found that successful marketing of the VELscope requires marketing efforts geared towards education of dental practitioners, focusing on the advantages of using the device as adjunctive diagnostic tool in the detection of oral diseases. In this regard, LED hosted or actively attended over 125 dental industry trade shows and seminars in 2011. LED's educational seminars are often hosted by both company employees and key opinion leaders in the dental industry who are supportive of LED's products.

**Products and Intellectual Property**

The Company's primary product is the VELscope Vx released in early 2011 and is comprised of fluorescence technology aids in the early visualization of mucosal diseases and enhances effective oral mucosal examinations. The VELscope Vx is a handheld device that provides dentists and hygienists with an easy-to-use adjunctive mucosal examination system for the early detection of abnormal tissue. The patented VELscope technology platform was developed in collaboration with the BCCA and MD Anderson Cancer Center, with funding provided in part by the NIH. It is based on the direct visualization of tissue fluorescence and the changes in fluorescence that occur when abnormalities are present. The VELscope Vx handpiece emits a safe blue light into the oral cavity, which excites the tissue from the surface of the epithelium through to the basement membrane (where premalignant changes typically start) and into the stroma beneath, causing it to fluoresce. The clinician is then able to immediately view the different fluorescence responses to help differentiate between normal and abnormal tissue. In fact, VELscope Vx is the only non-invasive adjunctive device clinically proven to help discover occult oral disease.

VELscope Vx provides a more effective oral cancer screening protocol with immediate benefits for the patient, clinician and practice. When used as an adjunctive aid in combination with traditional oral cancer examination procedures, VELscope Vx facilitates the early discovery and visualization of mucosal abnormalities prior to surface exposure that may be, or may lead to oral cancer. In one or two minutes, with no rinses or stains required, a VELscope examination helps oral healthcare professionals assure their patients that the standard of care for oral mucosal screening has been utilized. Adding to the VELscope's value as an adjunctive device is its ability to aid in the visualization of a wide spectrum of oral trauma and disease. A recent study at the University of Washington demonstrated that the VELscope system is a powerful tool for the discovery of mucosal abnormalities such as viral, fungal and bacterial infections, inflammation from a variety of causes (including lichen planus and other lichenoid reactions), squamous papillomas and salivary gland tumours. VELscope Vx combines minimal per-patient costs with more effective oral mucosal examinations.

The technology used in the VELscope was jointly developed by scientists at the BCCA and LED founder Peter Whitehead. The VELscope technology integrates four concepts: light, sophisticated filtering, natural tissue fluorophores and human optical and neural physiology. Base patents on the technology were awarded in 2000 and fully acquired by LED in 2003. These patents are expected to be valid until at least 2017. Additional patents have been submitted and are pending. The technology platform is based on the direct visualization of tissue fluorescence and the changes in fluorescence that can result when abnormal tissue is present. This technology helps clinicians visualize abnormal oral tissue that is often not apparent under white light.

LED expects that expanding its proprietary visualization technology beyond dental applications will provide gynecologists, gastroenterologists, ear nose and throat specialists, dermatologists and family practitioners with cost-effective tools to aid in the detection of oral cancer and other oral mucosal abnormalities. LED has sought patent protection for its projects by filing one or more patent applications for each aspect of a device, system or method, that LED believes is both patentable and that justifies the costs of patent protection. LED intends to protect future developments in the same manner. LED maintains certain of its intellectual property as trade secrets. LED also has pursued and intends to pursue trademark, copyright and other intellectual property protection as it believes is warranted.

VELscope, VELscope Vantage, and the VELscope Vx technologies are composed of a light source, light guide, and viewing handpiece. The VELscope handpiece emits a safe, visible, blue light into the oral cavity, which excites mucosal tissue and causes it to fluoresce. When viewed through the VELscope handpiece, abnormal tissue typically appears as an irregular, dark area that stands out against the otherwise normal, green fluorescence pattern of surrounding healthy tissue. This difference in appearance allows clinicians to examine the oral cavity in real time and differentiate between healthy mucosa and areas of concern that may require further action. When used in combination with traditional oral mucosal examination procedures, VELscope facilitates the discovery and enhances the visualization of mucosal abnormalities. LED received FDA 510(k) clearance for these claims in April 2007. FDA 510(k) clearance is a premarket notification required for manufacturers of medical devices.

One of LED's most profound commitments is to help reduce the mortality of oral cancer. The services of LED and its partners are directed toward developing a professional outreach program with key university–based oral pathology, oral surgery, and oral medicine leaders worldwide to assist healthcare providers as the need arises. LED is positioned to facilitate the dissemination of new findings that address early detection based on fluorescence and other technologies. Currently over 50% of U.S. dental colleges own at least one VELscope.

LED launched the VELscope in 2006 with its current version, the VELscope Vx, launched in early 2011.

## AMALGAMATION WITH SEARCHLIGHT

On February 24, 2011, and as accepted on November 21, 2011 by the TSX-V, the Company entered into a letter agreement (the "Agreement") with Searchlight Capital Corp. ("Searchlight"), a Capital Pool Company listed on the Exchange. The transaction resulted in the amalgamation of LED, its wholly-owned subsidiaries LED Dental Inc., LED Dental (US) Ltd., EMD Systems Ltd., Visiotech Diagnostics Inc. and Searchlight. On November 24, 2011, the Company began trading on the TSX Venture Exchange (trading symbol: LMD). The transaction was accounted for as an acquisition of Searchlight by LED. For purposes of this discussion, the "Company" is defined as the amalgamated entity.

## SIGNIFICANT EVENTS FOR THE THREE ENDED JUNE 30, 2012

### Financial Events

- Revenue decrease of 2% from the three months ended March 31, 2012 and increase of 19% over the three months ended June 30, 2011 which was attributable to seasonality encountered during the three months ended June 30, 2012 relative to the prior quarter and management's continuous effort to improve Company's performance.

- Total Expenses (excluding other operating expenses)[1] reduced by 24% from the three months ended March 31, 2012 and 29% as compared to the three months ended June 30, 2011. The decrease in total operating expenses over the three months ended March 31, 2012 and June 30, 2011 was due to decrease in all expense categories due to improved resource utilization and prudent cost management by the Company.

- EBITDA[2] of $46,825 for the three months ended June 30, 2012 compared to EBITDA of ($351,783) for the three months ended March 31, 2012 and EBITDA of ($707,287) for the three months ended June 30, 2011.

- The net income for the three months ended June 30, 2012 was $42,982 compared to a net loss of ($387,600) for the three months ended March 31, 2012 and net loss of ($644,688) for the three months ended June 30, 2011.

### Product and Customer Highlights

- VELscope Vx Enhanced Visual Assessment System was approved for use by Pacific Dental Services, currently affiliated with over 275 practices in the US market. Pacific Dental has been ranked on the Inc. 500 List of America's Fastest Growing Private Companies.

- Second Step Laboratory Services gained early momentum in the Canadian market, enabling dentists to offer patients a seamless and timely diagnostic service to complement the screening and detection of oral cancer.

- With over 12,000 units sold, LED estimates that 20 million oral scans have been performed worldwide, making the VELscope Vx by far the dominant global technology for the early detection of oral disease, including oral cancer.

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[1]Total expenses (excluding other operating expenses) is a non-IFRS measure that does not have a standard meaning and may not be comparable to a similar measure disclosed by other issuers. This measure does not have a comparable IFRS measure and is used by the Company to manage and evaluate its cash operating expenses.

[2] EBITDA or Earnings before Interest, Taxes, Depreciation and Amortization is a non-IFRS measure that does not have a standardized meaning and may not be comparable to a similar measure disclosed by other issuers. EBITDA referenced here relates to operating loss less other operating expenses. This measure does not have a comparable IFRS measure and is used by the Company to manage and evaluate the cash operating loss of the business.

## FINANCIAL RESULTS FOR THE THREE MONTHS ENDED JUNE 30, 2012 (UNAUDITED)

The following analysis of the results of operations for the three months ended June 30, 2012 includes comparisons to the three months ended March 31, 2012 and June 30, 2011.

### Revenue

Revenues are derived from the sale of the Company's VELscope product and related consumable products which are disposal components for singular use of the VELscope product. LED launched the new version of its primary product, the VELscope Vx, in January of 2011. Revenue is expressed net of distributor volume rebates, price discounts and warrant expense on distributor warrants of approximately $240,000 in the three months ended June 30, 2012 (March 31, 2012 – approximately $456,000); June 30, 2011 – approximately $264,000)

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| **Total revenue** | **$1,792,407** | **$1,828,991** | **$1,507,004** |

Revenues of approximately $1.8 million in the three months ended June 30, 2012 represented a slight decrease of 2% over the previous three months ended March 31, 2012 but an increase of 19% over the three months ended June 30, 2011. The changes in revenue are primarily attributable to seasonality encountered by Company during the three months ended June 30, 2012 relative to the prior quarters.

To date, the Company has had a significant portion of its revenue derived from sales to its distributor in North America. While the Company continues to focus its efforts on expanding to new markets, it is expected that in the near-term, revenue generation will continue to be concentrated from a small number of distributors. In each respective period, revenues from customers which amounted to 10% or more of the Company's revenues accounted for the following percentages of the Company's total revenues and is primarily attributable to its North American distributor:

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Revenue | $1,633,616 | $1,657,610 | $1,400,963 |
| **Percentage of total revenue** | **91%** | **91%** | **93%** |

The Company earned revenues attributed to the following geographical regions based on the location of the customer:

| | Three months ended June 30, 2012 | % | Three months ended March 31, 2012 | % | Three months ended June 30, 2011 | % |
|---|---|---|---|---|---|---|
| North America | $1,651,388 | 92% | $1,963,398 | 93% | $ 1,505,804 | 100% |
| Rest of World | 141,019 | 8% | 135,593 | 7% | 1,200 | <1% |
| | **$1,792,407** | **100%** | **$1,828,991** | **100%** | **$ 1,507,004** | **100%** |

The Company generated the majority of its revenue from the North American markets which is consistent with the prior periods.

**Gross Margin[3]**

The Company experienced gross margin for the following periods:

| | Three months ended June 30, 2012 | % | Three months ended March 31, 2012 | % | Three months ended June 30, 2011 | % |
|---|---|---|---|---|---|---|
| Revenues | $ 1,792,407 | 100% | $ 1,828,991 | 100% | 1,507,004 | 100% |
| Cost of goods sold | 675,294 | 38% | 781,602 | 43% | 709,396 | 47% |
| | **$ 1,117,113** | **62%** | **$ 1,047,389** | **57%** | **797,608** | **53%** |

Gross margins for the three months ended June 30, 2012 due to a higher percentage of revenue from the sale of consumables at higher margin relative to its VELscope Vx device product than the three months ended March 31, 2012 and June 30, 2011. Gross margin percentage increase is also due to a variety of factors, particularly being improved resource utilization with the resulting production costs, and the accompanying sales and pricing strategy.

**Expenses**

The Company reports its operating expenses by function as follows:

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Sales and marketing | $ 674,468 | $ 884,198 | $ 1,011,966 |
| Research and development | 142,626 | 174,161 | 189,410 |
| Administration | 253,194 | 340,813 | 303,519 |
| Other operating expenses | 13,263 | 17,431 | 22,684 |
| **Total expenses** | **$1,083,551** | **$1,416,603** | **$1,527,579** |
| **As a percentage of total revenue** | **60%** | **77%** | **101%** |

**Expenses (excluding Other Operating Expenses)**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Sales and marketing | $ 674,468 | $ 884,198 | $ 1,011,966 |
| Research and development | 142,626 | 174,161 | 189,410 |
| Administration | 253,194 | 340,813 | 303,519 |
| **Total expenses (excluding other operating expenses)** | **$1,070,288** | **$1,399,172** | **$1,504,895** |
| **As a percentage of total revenue** | **60%** | **76%** | **100%** |

Total operating expenses (excluding other operating expenses) decreased by 24% for the three months ended June 30, 2012 as compared to the three months ended March 31, 2012 and 29% as compared to the three months ended June 30, 2011. In particular, sales and marketing activities decreased by approximately $209,000, research and development costs decreased by approximately $31,000 and administration expenses decreased by approximately $87,000 over the prior quarter. Sales and

[3] Gross Margin is a non-IFRS measure that does not have a standard meaning and may not be comparable to a similar measure disclosed by other issuers. Gross Margin referenced here relates to revenues less cost of sales. This measure does not have a comparable IFRS measure and is used by the Company to manage and evaluate the operating performance of the Company.

marketing activities decreased by approximately $337,000, research and development costs decreased by approximately $46,000 and administration expenses decreased by approximately $50,000 over the second quarter of 2011.

**Sales and Marketing**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Sales and marketing | $ 674,468 | $ 884,198 | $ 1,011,966 |
| **As a percentage of total revenue** | **38%** | **48%** | **67%** |

The Company maintains a direct sales force, with staff in the United States and Canada which supports the worldwide sales and marketing activities. Sales and marketing expense consists primarily of salaries and related personnel costs, sales commissions, consulting fees, trade show expenses, marketing collateral, advertising costs and facilities.

The decrease in sales and marketing expense in the three months ended June 30, 2012 over the prior quarter was due to lower employee salary and related sales commissions from lower sales and the Company's transition from a higher cost decentralized sales team to a more cost effective centralized inside sales strategy in addition to lower marketing program expenses.

The decrease in sales and marketing expenses in the three months ended June 30, 2012 over the same period in the prior year is due to the Company's investment in the commercialization of its VELscope Vx product launched during the first and second quarters of fiscal 2011 with increased head count with higher salaries and sales commissions, travel and entertainment, trade show and other marketing initiatives.

**Research and Development**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Research and development | $ 142,626 | $ 174,161 | $ 189,410 |
| **As a percentage of total revenue** | **8%** | **10%** | **13%** |

Research and development expenses relate primarily to salaries and related benefit costs, as well as a portion of the Company's overall facilities costs.

The decrease in research and development costs during the three months ended June 30, 2012 over the same period in the prior year was attributable largely to the launch of the Company's VELscope Vx product in first part of fiscal 2011. The research and development costs incurred after the VELscope Vx product launch in early 2012 pertain to the Company's continued evolution of its VELscope product offering and the future expansion into new markets of its technology.

**Administration**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Administration | $ 253,194 | $ 340,813 | $ 303,519 |
| **As a percentage of total revenue** | **14%** | **19%** | **20%** |

Administration expenses include executive and administrative staff, facilities, public company costs, insurance, corporate variable compensation accruals, accounting and legal fees as well as various general administrative costs.

The decrease over the prior periods was primarily due to a one-time reversal of approximately $127,000 of previously recorded liability during three months ended June 30, 2012 resulting from receiving confirmation of debt forgiveness from the vendor.

**Other Operating Expenses**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Depreciation of equipment | $ 6,702 | $ 10,870 | $ 9,557 |
| Amortization of intangible assets | 6,561 | 6,561 | 13,127 |
| Stock-based compensation | - | - | - |
| **Total other operating expenses** | **$ 13,263** | **$ 17,431** | **$22,684** |

**EBITDA**

EBITDA was $46,825 for the three months ended June 30, 2012 compared to ($351,783) for the three months ended March 31, 2012 and ($707,287) for the three months ended June 30, 2011.

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Operating income (loss) | $ 33,562 | ($ 369,214) | ($ 729,971) |
| Add: Depreciation of equipment | 6,702 | 10,870 | 9,557 |
| Add: Amortization of intangible assets | 6,561 | 6,561 | 13,127 |
| Add: Stock-based compensation | - | - | - |
| Add: Warrants issued for distributor commitment | - | - | - |
| **EBITDA** | **$ 46,825** | **($ 351,783)** | **($ 707,287)** |

The increase in EBITDA was primarily due to increased revenues and lower expenses in the three months ended June 30, 2012 over the comparable periods.

**Other Income (Expenses)**

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Foreign exchange gain (loss) | $ 9,745 | ($ 20,777) | $77,259 |
| Interest income | - | 287 | - |
| Loss on disposal of assets | (702) | - | - |
| Miscellaneous income (expenses) | 377 | 2,104 | 8,024 |
| **Total other income (expenses)** | **$9,420** | **($18,386)** | **$85,283** |

Total other expenses for the three months ended June 30, 2012 was attributable to a foreign exchange gain of $9,745 and miscellaneous income of 377 offset by loss on disposal of assets of 702. Total other expenses for the three months ended March 31, 2012 was attributable to a foreign exchange loss of $20,777 offset by interest income of $287 and miscellaneous income of $2,104. Total other expenses for the three months ended June 30, 2011 was attributable to a foreign exchange gain of $77,259 and miscellaneous income of $8,024.

**Net Income (Loss) and Comprehensive Income (Loss)**

Net income (loss) and comprehensive income (loss) was $42,982 for the three months ended June 30, 2012 compared to ($387,600) for the three months ended March 31, 2012 and ($644,688) for the three months ended June 30, 2011.

| | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| **Net income (loss) and comprehensive income (loss)** | **$ 42,982** | **($ 387,600)** | **($ 644,688)** |

**FINANCIAL RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2012 (UNAUDITED)**

The following analysis of the results of operations for the six months ended June 30, 2012 includes comparisons to the six months ended June 30, 2011.

**Revenue**

Revenues are derived from the sale of the Company's VELscope product and related consumable products which are disposal components for singular use of the VELscope product. LED launched the new version of its primary product, the VELscope Vx, in January of 2011. Revenue is expressed net of distributor volume rebates, price discounts and warrant expense on distributor warrants of approximately $696,000 in the six months ended June 30, 2012 and approximately $869,000 in six months ended June 30, 2011.

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| **Total revenue** | **$3,621,398** | **$4,565,959** | **(21%)** |

Revenues decreased in the six months ended June 30, 2012 from the six months ended June 30, 2011 primarily due to significant initial sales by the Company to its distributor in North America during the six month ended June 30, 2011.

To date, the Company has had a significant portion of its revenue derived from sales to its distributor in North America. While the Company continues to focus its efforts on expanding to new markets, it is expected that in the near-term, revenue generation will continue to be concentrated from a small number of distributors. In each respective period, revenues from customers which amounted to 10% or more of the Company's revenues accounted for the following percentages of the Company's total revenues and is primarily attributable to its North American distributor:

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Revenue | $3,291,226 | $4,056,560 | (19%) |
| **Percentage of total revenue** | **91%** | **89%** | |

The Company earned revenues attributed to the following geographical regions based on the location of the customer:

| | Six months ended June 30, 2012 | % | Six months ended June 30, 2012 | % | Change |
|---|---|---|---|---|---|
| North America | $3,344,786 | 92% | $4,564,759 | 100% | (27%) |
| Rest of World | 276,612 | 8% | 1,200 | <1% | 23,051% |
| | **$3,621,398** | **100%** | **$4,565,959** | **100%** | **(21%)** |

The Company generated the majority of its revenue from the North American markets which is consistent with the prior periods.

**Gross Margin**

The Company experienced gross margin for the following periods:

| | Six months ended June 30, 2012 | % | Six months ended June 30, 2011 | % | Change |
|---|---|---|---|---|---|
| Revenues | $ 3,621,398 | 100% | $ 4,565,959 | 100% | (21%) |
| Cost of goods sold | 1,456,896 | 40% | 2,024,995 | 44% | (28%) |
| | **$ 2,164,502** | **60%** | **$ 2,540,964** | **56%** | **(15%)** |

LED had a higher percentage margin on sales for the six months ended June 30, 2012 due to a higher percentage of revenue from the sale of consumables at higher margin relative to its VELscope Vx device product than the six months ended June 30, 2011. Gross margin percentage increase is also due to a variety of factors, particularly being improved resource utilization with the resulting production costs, and the accompanying sales and pricing strategy.

**Expenses**

The Company reports its operating expenses by function as follows:

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Sales and marketing | $ 1,558,666 | $ 1,723,617 | (10%) |
| Research and development | 316,787 | 404,662 | (22%) |
| Administration | 594,007 | 596,693 | (1%) |
| Other operating expenses | 30,694 | 45,368 | (32%) |
| **Total expenses** | **$2,500,154** | **$2,770,340** | **(10%)** |
| **As a percentage of total revenue** | **69%** | **61%** | |

**Expenses (excluding Other Operating Expenses)**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Sales and marketing | $ 1,558,666 | $ 1,723,617 | (10%) |
| Research and development | 316,787 | 404,662 | (22%) |
| Administration | 594,007 | 596,693 | (1%) |
| **Total expenses (excluding other operating expenses)** | **$2,469,460** | **$2,724,972** | **(9%)** |
| **As a percentage of total revenue** | **68%** | **60%** | |

Total operating expenses (excluding other operating expenses) decreased by 9% for the six months ended June 30, 2012 as compared to the six months ended June 30, 2011. In particular, sales and marketing activities decreased by approximately $165,000, research and development costs decreased by approximately $88,000 and administration expenses decreased by approximately $2,000.

**Sales and Marketing**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Sales and marketing | $ 1,558,666 | $ 1,723,617 | (10%) |
| **As a percentage of total revenue** | **43%** | **38%** | |

The decrease in sales and marketing expenses in the six months ended June 30, 2012 over the same period in the prior year is due to the Company's investment in the commercialization of its VELscope Vx product launched during the first and second quarters of fiscal 2011 with increased head count with higher salaries and sales commissions, travel and entertainment, trade show and other marketing initiatives.

**Research and Development**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Research and development | $ 316,787 | $ 404,662 | (22%) |
| **As a percentage of total revenue** | **9%** | **9%** | |

The decrease in research and development costs during the six months ended June 30, 2012 over the same period in the prior year was attributable largely to the launch of the Company's VELscope Vx product in first part of fiscal 2011. The research and development costs incurred after the VELscope Vx product launch in early 2012 pertain to the Company's continued evolution of its VELscope product offering and the future expansion into new markets of its technology.

**Administration**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Administration | $ 594,007 | $ 596,693 | (1%) |
| **As a percentage of total revenue** | **16%** | **13%** | |

The decrease over the prior periods was primarily due to a one-time reversal of approximately $127,000 of previously recorded liability during six months ended June 30, 2012 resulting from receiving confirmation of debt forgiveness from the vendor offset by an increase in other administrative costs.

**Other Operating Expenses**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Depreciation of equipment | $ 17,572 | $ 19,114 | (8%) |
| Amortization of intangible assets | 13,122 | 26,254 | (50%) |
| **Total other operating expenses** | **$ 30,694** | **$ 45,368** | **(32%)** |

**EBITDA**

EBITDA was ($304,958) for the six months ended June 30, 2012 compared to ($184,008) for the six months ended June 30, 2011.

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Operating income (loss) | ($ 335,652) | ($ 229,376) | (46%) |
| Add: Depreciation of equipment | 17,572 | 19,114 | (8%) |
| Add: Amortization of intangible assets | 13,122 | 26,254 | (50%) |
| Add: Stock-based compensation | - | - | - |
| Add: Warrants issued for distributor commitment | - | - | - |
| **EBITDA** | **($ 304,958)** | **($ 184,008)** | **(66%)** |

The decrease in EBITDA was primarily due to decreased revenues but lower expenses in the six months ended June 30, 2012 over the same period in the prior year.

**Other Income (Expenses)**

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| Foreign exchange gain (loss) | ($ 11,032) | $ 102,335 | (111%) |
| Interest income | 287 | - | N/A |
| Loss on disposal of assets | (702) | - | N/A |
| Miscellaneous income (expenses) | 2,481 | 8,024 | (69%) |
| **Total other income (expenses)** | **($8,966)** | **110,359** | **(108%)** |

Total other expenses for the six months ended June 30, 2012 was attributable to a foreign exchange loss of $11,032 and loss on disposal of assets of 702 offset by miscellaneous income $2,481 and interest income of $287. Total other expenses for the six months ended June 30, 2011 was attributable to a foreign exchange gain of $102,335 and miscellaneous income of $8,024.

**Net Income (Loss) and Comprehensive Income (Loss)**

Net income (loss) and comprehensive income (loss) was ($344,618) for the six months ended June 30, 2012 compared to ($119,017) for the six months ended June 30, 2011.

| | Six months ended June 30, 2012 | Six months ended June 30, 2011 | Change |
|---|---|---|---|
| **Net income (loss) and comprehensive income (loss)** | **($ 344,618)** | **($ 119,017)** | **(290%)** |

Net loss and comprehensive loss for the six months ended June 30, 2012 was higher than the six months ended June 30, 2011 due primarily to decreased revenues offset by decreased operating expenses.

## LIQUIDITY AND CAPITAL RESOURCES

The Company finances its operations and capital expenditures through cash generated from operations and equity financings. As at June 30, 2012, the Company had cash and cash equivalents totaling approximately $768,000 with working capital[4] of approximately $239,000 as compared to cash and cash equivalents totaling approximately $918,000 and working capital of approximately $183,000 as at March 31, 2012 and cash and cash equivalents of $1,545,000 and working capital of approximately $361,000 as at June 30, 2011.

[4] Working Capital is a non-IFRS measure that does not have a standardized meaning and may not be comparable to a similar measure disclosed by other issuers. This measure does not have a comparable IFRS measure. Working Capital is defined as current assets less current liabilities. The Company believes that the inclusion of this no-IFRS measure financial measure provides investors with an alternative presentation useful to investors' understanding of the Company's core operating results and trends.

**Three months ended June 30, 2012**

| Cash provided by (used in): | Three months ended June 30, 2012 | Three months ended March 31, 2012 | Three months ended June 30, 2011 |
|---|---|---|---|
| Operating activities | $ (150,066) | $ 30,758 | $ 1,628,370 |
| Investing activities | - | (17,074) | - |
| Financing activities | (601) | (87,700) | (81,346) |
| **Increase (decrease) in cash and cash equivalents** | **($ 150,667)** | **($ 74,016)** | **$ 1,547,024** |

Cash used in or provided by operating activities for all comparable periods was attributable to revenues earned offset by operating expenditures primarily consisting of sales and marketing costs to market the Company's new VELscope Vx product, and overall corporate administration activities.

The investing activities during the three months ended March 31, 2012 pertain to the Company purchasing equipment. There were no investing during the three months ended June 30, 2012 and 2011.

The financing activities during the three months ended June 30, 2012 relate to the repayment of capital lease obligations. The financing activities during the three months ended March 31, 2012 relate to the repayment of shareholder loans and capital lease obligations offset by the release of restricted cash. The financing activities during the three months ended June 30, 2011 is attributable mainly to repayment of shareholder loans and capital lease obligations.

**Six months ended June 30, 2012**

| Cash provided by (used in): | Six months ended June 30, 2012 | Three months ended June 30, 2011 |
|---|---|---|
| Operating activities | ($ 119,306) | $ 149,899 |
| Investing activities | (17,074) | (39,563) |
| Financing activities | (88,303) | 1,165,652 |
| **Increase (decrease) in cash and cash equivalents** | **($ 224,683)** | **$ 1,275,988** |

Cash used in or provided by operating activities for comparable periods was attributable to revenues earned offset by operating expenditures primarily consisting of sales and marketing costs to market the Company's new VELscope Vx product, and overall corporate administration activities.

The investing activities during the six months ended June 30, 2012 and 2011 pertain to the Company purchasing equipment.

The financing activities during the six months ended June 30, 2012 relate to the repayment of capital lease obligations and shareholder loans offset by the release of the restricted cash. The financing activities during the six months ended June 30, 2011 is attributable to private placement proceeds offset by repayment of shareholder loans and capital lease obligations.

**STAFFING LEVELS**

The following table summarizes the Company's headcount, by functional group:

| | June 30, 2012 | As at March 31, 2012 | June 30, 2011 |
|---|---|---|---|
| Sales and marketing | 13 | 13 | 8 |
| Research and development | 2 | 2 | 1 |
| Administration | 5 | 5 | 4 |
| **Total** | **20** | **20** | **13** |

## COMMITMENTS

The Company continues to have no bank debt, off-balance sheet financing arrangements or significant capital leases. The Company has leased facilities in Canada. Minimum lease payments pertaining to its leased facilities as at June 30, 2012 are $13,915 for the year ending December 31, 2012. As well, the Company has capital lease payments totaling $11,445 as June 30, 2012.

## INTANGIBLE ASSETS IMPAIRMENT

Due to ongoing operating losses of the Company and current volatility and uncertainty of global financial markets, there is a possibility that the carrying values attributable to the Company's intangible assets may become impaired. At December 31, 2011, management had tested the intellectual property and intangibles for recoverability and no events or changes in circumstances indicated that the carrying values may not be recoverable. Therefore, there is no impairment of these assets at December 31, 2011. The recorded balance of intangible assets is $102,788 as at June 30, 2012. The remaining carrying value is the fair value of the estimated future cash flow stream associated with the assets.

## OFF-BALANCE SHEET ARRANGEMENTS

None.

## TRANSACTIONS WITH RELATED PARTIES

Transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

Related parties include key management, the Board of Directors, close family members and enterprises which are controlled by these individuals as well as certain persons performing similar functions.

In addition to the loans received from shareholders, and related interest accrual and payment during the three and six months ended June 30, 2012 and 2011, the Company paid or accrued the following compensation expenses to key personnel of the Company:

| | **Three months ended June 30, 2012** | **Three months ended June 30, 2011** | **Six months ended June 30, 2012** | **Six months ended June 30, 2011** |
|---|---|---|---|---|
| Short-term compensation* | $ 109,587 | $ 118,055 | $ 222,528 | $ 269,238 |
| Post employment benefits | $ Nil | $ Nil | $ Nil | $ Nil |
| Other long-term benefits | $ Nil | $ Nil | $ Nil | $ Nil |
| Termination benefits | $ Nil | $ Nil | $ Nil | $ Nil |
| Share-based payments | $ Nil | $ Nil | $ Nil | $ Nil |

(*) Included in short-term compensation are consulting fees paid to the former CFO as well as royalties accrued in relation to the employment agreement with the current CEO. The Company accrued royalties of approximately $25,400 during the three months ended June 30, 2012 (three months ended June 30, 2011 - $25,800). The Company accrued royalties of approximately $51,400 during the six months ended June 30, 2012 (six months ended June 30, 2011 - $83,000). As at June 30, 2012, total royalties accrued but not paid was approximately $159,500.

During the three and six months ended June 30, 2012, and 2011, there were no options awarded to directors and key management under the Company's stock option plan.

## PROPOSED TRANSACTIONS

None.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

These interim condensed consolidated financial statements of the Company, approved by the Board of Directors on August 10, 2012, have been prepared in accordance with International Financial Reporting Standards ("IFRS") and their interpretations adopted by the International Accounting Standards Board ("IASB").

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*. These interim condensed consolidated financial statements have been prepared using the historical cost basis and the accounting policies set out below have been applied consistently to all periods presented in these interim condensed consolidated financial statements. Accordingly, these interim condensed consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction statements as at and for the year ended December 31, 2011.

The accounting policies set out below have been applied consistently to all periods presented in these interim condensed consolidated financial statements.

### Revenue Recognition

Revenue from product and service sales is recognized when the amount is fixed or determinable, title has transferred or initial services have been performed, and collection is reasonably assured.

Royalty revenue is recognized when the right to receive a royalty has been established and collection is reasonably assured.

### Intangible Assets

Intangible assets acquired either individually or with a group of other assets are initially recognized or measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination that meet the specified criteria for recognition apart from goodwill, is allocated to the individual assets acquired based on their relative fair values.

Intangible assets with finite useful lives are amortized over their estimated useful lives. Amortization is calculated over their useful lives using the straight-line method and the following periods. The amortization methods and estimated useful lives of intangible assets are reviewed annually. Intangible assets are tested for impairment by comparing their carry values to the sum of the undiscounted cash flows expected to result from their use or eventual disposition. If not recoverable, the impairment charge is the difference between the carrying value and fair value.

Intangible assets, which consist of patents, intellectual property and related know-how, have finite lives and are measured at cost less accumulated amortization and accumulated impairment losses.

Intangible assets are being amortized using the straight line method over a 13 year period commencing in 2004.

### Accounting standards issued but not yet effective

### Accounting standards effective July 1, 2012

### IAS 1 – Presentation of Financial Statements

In June 2011, the IASB amended IAS 1 by revising how certain items are presented in other comprehensive income. Items within other comprehensive income that may be reclassified to profit and loss will be separated from items that will not. The standard is effective for financial years beginning on or after July 1, 2012 with early adoption permitted. There are no additional significant impacts on the Company.

## Accounting standards anticipated to be effective January 1, 2013

### IFRS 9 – Financial Instruments: Classification and Measurement

IFRS 9 - *Financial Instruments: Classification and Measurement* was published and contained requirements for financial assets updating IFRS 7. Requirements for financial liabilities were added to IFRS 9 in October 2010. Most of the requirements for financial liabilities were carried forward unchanged from IAS 39. However, some changes were made to the fair value option for financial liabilities to address the issue of own credit risk. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

### IFRS 10 – Consolidated Financial Statements

IFRS 10 – *Consolidated Financial Statements* requires that beginning January 1, 2012, a reporting entity should consolidate any investee that it controls. Control is the basis for consolidation for all types of investees. IFRS 10 also provides guidance on assessing control in circumstances where the assessment has proven to be difficult. IFRS 10 provides more guidance about the factors to consider in such structures that involve potential voting rights, agency relationships, relationships with structured entities and control without a majority of voting rights. The Company consolidation with its current subsidiaries and related consolidation decisions should be unaffected by the new consolidation model in IFRS 10.

### IFRS 11 – Joint Arrangements

IFRS 11 – *Joint Arrangement* requires a venturer to classify its interest in a joint arrangement as a joint operation or a joint venture. The standard eliminates the use of the proportionate consolidation method to account for joint ventures. Joint ventures will be accounted for using the equity method of accounting while for a joint operation the venturer will recognize its share of the assets, liabilities, revenues and expenses of the joint operation. IFRS 11 supersedes SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* and IAS 31 *Joint Ventures.* The effective date of this amendment is for annual periods beginning on or after January 1, 2013. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

### IFRS 12 – Disclosure of Interest in Other Entities

IFRS 12 – *Disclosure of Interest in Other Entities* sets out disclosure requirements which begin January 1, 2013 for reporting entities that have an interest in a subsidiary, joint arrangement, associate or unconsolidated structured entity. There is no additional interest or disclosures required.

### IFRS 13 – Fair Value Measurement

IFRS 13 - *Fair Value Measurement* is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, sets out in a single IFRS a framework for measuring fair value and new required disclosures about fair value measurements. Management anticipates that this standard will be adopted in the Company's
financial statements for the period beginning January 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 13.

### IFRS 19 – Employee Benefits

*IFRS 19 – Employee Benefits* is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted, sets out to eliminated the use of the "corridor" approach and mandates all remeasurement impacts be recognized in Other Comprehensive Income. It also enhances the disclosure requirements, providing better information about the characteristics of defined benefit plans and the risk that entities are exposed to through participation in those plans. This amendment clarifies when a company should recognize a liability and an expense for termination benefits. The Company is assessing the impact of this amended standard.

**IAS 28 – Investments in Associates and Joint Ventures**

The IASB also amended IAS 28, an existing standard, to include joint ventures in its scope and to address the changes in IFRS 10 to IFRS 12. The effective date of this amendment is for annual periods beginning on or after January 1, 2013. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements

## FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

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 processes, inclusive of documented investment policies, counterparty limits, and controlling and reporting structures. The type of risk exposure and the way in which such exposure is managed is provided as follows:

Classification of financial instruments

Financial assets included in the statement of financial position are as follows:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Cash and cash equivalents | | |
| Cash and cash equivalents | $ 767,677 | $ 992,360 |
| Restricted cash | 5,000 | 25,000 |
| Loans and receivables: | | |
| Receivables | 1,068,294 | 303,800 |
| | **$ 1,840,971** | $ 1,321,160 |

Financial liabilities included in the statement of financial position are as follows:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Non-derivative financial liabilities: | | |
| Trades payable | $ 1,590,374 | $ 1,029,909 |
| Due to shareholders | - | 104,544 |
| Capital lease obligations | 11,445 | 12,618 |
| | **$ 1,601,819** | $ 1,147,071 |

Fair value

The fair value of the Company's financial assets and liabilities approximates the carrying amount.

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

The carrying value of the Company's financial instruments are measured based on Level 1 input of the fair value hierarchy.

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risks arising from its cash holdings and receivables. The Company manages credit risk by placing cash with major Canadian financial institutions. Receivables are due for completed sales and reimbursements. Management believes that credit risk related to these amounts is low.

The Company monitors collectability of receivables on an on-going basis to determine credit risk. In order to mitigate credit risk, the Company offers credit terms to established customers. Other customers are required to pay in advance or by credit card, prior to shipping of the product. At June 30, 2012, no accounts receivable are due beyond one year.

As at June 30, 2012 and December 31, 2011, the Company's exposure to credit risk for these financial instruments was as follows:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Cash and cash equivalents | $ 767,677 | $ 992,360 |
| Restricted cash | 5,000 | 25,000 |
| Receivables | 1,068,294 | 303,800 |
| | **$ 1,840,971** | $ 1,321,160 |

Receivables (related to trade accounts receivable) balances of $1,044,275 (December 31, 2011 - $230,810) were aged as follows as at June 30, 2012 and December 31, 2011. It does not include harmonized sales tax receivable of $24,019 as at June 30, 2012 (December 31, 2011 - $72,990).

Included in the balance as at June 30, 2012 was $946,443 which was related to the net accounts receivable balance of the Distributor. The Distributor's accounts receivable balance of $1,475,418 was netted against its accounts payable balance of $528,975.

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Current | $ 493,212 | $ 776 |
| 31-60 days | 507,284 | 65,491 |
| Over 60 days | 43,779 | 164,543 |
| | **$ 1,044,275** | **$230,810** |

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company has a planning and budgeting process in place to help determine the funds required to support the Company's normal operating requirements on an ongoing basis. The Company ensures that there are sufficient funds to meet its short-term business requirements, taking into account its anticipated cash flows from operations and its holdings of cash and cash equivalents.

To manage liquidity risk, the Company reviews additional sources of capital to continue its operations and discharge its commitments as they become due. Historically, the Company's sole source of funding has been the issuance of equity securities for cash, primarily through private placements.

Trades payable was aged as follows as at June 30, 2012 and December 31, 2011 and does not include accrued liabilities of $496,288, warranty provision of $10,316 and state sales tax payable of $5,318 as at June 30, 2012 (December 31, 2011 - $377,220, $10,316 and $5,323 respectively).

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Current | $ 746,615 | $ 296,326 |
| 31-60 days | 341,051 | 119,583 |
| Over 60 days | 502,708 | 614,000 |
| | **$ 1,590,374** | $1,029,909 |

The following is an analysis of the contractual maturities of the Company's non-derivative financial liabilities as at June 30, 2012:

| | Within one year | Between one and five years |
|---|---|---|
| Trades payable | $ 1,590,374 | $ - |
| Capital lease obligations | 2,756 | 8,689 |
| | **$ 1,593,130** | **$ 8,689** |

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk is limited to the portion of the Company's cash held in bank accounts that earn interest. Due to the limited and short term nature of these financial instruments, fluctuations in the interest rates will not have a significant impact on their fair value. As at June 30, 2012, the Company had not entered into any derivative contracts to manage this risk.

## DISCLOSURE OF OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares, without par value and an unlimited number preference shares without par value. As of August 14, 2012, the Company has 36,335,508 common shares outstanding, with 5,173,877 held under escrow.

The Company has instituted a rolling incentive stock option plan whereby shares reserved for issuance under the plan shall reflect 10% of the issued and outstanding common shares of the Company from time to time. As of August 14, 2012, the Company is entitled to grant incentive stock options for 3,633,551 common shares under the Company’s stock option plan of which none have been issued. The Company also has 330,000 Agents Options and 8,851,968 warrants outstanding as of August 14, 2012.

## RISKS AND UNCERTAINTIES

An investment in the securities of the Company may be regarded as speculative due to the Company’s stage of development. Risk factors relating to the Company could materially affect the Company’s future results and could cause them to differ materially from those described in forward-looking statements relating to the Company. Prospective investors should carefully consider these risks.

The following are some of the risks that are associated with the Company’s business and operations and should be carefully considered by any potential investor in the Company’s shares:

### History of Losses

The Company has a history of losses, and there can be no assurance that the Company’s losses will not continue in the future. As at June 30, 2012, the Company had an accumulated deficit of approximately $24.1 million. The Company’s prospects must be considered in the context of its stage of development, the risks and uncertainties it faces, and the inability of the Company to accurately predict its operating results in the results of product development and sales and marketing initiatives. There can be no assurances that implementation of the Company’s strategies will result in the Company becoming profitable.

### Operational Risk

In the normal course of business, LED’s operations continue to be influenced by a number of internal and external factors, and are exposed to risks and uncertainties, that can affect its business, financial condition and operating results. LED’s activities are subject to ongoing operational risks, including the performance of key suppliers, product performance, government and other industry regulations, all of which may affect its ability to meet its obligations. While management believes its innovation and technology make it a leader in the industry, revenue and results may be affected if products are not accepted in the market place, are not approved by regulatory authorities, or if products are not brought to market in a timely manner. LED is reliant on a small number of key employees, the loss of any one of whom could materially affect operating results and the ability to design and manufacture new products.

### Distributor Risks

LED distributes its product in the North American market through an exclusive arrangement with one large distributor. In the event this distributor is unable or unwilling to promote and deliver the product to end customers, the Company’s financial condition and operating results could be materially impacted. LED is seeking distribution partners in order to expand its business internationally. There can be no assurance the Company will be successful in finding such partners, nor that any such partners will be successful in managing the nuances of their markets to ensure the success of the Company’s products in those markets.

**Disruptions in Production**

Factors that affect the production and sale of LED's products which could result in decreases in profitability include: (a) Acts of God; (b) the expiration or termination of leases, contracts, permits or licences; (c) sales price redeterminations; (d) future litigation; (e) work stoppages or other labour difficulties; (f) disputes with suppliers, distributors and subcontractors; (g) political risk with offshore suppliers; (h) reliance on suppliers with highly technical and not easily replaceable expertise; and (i) changes in the market and general economic conditions. Weather conditions, equipment replacement or repair and fires can have a significant impact on operating results.

**Seasonality**

Sales may have seasonal components which may result in significant variances in quarterly operating results and may also significantly increase working capital requirements.

**Management's Estimates**

Management's estimates may prove to be inaccurate due to unexpected changes in business or market conditions.

**Regulatory Requirements**

Regulatory requirements in international markets may require clinical or other studies that may restrict the ability or timing of LED to sell in these markets.

**Reliance on Few Suppliers**

The Company has a limited number of suppliers for the raw materials required for its products. A dispute with one of these suppliers, or adverse changes in the business of the suppliers may have a negative impact on the business, operating results and financial condition of the Company if it is unable to source comparable raw materials from alternate sources at competitive rates.

**Reliance on Subcontractors**

LED utilizes subcontractors who are responsible for its manufacturing requirements. If subcontractors manufacturing a material amount of products cease operations or are unable to come to terms on suitable arrangements with LED, LED's business and profitability may be adversely affected.

**The Company May Not Realize the Benefits Currently Anticipated**

As part of its strategy, the Company intends to continue its efforts to expand its existing customer base and products. A number of risks and uncertainties are associated with the development of new customers and products, including political, regulatory, design, sourcing, labour, operating, technical, and technological risks. There are also uncertainties relating to capital and other costs, and financing risks in developing new products. The failure to develop one or more of these initiatives successfully could have an adverse effect on the Company's financial position and results of operations.

**Operating Cost Fluctuations**

Although the Company believes it has consistently adopted conservative assumptions in its estimations, no assurances can be given that such assumptions will prove to be accurate, and, therefore, the operating costs of the Company may prove to be higher or lower than those estimated.

**Fluctuations in Exchange Rates**

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States. The Company's functional currency is the Canadian dollar. The Company has not hedged its exposure to currency fluctuations.

Assuming that all other variables remain constant, a 10% change in the value of the Canadian dollar against the U.S. dollar would not materially affect the loss from operations.

## Taxation

Canadian taxation authorities may challenge expense or tax credits claimed by LED including research and development expenses and related tax credits. If Canadian tax authorities successfully challenge such expenses or the correctness of tax credit claims, LED or the Resulting Company's operating results could be adversely affected. If Canadian taxation authorities reduce the tax credit either by reducing the rate of the grant or the eligibility of some research and development expenses in the future, LED or the Company's operating results will be adversely affected.

## Worsened General Economic Conditions

The decline in the global economic environment in 2009 and the continuing economic instability in certain parts of the world resulted in increasing uncertainty regarding future revenue and customer commitments, both in terms of timing and magnitude for such future sales. If the global economic climate does not recover, the Company may not generate the sales activity required to support its operations resulting in requirement for additional restructurings and erosion of its existing capital resources which may hinder the future viability of the Company.

## Additional Financing

The Company has a history of operating losses and uses cash raised in equity markets to partially fund working capital. If adequate funds are not available when required or on acceptable terms, the Company may be required to delay, scale back or terminate its product development activities and sales and marketing efforts, and may be unable to continue operations. There can be no assurance that the Company will be able to obtain the additional financial resources required to compete in its markets on favourable commercial terms or at all. Any equity offering may result in dilution to the ownership interests of shareholders and may result in dilution of the value of such interests. The availability, or lack thereof, of bank credit, additional supplier credit, or additional equity investment could adversely affect the Company's ability to meet its business objectives. Recent market events and conditions, including disruptions in the Canadian and international credit markets and other financial systems and the deterioration of the Canadian and global economic conditions, could, among other things, impede access to capital or increase the cost of capital, which would have an adverse effect on the Company's ability to fund its working capital and other capital requirements. The Company's access to additional capital may not be available on terms acceptable to the Company or at all.

## Research and Development

If the Company fails to develop new products, incurs delays in developing new products, or if the product the Company develops are not successful, the Company's business could be harmed. Even if the Company does develop new products which are accepted by its target markets, the Company cannot assure that the revenue from these products will be sufficient to justify the Company's investment in research and development.

## Stock Price Volatility

The market price for the common shares of the Company fluctuates significantly, and these fluctuations tend to be exaggerated if the trading volume is low. The market price of the common shares may rise or fall in response to announcements of technological or competitive developments, acquisitions or strategic alliances by the Company or its competitors, the gain or loss by the Company of significant orders or broad market fluctuations.

## Product Development and Technological Change

The market for the Company's products is characterized by rapidly changing technology, evolving industry standards and frequent new product introductions. To be successful, the Company will need to enhance existing products and to introduce new products and features in response to changing standards, customer requirements, and technological innovations by others. There can be no assurance that the Company will be successful in doing this in a timely manner or at all. There can be no assurance that products or technologies developed by others will not render the Company's products obsolete or non-competitive. There is no assurance that the Company will be able to successfully develop next generation operational products. Failure to do so may have an adverse effect on the business, operating results and financial condition of the Company.

**Sales and Marketing and Strategic Alliances**

If the Company is to become successful, it must continue to expand its sales and distribution channels and its marketing and technology alliances. There is no assurance the Company will be able to reach agreements with additional alliance or distribution partners on a timely basis or at all, or that these partners will devote sufficient resources to advancing the Company's interests. The Company's business, results of operation, financial condition and stock price may be materially adversely affected if any strategic partner discontinues its relationship with the Company for any reason. Additionally, the Company at times relies on the voluntary efforts of its strategic partners rather than compliance with contractual obligations, and there are at times no minimum performance requirements. Therefore, the Company cannot be certain that these relationships will be successful.

**Dependence on a Small Number of Customers**

The Company's revenue is dependent, in large part, on significant contracts from a limited number of customers. During the three and six months ended June 30, 2012, approximately 91% of the Company's consolidated revenue was attributable to its distributor. Management believes that revenue derived from current and future large customers will continue to represent a significant portion of total revenue. The inability to continue to secure and maintain a sufficient number of large contracts would have a material adverse effect on the business, financial condition, operating results and cash flows of the Company. Moreover, the success of the Company will depend in part upon its ability to obtain orders from new customers, as well as the financial condition and success of its customers and general economic conditions.

**Intellectual Property Protection**

The Company's ability to compete may be affected by its ability to protect its intellectual property. It relies primarily on a combination of copyright, trademark, patent and trade secret laws, confidentiality procedures and contractual provisions to protect its intellectual property. While the Company believes that its products and technologies are adequately protected against infringement, there can be no assurance of effective protection. Monitoring and identifying unauthorized use of the Company's technology is difficult, and the prohibitive cost of litigation may impair the Company's ability to prosecute any infringement. The commercial success of the Company will also depend upon its products not infringing any intellectual property rights of others and upon no claims for infringement being made against the Company. The Company believes that it is not infringing any intellectual property rights of third parties, but there can be no assurance that such infringement will not occur. An infringement claim against the Company by a third party, even if it is invalid, could have a material adverse effect on the Company because of the costs of defending against such a claim. LED may fail to protect or obtain protection of intellectual property. In addition, LED may be exposed to infringement, misappropriation or other claims by third parties which, if determined adversely, could result in LED paying significant damage awards. LED currently uses patents, trademarks and contractual arrangements with employees to protect its intellectual property rights. LED's existing and future patents could be challenged, invalidated, circumvented or rendered unenforceable. LED's pending patent applications may not result in issued patents, or if patents are issued, such patents may not provide meaningful protection again competitors or against competitive technology. Patents afford only limited protection, and the actions that LED take to protect intellectual property rights may not be adequate. In addition, the process of seeking patent and trademark protection can be time consuming and expensive and there can be no assurance that any future patent or trademark applications will be granted in respect of LED's technology or business.

**Competition**

Because of intense market competition, the Company may not succeed. Some of the Company's current and potential competitors have longer operating histories, stronger brand names and greater financial, technical, marketing and other resources than the Company. Current and potential competitors may also have existing relationships with many of the Company's prospective customers, and prospective OEM customers may be developing products for their own use that are comparable to the Company's products. In addition, the Company expects competition to persist and intensify in the future, which could adversely affect the Company's ability to increase sales. Competitors have and may in the future align themselves with one or more of several large distributors of dental products which may include exclusive marketing arrangements making a significant portion of the market unavailable to LED.

**Potential Fluctuations in Quarterly Results**

The Company's quarterly operating results may vary significantly depending on factors such as the timing of new product introductions and changes in pricing policies by the Company and its competitors, market acceptance of new and enhanced versions of the Company's products and the timing of significant orders. Because the Company's operating expenses are based

on anticipated revenues and a high percentage of the Company's expenses are relatively fixed in the short term, variations in the timing of recognition of revenues can cause significant fluctuations in operating results from quarter to quarter and may result in unanticipated quarterly earnings shortfalls or losses. The market price of the Company's common shares may be highly volatile in response to such quarterly fluctuations.

**Dependence on Key Personnel**

The Company's future success depends largely on its ability to attract and retain talented employees. The Company's future results of operations will depend in part on the ability of its officers, management and other key employees to implement and expand operational, customer support and financial control systems and to expand, train and manage its employee base. The Company's future performance will also depend to a significant extent on its ability to identify, attract, train and retain highly skilled sales, technical, marketing and management personnel. If the Company were to lose the services of any key personnel, the Company may encounter difficulties finding qualified replacement personnel. LED's success is largely attributable to the leadership, contacts and efforts of LED's chief executive officer and senior management. If LED's chief executive officer or one or more of the members of the senior management cease working with the Company, and the Company is unable to engage suitable replacements on a timely and commercially viable basis, the business, operating results and financial condition of the Company may be adversely affected.

**Acquisitions**

The Company in the future may, acquire businesses, products or technologies that it believes complement or expand its existing business. Acquisitions of this type involve a number of risks, including the possibility that the operations of the acquired business will not be profitable or that the attention of the Company's management will be diverted from the day-to-day operation of its business. An unsuccessful acquisition could reduce the Company's margins or otherwise harm its financial condition. Any acquisition could result in a dilutive issuance of equity securities, the incurrence of debt and the loss of key employees. The Company cannot ensure that any acquisitions will be successfully completed or that, if one or more acquisitions are completed, the acquired businesses, products or technologies will generate sufficient revenues to offset the associated costs of the acquisitions or other adverse effects.

**Product Liability and Medical Malpractice Claims**

LED will be exposed to risks associated with product liability claims if the use of LED's products results in injury or property damage. Users and their patients of the VELscope may be injured as a result of malfunctions, defects or other causes. In addition, medical malpractice claims may be brought against LED. Because of LED's limited operating history, it is difficult to predict if product liability or medical malpractice claims will be brought in the future. LED carries what it believes to be adequate product liability insurance, but LED may not have adequate resources to satisfy a judgment if a successful claim is brought. The assertion of product liability or medical malpractice claims may also significantly damage LED's reputation.

**Future Share Sales**

If the Company's shareholders sell substantial amounts of the Company's common shares, the market price of the Company's common shares could decrease.

**Management of Growth**

The Corporation's future results of operations will depend in part on the ability of its officers and other key employees to implement and expand operational, customer support and financial control systems and to expand, train and manage its employee base. The Corporation's future performance will also depend to a significant extent on its ability to identify, attract, train and retain highly skilled sales, technical, marketing and management personnel.

**INTERNAL CONTROL OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS**

The Chief Executive Officer and Director of Finance have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Company is made known to them by others within the Company. The Chief Executive Officer and Director of Finance have also designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of the financial statements in accordance with IFRS.

The Chief Executive Officer and Director of Finance have evaluated the effectiveness of the Company's disclosure controls and procedures and assessed the design of the Company's internal controls over financial reporting. This evaluation identified no instances in which internal controls did not operate in an effective manner. Nonetheless, the Company has further strengthened its internal control processes to mitigate future potential material financial statement misstatements and other internal control violations. No additional changes were made in the Company's internal control over financial reporting during the three months ended June 30, 2012 and the most recent interim period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Because of the inherent limitations in a control system, any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will prevent or detect all misstatements, due to error or fraud, from occurring in the financial statements. As the Company has a limited number of personnel, management has concluded that a weakness exists in the design of internal controls over financial reporting caused by a lack of adequate segregation of duties. This weakness has the potential to result in material misstatements in the Company's financial statements and should also be considered a weakness in its disclosure controls and procedures. Management has concluded that taking into account the present stage of the Company's development and the best interests of its shareholders, the Company does not have sufficient size and scale to warrant the hiring of additional personnel to correct this weakness at this time. To help mitigate the impact of this weakness and to ensure quality financial reporting, supervisory controls are exercised by management and the Audit Committee is vigilant in its' oversight.

The Chief Executive Officer and Director of Finance of the Company conducted an evaluation of the disclosure controls and procedures as required by National Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings" issued by the Canadian Securities Administrators. They concluded that as at June 30, 2012, the Company's disclosure controls and procedures were effective to provide reasonable assurance that material information regarding required disclosures was made known to them on a timely basis.