Winning the Battle Against Sepsis

SECOND QUARTER REPORT 2012

SPECTRAL INC
Diagnostics

Second Quarter Letter to Shareholders

Dear Shareholders,

Spectral management is encouraged with the progress that we made with our Phase III EUPHRATES trial in the second quarter.

During the reporting period, we announced that the U.S. Food and Drug Administration (FDA) will allow Spectral to double the number of trial sites to 60 in total, for the Company's personalized medicine approach to treating septic shock.

We continued enrolling patients into our EUPHRATES trial at a per site rate that is higher than previous sepsis trials. Directed by the Company's Endotoxin Activity Assay (EAA™), which is the only FDA-cleared diagnostic for the risk of developing sepsis, Spectral's EUPHRATES trial is currently targeted to enroll 306 evaluable patients. Sixty-two patients have been randomized into the trial as of July 31, 2012.

We also disclosed that the Company’s focused approach to patient selection, using a high endotoxin level as entry criteria, has resulted in a composite mortality rate ranging from 35% to 40% in our Phase III trial, compared to a predicted composite mortality of 27.5%. This is positive news, as a challenge faced by recent, unsuccessful sepsis trials has been the low rate of placebo mortality, which may make demonstration of benefit difficult.

There continues to be a significant unmet medical need in the area of severe sepsis and septic shock. Subsequent to quarter end, AstraZeneca and BTG announced that the sepsis drug candidate they were jointly developing failed to help patients in a Phase II clinical trial and its development will now be halted.

We remain very optimistic about our future because our EUPHRATES trial is the most advanced clinical trial in the area of severe sepsis. As we accelerate the enrollment of patients in our Phase III sepsis trial, we are increasing our lead to potentially introduce a new sepsis product to the market.

I would like to thank our shareholders for your continuing support and I look forward to updating you on the progress of the EUPHRATES trial.

Sincerely,

Dr. Paul Walker
President & CEO

August 14, 2012

MANAGEMENT'S DISCUSSION & ANALYSIS
(All figures are expressed in thousands of Canadian dollars)

This Management's Discussion & Analysis ("MD&A") for the six months ended June 30, 2012 has been prepared to help investors understand the financial performance of the Company in the broader context of the Company's strategic direction, the risks and opportunities as understood by management, and the key success factors that are relevant to the Company's performance. Management has prepared this document in conjunction with its broader responsibilities for the accuracy and reliability of the financial statements, as well as the development and maintenance of appropriate information systems and internal controls to ensure that the financial information is complete and reliable. The Finance and Audit Committee of the Board of Directors has reviewed this document and all other publicly reported financial information for integrity, usefulness, reliability and consistency.

This discussion should be read in conjunction with the Condensed Interim Financial Statements of the Company, and the notes thereto, for the six months ended June 30, 2012 (the "Condensed Interim Financial Statements") and the Audited Annual Financial Statements of the Company, and the notes thereto for the years ended December 31, 2011 and 2010 (the "Annual Financial Statements"), as well as management's discussion and analysis for the year ended December 31, 2011.

FORWARD LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking information within the meaning of securities laws. Forward-looking information may relate to our future outlook and anticipated events or results and may include statements regarding our future financial position, business strategy, budgets, litigation, projected costs, capital expenditures, financial results, taxes and plans and objectives. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. These statements are based on certain factors and assumptions regarding, among other things, expected growth, results of operations, performance, and business prospects and opportunities. While we consider these assumptions to be reasonable based on information currently available to us, they may prove to be incorrect. Forward looking-information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include, among other things, the availability of funds and resources to pursue development projects, the successful and timely completion of clinical studies, and the ability to take advantage of business opportunities, the granting of necessary approvals by regulatory authorities, and as general economic, market and business conditions. For more exhaustive information on these risks and uncertainties you should refer to our most recently filed Annual Information Form which is available at www.sedar.com. Forward-looking information contained in this MD&A is based on our current estimates, expectations and projections, which we believe are reasonable as of the current date. You should not place undue importance on forward-looking information and should not rely upon this information as of any other date. While we may elect to, we are under no obligation and do not undertake to update this information at any particular time.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS

The Company's management maintains a system of disclosure controls and procedures to provide reasonable assurance that material information is made known, and has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS") and in accordance with International Accounting Standard ("IAS") 34 Interim Financial Reporting. There has been no change during the Company's most recent interim period in the internal controls over financial reporting.

The accounting policies applied in these financial statements are based on IFRS effective for the six months ended June 30, 2012, as issued and outstanding as of August 14, 2012, the date the Board of

Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's Condensed Interim Financial Statements for the six months ended June 30, 2012 could result in restatement of these financial statements, including the transition adjustments recognized on the change-over to IFRS.

Dr. Paul M. Walker, Chief Executive Officer, and Mr. Anthony Businskas, Chief Financial Officer, in accordance with Multilateral Instrument NI 52-109, have also both certified that:

- They have reviewed the Condensed Interim Financial Statements and this MD&A ("the Filings");
- Based on their knowledge, these Filings do not contain any untrue fact or omit a material fact;
- The Filings present fairly the financial position, loss and comprehensive loss, and cash flows of the Company;
- They have designed such disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company is made known to them by others within the Company, particularly during the period in which the annual filings are being prepared;
- They have designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

This document and the related financial statements can also be viewed on the Company's website at www.spectraldx.com and at www.sedar.com. The Company's Annual Information Form and Management Information Circular are also available on these websites.

INTRODUCTION

Spectral Diagnostics Inc. ("Spectral" or the "Company") is strategically focused on the development and commercialization of a treatment for severe sepsis utilizing its Endotoxin Activity Assay (EAA™) and the Toraymyxin therapeutic. If approved, this will be the first theranostics product, a targeted therapy guided by a specific diagnostic, in the area of sepsis. The Company also manufactures and sells certain proprietary reagents.

EAA™

Spectral has pioneered the development of biochemical markers for the clinical syndrome known as "severe sepsis". In 2003, the Company achieved U.S. Federal Drug Administration ("FDA"), Health Canada and European CE clearance of the Endotoxin Activity Assay ("EAA™") for the first recognized rapid test for the risk of developing sepsis in the Intensive Care Unit ("ICU"). In North America alone over 750,000 patients are diagnosed with the clinical syndrome of sepsis annually. Between 30% and 50% of patients with severe sepsis die in the ICU. Earlier identification and treatment of patients at risk for sepsis reduces mortality and saves significant cost by reducing the length of stay in the ICU and helping to guide therapeutic interventions. Spectral's EAA™ endotoxin measurement is the only FDA cleared diagnostic for this indication currently on the market.

TORAYMYXIN

Toraymyxin is a therapeutic hemoperfusion device that removes endotoxin from the bloodstream. Toraymyxin has been used in more than 100,000 patients globally and has demonstrated in clinical trials that it safely and effectively removes endotoxin and reduces mortality in patients with severe sepsis.

Results of a randomized controlled trial (the EUPHAS trial) were published in the *Journal of the American Medical Association* (JAMA, 2009; Vol. 301 No. 23, 2445-2452). The results demonstrated that when Toraymyxin is added to conventional therapy, there is significantly improved hemodynamics and organ function, and reduced 28-day mortality in patients with severe sepsis and septic shock in comparison to those patients in the conventional therapy group.

PROPRIETARY REAGENTS

Spectral develops, produces and markets recombinant proteins, antibodies and calibrators. These materials are sold for use in research and development as well as in products manufactured by other diagnostic companies through non-exclusive license and supply agreements. Royalty revenues are earned from these license arrangements based on a percentage of end user sales of Troponin I.

CLINICAL DEVELOPMENT

The Company's only clinical development program is focused on obtaining U.S. FDA approval for Toraymyxin.

On March 6, 2009, Spectral signed a license agreement with Toray Industries, Inc. of Japan granting Spectral the exclusive development and commercial rights in the U.S. for Toraymyxin, a therapeutic device for the treatment of sepsis that removes endotoxin from the bloodstream. Under the terms of the agreement, Spectral is seeking U.S. FDA approval for Toraymyxin and intends to commercialize the product, together with its Endotoxin Activity Assay (EAA™), the only FDA cleared diagnostic for the measurement of endotoxin.

On February 26, 2010, the Company received final approval of its Investigation Device Exemption ("IDE") from the U.S. FDA, which permits the Company to conduct a pivotal trial for Toraymyxin (the EUPHRATES trial) in the United States.

On March 2, 2010, the Company completed a private placement financing for aggregate gross proceeds of $19,500. Net proceeds from the financing, after related costs, were $17,608. These funds are being utilized primarily for the regulatory approval of Toraymyxin in the U.S. market.

In October, 2010, the Company announced the initiation of its EUPHRATES trial (Evaluating the Use of Polymyxin B Hemoperfusion in a Randomized controlled trial of adults Treated for Endotoxemia and Septic shock) in the United States comparing standard of care versus Toraymyxin plus standard of care.

In November, 2010, the Company signed a long-term, exclusive distribution agreement with Toray Industries, Inc. and Toray Medical Co., Ltd. of Japan (collectively "Toray") to market and sell Toraymyxin in Canada. Both the Toraymyxin product and Spectral's EAA™ diagnostic are already approved for sale by Health Canada. The Company is developing commercial plans for the Canadian market. The first step in the Canadian commercialization process will be the inclusion of Canadian sites in the EUPHRATES trial.

On September 9, 2011, the Company completed a plan of arrangement with Medwell Capital Corp. ("Medwell"), whereby Spectral issued 33,333,333 common shares in exchange for $10 million cash. In accordance with the plan of arrangement, Medwell distributed 54,282,834 Spectral common shares to its shareholders and retained a 13.40% residual ownership position in Spectral. These funds are being utilized primarily for the execution and expansion of the EUPHRATES trial.

In the fourth quarter of 2011, "Xigris", an Eli Lilly product, was withdrawn from the worldwide market, following results of a European clinical study which showed that the trial did not meet the primary endpoint of a statistically significant reduction in 28-day all cause mortality in patients with septic shock. In February, 2012, the first of two anticipated pivotal phase III sepsis studies for Tolactoferrin alfa ("Aggenix AG") was halted for safety reasons. While unfortunate for sepsis patients and clinicians, the opportunity to find an effective treatment remains.

On June 20, 2012, the FDA approved the Company's request to add up to an additional 30 clinical trial sites. The Company now has the capability to expand the trial to a total of 60 clinical sites in North America and internationally. There are currently 22 operational sites and the Company has targeted 40 sites to be enrolling patients by the end of the year. Additional sites will be initiated as necessary in 2013.

As of July 31, 2012 a total of 62 patients were randomized into the trial after meeting both clinical entry criteria and the biomarker criteria of a high endotoxin level. The EUPHRATES trial's enrollment rate continues to exceed, on a per-site basis, enrollment rates of previous sepsis trials. Expanding the number of sites should accelerate patient enrollment, which would enable the Company to meet its timelines to receive final data from the trial. The trial, as currently configured, is expected to enroll 306 evaluable patients, with 28 day mortality being the primary end point. An interim analysis is, at this time, expected to occur in the first half 2013.

The EUPHRATES trial is now the only active and most innovative Phase III study in the area of septic shock.

The Company's focus continues to be on the implementation of the EUPHRATES trial and obtaining regulatory approval in the United States for a treatment for severe sepsis and septic shock that combines Spectral's EAA™ diagnostic with a targeted therapy-Toraymyxin. This theranostics approach is the first in the area of sepsis.

At June 30, 2012, the Company had approximately $14,300 of cash, cash equivalents and a short-term investment to fund its clinical development activities and operations.

Toraymyxin is marketed in Japan and Europe and has been used to treat more than 80,000 sepsis patients safely and effectively. Spectral's EAA™ can identify patients that will benefit from Toraymyxin and monitor the effects of the treatment. This combination of the EAA™ diagnostic and the Toraymyxin

therapeutic has been utilized by clinicians in Europe since November 2007 and has demonstrated a significant reduction in mortality. The market opportunity for Spectral is large, as the combined diagnostic and therapeutic product is expected to fulfill a major unmet need for the approximately 250,000 patients who develop severe sepsis or septic shock in the U.S. each year. Over half of these patients have highly elevated levels of endotoxin. The U.S. market potential for this treatment is estimated at over $ 1 billion.

OPERATIONS

During the first half of 2012, the Company's activities continued to focus on implementation of the EUPHRATES trial.

The Company also continued to sell its EAA™ diagnostic and its proprietary reagents under the terms of existing commercial arrangements.

OPERATING RESULTS

SELECTED FINANCIAL INFORMATION

REVENUE

Revenue for the three months ended June 30, 2012 was $599, compared to $691 for the same period in the preceding year. For the six months ended June 30, 2012 revenue was $1,275 compared to $1,313 for the same period in 2011. Quarterly fluctuations in revenue are primarily related to timing. Sales of the EAA ™ diagnostic and reagents, as well as royalty revenues, are expected to continue at levels consistent with 2011 for the remainder of the year.

EXPENSES

Total expenses for the three months ended June 30, 2012 were $2,798, compared to $2,447 in the second quarter of 2011. For the six months ended June 30, 2012 total expenses were $5,774 compared to $4,570 for the same period in 2011.The increase of $1,204 for the six months ended June 30, 2012 is attributable almost entirely to higher EUPHRATES trial costs (as disclosed in Note 9 of the Condensed Interim Financial Statements). This is a result of the increased number of sites and the higher number of randomized patients in the trial.

The Company continues to maintain a low cost operating structure and expects no material increase in non clinical operating costs in 2012.

Employee benefits in the first half of 2012 were consistent the same period in 2011.

The $375 of service fees was paid to Medwell. The Company signed a three year contract with Medwell, effective January 1, 2010, whereby Medwell provides consulting services and resources to Spectral, as required, assisting the Company in the regulatory and commercialization process for Toraymyxin and certain corporate initiatives. Medwell was paid $1,500 per annum ($375 per quarter), plus applicable expenses, up to and including July 31, 2012. Effective August 1, 2012, pursuant to a restructuring of the services agreement, Medwell will be paid $400 per annum ($100 per quarter) plus up to $50 of applicable expenses. The contract expires on December 31, 2013, unless mutually agreed upon by both parties to extend the term.

Finance income represents interest earned on Company's short-term investment.

SHAREHOLDERS AND PLAN OF ARRANGEMENT (2011)

On March 28, 2011 the Company, and Medwell, announced a non-brokered agreement whereby Medwell and a consortium of buyers purchased, in private transactions, 12,449,501 common shares and 962,500 common share purchase warrants of Spectral from GrowthWorks Canadian Fund Ltd., representing

15.60% of Spectral's issued and outstanding shares. After this transaction, Medwell owned approximately 45.0% of the outstanding common shares of the Company.

On September 9, 2011, the Company and Medwell concluded a plan of arrangement, whereby Medwell acquired a further 33,333,333 Spectral common shares for $10 million cash at a subscription price of $0.30 per share. The Company received, after all transaction costs, net proceeds of $9,563, which will be used primarily to advance the Toraymyxin therapeutic through to the end of the Phase III EUPHRATES trial and data release. As part of this transaction, Medwell distributed 54,282,834 Spectral shares directly to its shareholders. Medwell now holds 15,200,000 Spectral shares, representing approximately 13.40% of the Spectral's issued and outstanding capital (calculated on a non diluted basis). Medwell also holds 15,200,000 Spectral warrants, which are exercisable at $0.60 each and expire on March 2, 2014.

NORMAL COURSE ISSUER BID

On November 11, 2011 the Company announced that the Toronto Stock Exchange (the TSX") approved its notice of intention to make a normal course issuer bid for its outstanding common shares (the "Shares"). Pursuant to the notice, the Company is entitled to purchase up to 2,277,667 Shares, representing 2% of its issued and outstanding shares during the twelve month period commencing November 15, 2011 and ending November 14, 2012. There are currently 113,883,394 Shares issued and outstanding. The Company may purchase up to 14,535 Shares on the TSX during any trading day. All Shares purchased under the issuer bid will be cancelled. To date, the Company has not purchased any of its Shares under this normal course issuer bid.

OTCQX INTERNATIONAL

On January 11, 2012 the Company announced that its common shares have commenced trading on OTCQX International, the highest tier of the OTC market in the U.S. Shares are traded under the symbol "DIAGF". The Company's common shares continue to trade on the TSX under the symbol "SDI".

BALANCE SHEET, FINANCIAL CONDITION AND LIQUIDITY

Cash and cash equivalents of $9,226 as at June 30, 2012 (December 31, 2011 - $13,470) decreased by $4,244. This decrease is attributable to the following cash utilization:

Cash operating losses	(4,170)
Other	(16)
Working capital	82
Property, plant and equipment additions	(140)
	$(4,244)

The Company also held a short term investment of $5,102 as at June 30, 2012 (December 31, 2011 - $5,086).

OUTLOOK

The Company will continue to generate sales in 2012 pursuant to its existing commercial arrangements for EAA™ and its proprietary biological reagents. The strategic focus for the next several years will be on the successful completion of the EUPHRATES trial. Twenty-two clinical sites are currently screening patients and enrolment is progressing at a steady pace. The Company anticipates that a total of 40 clinical trial sites should be operational by the end of 2012. An analysis of interim results is anticipated in

the first half 2013, subject to achieving required patient enrolment rates. As at June 30, 2012 the Company had $14,300 available to fund its clinical development activities and operations.

BUSINESS RISKS

The Company's operations are exposed to a variety of risk factors inherent in new product development. The Company's short operating history in its new endeavours makes prediction of future operating results difficult. Actual future results may differ significantly from those projected in any forward-looking statements. Key business risks for the Company are detailed in its most recent Annual Information Form which is available at www.sedar.com.

CRITICAL ACCOUNTING POLICIES

The Condensed Interim Financial Statements of Spectral for the six months ended June 30, 2012 are prepared in accordance with IAS 34, "Interim Financial Reporting". The Condensed Interim Financial Statements should be read in conjunction with the Annual Financial Statements for the year ended December 31, 2011, which have been prepared in accordance with IFRS. The Company has identified the accounting policies and estimates that are critical to the understanding of the Company's operation and financial results in the Condensed Interim Financial Statements. Certain polices are selected by management and approved by the Finance and Audit Committee of the Board of Directors. These accounting policies are set out in Note 3 of the Annual Financial Statements for the years ended December 31, 2011 and 2010. Certain policies are more significant than others and are, therefore, considered critical accounting policies. Accounting policies are considered to be critical if they rely on a substantial amount of judgment in their application or if they result from a choice between accounting alternatives and that choice has a material impact on the reported results or financial position.

In addition to accounting policies, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Interim Financial Statements and the reported amounts of revenue and expenses during the reporting period. The most significant estimates are related to the recoverability of purchased technology and licences, property, plant and equipment and valuation assumptions related to share-based compensation. Actual results could differ from those estimates. The Condensed Interim Financial Statements of the Company have been prepared using similar estimation methods for the critical accounting estimates as were used for the Annual Financial statements and they conform to the requirement of IAS 34 "Interim Financial Reporting".

RISK MANAGEMENT

FINANCIAL RISK MANAGEMENT

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse affects on the Company's financial performance.

a. Market Risk

i. Currency risk: The majority of the Company's revenue is denominated in U.S. dollars and Euros. At June 30, 2012, cash included US$191. Trade and other receivables included a total of US$381 and €63. Trade and other liabilities included a total of US$945 and €1. There is no active hedging program currently in place due to the relatively short time frame for settlement of these balances. A 10% change in the U.S./CDN or EURO/CDN exchange rate on the June 30, 2012 amounts would have a $30 impact on net income.

ii. Interest rate risk: The Company has no material exposure to fluctuations in interest rates.

b. Credit Risk

i. Cash: The Company places its cash with Canadian Schedule I banks.

ii. Cash equivalent: Cash equivalent consist of a premium money market investment account placed with a Canadian Schedule I bank. The premium money market investment account can be converted to cash on demand.

iii. Short-term investment: Short-term investment includes an interest bearing security with an original maturity of greater than three months and remaining maturity of less than one year. The short-term investment is classified as held-for-trading and is accounted for at fair value.

iv. Accounts receivable: The Company sells its products to distribution partners in major markets. The credit risk associated with the accounts receivable pursuant to these agreements is evaluated during initial negotiations and on an ongoing basis. There have been no events of default under these agreements. As at June 30, 2012 no material accounts receivable balances were considered impaired or past due.

c. Liquidity Risk

There has been no material change since the Company's year end.

CAPITAL RISK MANAGEMENT

The Company's primary objective, when managing capital, is to maintain appropriate levels of cash and cash equivalents for working capital and operating purposes, as well as funding commercialization of its core products. Capital includes shareholders' equity.

Spectral Diagnostics Inc.

Condensed Interim Financial Statements

June 30, 2012
(Unaudited)

These unaudited condensed interim financial statements have been prepared by management of Spectral Diagnostics Inc. and have not been reviewed by the Company's auditor.

Spectral Diagnostics Inc.

Condensed Interim Statement of Financial Position

(in thousands of Canadian dollars)

	Note	June 30 2012 $	December 31 2011 $
		Unaudited	Audited
Assets			
Current assets			
Cash and cash equivalents		9,226	13,470
Short-term investment		5,102	5,086
Trade and other receivables		640	515
Inventories		245	295
Prepayments		274	407
		15,487	19,773
Non-current assets			
Property, plant and equipment		465	419
Intangible assets		447	459
		912	878
Total assets		16,399	20,651
Liabilities			
Current liabilities			
Trade and other payables		1,645	1,610
Deferred revenue		91	102
Total liabilities		1,736	1,712
Equity			
Share capital		27,101	27,101
Contributed surplus		3,864	3,864
Other equity reserves	8	8,205	8,082
Deficit		(24,507)	(20,108)
Total equity		14,663	18,939
Total liabilities and equity		16,399	20,651

The accompanying notes are an integral part of these unaudited condensed interim financial statements.

Spectral Diagnostics Inc.

Condensed Interim Statement of Loss and Comprehensive Loss
For the six months ended June, 2012 and 2011
(Unaudited)

(in thousands of Canadian dollars, except for share and per share data)

		Three months ended June 30		Six months ended June 30	
	Note	2012	2011	2012	2011
		$	$	$	$
Revenue		599	691	1,275	1,313
Other income		30	23	66	50
Expenses					
Changes in inventories of finished goods and work- in-process		52	94	151	138
Raw materials and consumables used		103	56	202	117
Employee benefits	8, 10	641	673	1,406	1,413
Consulting and professional fees		1,056	887	2,246	1,347
Management services	11	375	375	750	750
Regulatory and investor relations		99	68	222	137
Travel and entertainment		313	136	459	246
Depreciation and amortization		55	49	106	214
Foreign exchange (gain)loss		(7)	10	4	17
Other expenses		111	99	228	191
		2,798	2,447	5,774	4,570
Operating loss		(2,169)	(1,733)	(4,433)	(3,207)
Finance income		18	16	34	32
Loss and comprehensive loss for the period		(2,151)	(1,717)	(4,399)	(3,175)
Basic and diluted loss per common share		(0.02)	(0.02)	(0.04)	(0.04)
Weighted average number of common shares outstanding		113,883,394	80,550,061	113,883,394	80,550,061

The accompanying notes are an integral part of these unaudited condensed interim financial statements.

Spectral Diagnostics Inc.

Condensed Interim Statement of Changes in Equity
(Unaudited)

(in thousands of Canadian dollars, except number of shares)

	Note	Issued capital Number	$	Contributed surplus $	Share-based compensation $	Warrants $	Deficit $	Total equity $
Balance, January 1, 2011		80,550,061	17,538	3,696	2,722	5,311	(13,395)	15,872
Loss and comprehensive loss for the period		-	-	-	-	-	(3,175)	(3,175)
Share-based compensation	8, 10	-	-	-	157	-	-	157
Balance, June 30, 2011		80,550,061	17,538	3,696	2,879	5,311	(16,570)	12,854
Balance, January 1, 2012		113,883,394	27,101	3,864	2,939	5,143	(20,108)	18,939
Loss and comprehensive loss for the period		-	-	-	-	-	(4,399)	(4,399)
Share-based compensation	8, 10	-	-	-	123	-	-	123
Balance, June 30, 2012		113,883,394	27,101	3,864	3,062	5,143	(24,507)	14,663

The accompanying notes are an integral part of these unaudited condensed interim financial statements.

Spectral Diagnostics Inc.

Condensed Interim Statement of Cash Flows
For the six months ended June 30, 2012 and 2011
(Unaudited)

(in thousands of Canadian dollars)

	Note	Six months ended June 30 2012	June 30 2011
		$	$
Cash flow provided by (used in)			
Operating activities			
Loss and comprehensive loss for the period		(4,399)	(3,175)
Adjustments for:			
Depreciation on property, plant, and equipment		94	84
Amortization of intangible assets		12	130
Share-based compensation	8, 10	123	157
Changes in items of working capital :			
Trade and other receivables		(125)	(207)
Inventories		50	(27)
Prepayments		133	(78)
Trade and other payables		35	(58)
Deferred revenue		(11)	(50)
Net cash used in operating activities		(4,088)	(3,224)
Investing activities			
Property, plant and equipment expenditures		(140)	(38)
Short-term investment		(16)	(32)
Net cash used in investing activities		(156)	(70)
Decrease in cash and cash equivalents		(4,244)	(3,294)
Cash and cash equivalents, beginning of period		13,470	10,311
Cash and cash equivalents, end of period		9,226	7,017

The accompanying notes are an integral part of these unaudited condensed interim financial statements.

(in thousands of Canadian dollars, except for share and per share data)

1. Nature of operations

Spectral Diagnostics Inc. (Spectral or the Company) was incorporated on July 29, 1991 in Ontario, Canada. The address of the registered office is 135-2 The West Mall, Toronto, Ontario.

Spectral is a limited public company, which is listed on the Toronto Stock Exchange (the "TSX") under the symbol "SDI". Effective January 11, 2012, Spectral's shares also began trading on the OTCQX exchange in the U.S. under the symbol "DIAGF".

The Company is strategically focused on the development and commercialization of a treatment for severe sepsis utilizing its Endotoxin Activity Assay (EAA™) diagnostic and the Toraymyxin therapeutic, for which it is currently seeking U.S. Food & Drug Administration ("FDA") approval once the EUPHRATES trial (Note 9) is complete.

These condensed interim financial statements were approved for issue by the Board of Directors on August 14, 2012. These condensed interim financial statements have not been audited.

2. Basis of preparation

These condensed interim financial statements for the six months ended June 30, 2012 have been prepared in accordance with IFRS as issued by the IASB applicable to the preparation of interim financial statements, including IAS 34, "Interim Financial Reporting". The condensed interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2011, which have been prepared in accordance with IFRS.

3. Accounting policies

The accounting policies adopted are consistent with those of the previous financial year.

4. Estimates

The preparation of interim financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results could differ from those estimates.

In preparing these condensed interim financial statements, the significant judgments made by management in applying the accounting policies and the key sources of estimation and uncertainty were the same as those that applied to the financial statements for the year ended December 31, 2011.

(in thousands of Canadian dollars, except for share and per share data)

5. Accounting standards issued but not yet applied

There are no new IFRSs or IFRICs that are effective for the first time for this interim period that would be expected to have a material impact on the Company.

6. Financial risk management

a. Financial risk

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The condensed interim financial statements do not include all financial risk management information and disclosures required in the annual financial statements. They should be read in conjunction with the annual financial statements as at December 31, 2011. There have been no changes in the risk management since year end or in any risk management policies.

The Company's management continues to use prudent business practices to minimize any potential adverse effects on the Company's financial performance.

b. Liquidity risk

There has been no material change since the Company's year end.

7. Commitments

The Company has committed to expenditures of approximately $5,000 in the next year and another $10,000 thereafter for its U.S. pivotal trial.

8. Share-based compensation

The Company granted the following share options to directors, officers, employees and others at the discretion of the Board of Directors.

	June 30 2012			June 30 2011	
Date	Number of share options	Exercise price	Date	Number of share options	Exercise price
January 17, 2012	860,000	$0.285	March 15, 2011	1,255,000	$0.315
May 18, 2012	95,000	$0.200			

(in thousands of Canadian dollars, except for share and per share data)

The exercise prices of the share options are equal to the closing market price of the Company's shares on the Toronto Stock Exchange on the immediately preceding day of the grant of the option. Share options issued to the Company's directors were vested at the time of the grant. Share options issued to the Company's officers, employees and others in 2012 vested at 25% of the grant amount at the time of the grant. The balance of the employee and other share options vest equally in each successive quarter and will be fully vested by January 16, 2015 and May 17, 2015 respectively. Share options issued to the Company's officers and employees in 2011 vested at 25% of the grant amount at the time of the grant. The balance of these share options vest equally in each successive quarter and will be fully vested by March 14, 2014. The contractual life of each share option is five years. There is no cash settlement of the share options.

The volatility measured at the standard deviation of continuously compounded share returns is based on statistical analysis of weekly share prices over the last five years.

Share options granted were valued using the Black-Scholes option pricing model, with the following assumptions:

		June 30 2012	**June 30 2011**
	May 18, 2012	January 17, 2012	March 15, 2011
Risk-free interest rate	1.42%	1.26%	2.54%
Expected life	5 years	5 years	5 years
Annualized volatility	88.92%	89.74%	95.25%
Dividend rate	0%	0%	0%
Grant date fair value	$0.20	$0.275	$0.32

9. The EUPHRATES trial

The EUPHRATES (Evaluating the Use of Polymyxin B Hemoperfusion in a Randomized controlled trial of Adults Treated for Endotoxemia and Septic shock) trial is a randomized, double-blind control trial of standard of care versus standard of care and Toraymyxin, directed by Spectral's EAA™, an FDA cleared assay for use in sepsis.

(in thousands of Canadian dollars, except for share and per share data)

The Company has incurred the following costs associated with this clinical trial:

	Three months ended June 30		Six months ended June 30	
	2012 $	2011 $	2012 $	2011 $
Program management	816	439	1,598	717
Program oversight	77	14	192	30
Clinical site costs	231	314	467	391
Diagnostic supply and training	63	46	129	85
Employee benefits	89	84	183	161
Total EUPHRATES	**1,276**	**897**	**2,569**	**1,384**

The trial costs have been included in the statement of loss and comprehensive loss where applicable.

10. Employee benefits

Key management includes the Company's directors and officers. Compensation awarded to key management included:

	Three months ended June 30 2012		Six months ended June 30 2012	
		$		$
	All employees	Key management	All employees	Key management
Salaries	498	275	1,010	564
Bonuses	-	-	-	-
Short term employee benefits	66	16	128	45
Directors fees	42	42	97	97
Post-employment benefits	-	-	42	42
Share- based compensation	31	24	123	104
Other	4	3	6	3
	641	**360**	**1,406**	**855**

(in thousands of Canadian dollars, except for share and per share data)

	Three months ended June 30 2011		Six months ended June 30 2011	
		$		$
	All employees	Key management	All employees	Key management
Salaries	488	258	947	525
Bonuses	-	-	-	-
Short term employee benefits	58	19	120	54
Directors fees	88	88	137	137
Post-employment benefits	-	-	44	44
Share- based compensation	31	24	157	138
Other	8	2	8	2
	673	**391**	**1,413**	**900**

11. Related party transactions

a. The Company has entered into a services agreement with Medwell Capital Corp. ("Medwell"), which entity owns approximately 13.40% (2011: 45.00%) of the outstanding common shares of Spectral (calculated on a non-diluted basis). In addition, Medwell holds warrants that entitle it to acquire a further 15,200,000 Shares at a price of $0.60 per Share until March 2, 2014.

The agreement, effective January 1, 2010, is for the provision of various consulting services to assist the Company in its commercialization activities. Under the terms of the agreement, Medwell was paid $1,500 per annum plus applicable expenses from January 1, 2011 through July 31, 2012.

Effective August 1, 2012, pursuant to a restructuring of the services agreement, Medwell will be paid $400 per annum plus up to $50 of applicable expenses. The agreement will terminate December 31, 2013, unless both parties mutually agree to extend the term.

As at June 30, 2012, the amount owing to Medwell was $299 (2011: $141) and was paid in the subsequent period.

b. Compensation of key management is disclosed in Note 10.

c. As of February 29, 2012, Birch Hill Equity Partners Management Inc. ("Birch Hill") became the owner, directly and indirectly, of 12,029,153 Shares, representing approximately 10.60% of the outstanding common shares of Spectral (calculated on a non-diluted basis). There are no transactions with Birch Hill.

There are no other related party transactions.

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