

PreMD Inc.  
Form 20-F  
June 21, 2007

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As filed with the Securities and Exchange Commission on June 20, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 20-F**

**(Mark One)**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2006**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission file number**

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**PreMD Inc.**

**(Exact name of Registrant as specified in its charter)**

**Not Applicable**

**(Translation of Registrant's Name into English)**

**Canada**

**(Jurisdiction of incorporation or organization)**

**4211 Yonge Street, Suite 615**

**Toronto, Ontario M2P 2A9, Canada**

**(Address of principal executive offices)**

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**Securities registered or to be registered pursuant to Section 12(b) of the Act.**

| <b>Title of each class</b> | <b>Name of each exchange on which registered</b>              |
|----------------------------|---|
| Common Shares              | The American Stock Exchange and<br>The Toronto Stock Exchange |

**Act. Securities registered or to be registered pursuant to Section 12(g) of the Act.**  
**None.**

**Act. Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.**  
**None.**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 21,858,223 as of December 31, 2006.

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or (15)(d) of the Securities Exchange Act of 1934.  
Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such reporting requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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## NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Securities and Exchange Commission encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This Annual Report on Form 20-F contains such "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Also, PreMD Inc.'s management may make forward-looking statements orally or in writing to investors, analysts, the media and others. Forward-looking statements express our expectations or predictions of future events or results. They are not guarantees and are subject to many risks and uncertainties. There are a number of factors that could cause actual events or results to be significantly different from those described in the forward-looking statements. Forward-looking statements might include one or more of the following:

- anticipated strategic alliances or arrangements with development or marketing partners;
  - anticipated research and product development results;
  - projected development and commercialization timelines;
- descriptions of plans or objectives of management for future operations, products or services;
  - anticipated financing activities;
  - forecasts of future economic performance; and
- descriptions or assumptions underlying or relating to any of the above items.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts or events. They use words such as "anticipate", "estimate", "expect", "project", "intend", "opportunity", "plan", "potential", "words of similar meaning. They may also use words such as "will", "would", "should", "could" or "may". Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, we do not assume responsibility for the accuracy and completeness of such statements. Given these uncertainties, you should not place undue reliance on these forward-looking statements, which speak only as of the date of this report. You should carefully consider that information before you make an investment decision. You should review carefully the risks and uncertainties identified in this report.

We are not under any obligation, and expressly disclaims any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Unless the context otherwise requires, references herein to "we", "us", "our", the "Company", the "Corporation", or to "PreMD" are to PreMD Inc. and its consolidated subsidiaries.

**PART I****ITEM 1. Identity of Directors, Senior Management and Advisers.****A. Directors and Senior Management**

Not Applicable.

**B. Advisers**

Not Applicable.

**C. Auditors**

Not Applicable.

**ITEM 2. Offer Statistics and Expected Timetable.**

Not Applicable.

**ITEM 3. Key Information.****Currency and Exchange Rates**

All dollar amounts set forth in this Annual Report are in Canadian dollars, except where otherwise indicated. The following table sets forth (i) the exchange rates for the Canadian dollar, expressed in U.S. dollars, in effect at the end of each of the financial periods indicated; (ii) the average exchange rates based on the last day of each month during such periods; and (iii) the high and low exchange rates during such periods, in each case based on the noon buying rate in New York City for cable transfers in Canadian dollars, as certified for customs purposes by the Federal Reserve Bank of New York. The foreign exchange spot rate as at May 31, 2007 was \$0.0.9345.

|         | 2006   | 2005   | 2004   | 2003   | 2002   |        |
|---------|--------|--------|--------|--------|--------|--------|
| Average | 0.8818 | 0.8254 | 0.7682 | 0.7136 | 0.6368 |        |
|         | May 07 | Apr-07 | Mar-07 | Feb-07 | Jan-07 | Dec-06 |
| Low     | 0.8980 | 0.8633 | 0.8467 | 0.8437 | 0.8457 | 0.8582 |
| High    | 0.9345 | 0.9035 | 0.8673 | 0.8631 | 0.8586 | 0.8760 |
| Average | 0.9133 | 0.8812 | 0.8560 | 0.8540 | 0.8501 | 0.8672 |

**A. Selected Financial Data**

The following table presents selected financial data of the Corporation. This data is derived from the Corporation's consolidated financial statements and the notes to those statements. You should read this data along with "Operating and Financial Review and Prospects" and the Corporation's consolidated financial statements and the notes to those statements incorporated into this Annual Report. All financial data as of December 31, 2006, December 31, 2005, December 31, 2004, December 31, 2003 and December 31, 2002 has been derived from the audited consolidated financial statements incorporated into this Annual Report.

The Corporation's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), which differs in certain significant respects from United States



generally accepted accounting principles (“U.S. GAAP”). A detailed description of the principal differences between Canadian GAAP and U.S. GAAP as they relate to the Corporation and a reconciliation to U.S. GAAP is included in note 10 to the audited consolidated financial statements incorporated into this Annual Report.

|                       | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2006</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2005</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2004</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2003</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2002</b> |
|-----------------------|--|--|--|--|--|
| <b>Canadian GAAP:</b> |  |  |  |  |  |

**Operating Results**

|   |              |              |              |              |              |
|---|--------------|--------------|--------------|--------------|--------------|
| Product sales                             | \$ 6,513     | \$ 425,730   | \$ 183,258   | nil          | nil          |
| License revenue                           | 3,328,827    | 1,153,308    | 302,080      | \$ 16,900    | nil          |
| Total expenses                            | 9,712,856    | 6,512,146    | 6,192,649    | 4,561,179    | \$ 4,465,577 |
| Investment tax credits                    | 200,000      | 198,923      | 205,000      | 223,146      | 189,908      |
| Interest income                           | 265,369      | 173,130      | 123,626      | 258,422      | 257,407      |
| Net loss                                  | \$ 5,948,971 | \$ 4,989,705 | \$ 5,568,899 | \$ 4,062,711 | \$ 4,018,262 |
| Net loss per share:                       |              |              |              |              |              |
| - basic and diluted loss per share        | \$ 0.27      | \$ 0.23      | \$ 0.26      | \$ 0.19      | \$ 0.20      |
| Loss from continuing operations per share | \$ 0.27      | \$ 0.23      | \$ 0.26      | \$ 0.19      | \$ 0.20      |

Operating results that would differ under U.S. GAAP are as follows:

|                                    | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2006</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2005<br/>(restated)</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2004</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2003</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2002</b> |
|------------------------------------|--|---|--|--|--|
| <b>U.S. GAAP:</b>                  |  |   |  |  |  |
| Net loss                           | \$ 5,886,869   | \$ 4,904,124  | \$ 5,478,184   | \$ 3,949,318   | \$ 4,871,140   |
| Net loss per share:                |  |   |  |  |  |
| - basic and diluted loss per share | \$ 0.27  | \$ 0.23   | \$ 0.26  | \$ 0.19  | \$ 0.24  |

|                       | <b>As at<br/>December<br/>31,<br/>2006</b> | <b>As at<br/>December<br/>31,<br/>2005</b> | <b>As at<br/>December<br/>31,<br/>2004</b> | <b>As at<br/>December<br/>31,<br/>2003</b> | <b>As at<br/>December<br/>31,<br/>2002</b> |
|-----------------------|--|--|--|--|--|
| <b>Canadian GAAP:</b> |  |  |  |  |  |

**Financial Position**

|  |                |               |              |              |               |
|--|----------------|---------------|--------------|--------------|---------------|
| Total assets                             | \$ 5,279,500   | \$ 11,293,190 | \$ 6,996,079 | \$ 8,074,027 | \$ 11,379,383 |
| Long-term debt                           | 6,350,680      | 5,893,340     | nil          | nil          | nil           |
| <b>Shareholders' Equity</b>              |                |               |              |              |               |
| Capital stock                            | 25,263,480     | 24,449,826    | 24,192,321   | 24,056,853   | 23,785,884    |
| Total shareholders' equity (deficiency)  | \$ (2,967,542) | \$ 1,844,297  | \$ 2,496,842 | \$ 7,438,279 | \$ 10,689,828 |
| Weighted average number of common shares |                |               |              |              |               |
| Outstanding                              | 21,663,698     | 21,487,008    | 21,276,497   | 20,967,677   | 20,406,733    |
| Cash dividends declared per share        | nil            | nil           | nil          | nil          | nil           |



Financial position and shareholders' equity that would differ under U.S. GAAP are as follows:

| <b>U.S. GAAP:</b>                          | <b>As at<br/>December 31,<br/>2006</b> | <b>As at<br/>December 31,<br/>2005<br/>(restated)</b> | <b>As at<br/>December 31,<br/>2004</b> | <b>As at<br/>December 31,<br/>2003</b> | <b>As at<br/>December 31,<br/>2002</b> |
|--|--|---|--|--|--|
| <b>Financial Position</b>                  |  |   |  |  |  |
| Total assets                               | \$ 5,167,639                           | \$ 11,211,832   | \$ 6,633,221                           | \$ 7,620,454                           | \$ 10,812,417                          |
| Derivative liability                       | \$ 2,402,244                           | \$ 2,592,630  | nil                                    | nil                                    | nil                                    |
| <b>Shareholders' Equity</b>                |  |   |  |  |  |
| Capital stock                              | \$ 29,981,717                          | \$ 29,182,269   | \$ 28,924,764                          | \$ 28,789,296                          | \$ 28,399,039                          |
| Total shareholders' equity<br>(deficiency) | \$ (5,481,647)                         | \$ (829,691)  | \$ 2,133,984                           | \$ 6,984,706                           | \$ 10,122,862                          |

**B. Capitalization and Indebtedness**

Not Applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not Applicable.

**D. Risk Factors**

You should consider each of the following factors as well as other information in and incorporated into this Annual Report in evaluating the Corporation's business and its prospects. The risks and uncertainties described below are not the only ones the Corporation faces. Additional risks and uncertainties not presently known to the Corporation or that the Corporation currently considers immaterial may also impair the Corporation's business operations. If any of the following risks actually occur, the Corporation's business and financial results could be harmed and the trading price of the Corporation's common stock could decline. You should also refer to the other information set forth in and incorporated into this Annual Report on Form 20-F, including the Corporation's consolidated financial statements and the related notes.

**Risks Related to the Corporation's Business**

*The Corporation has limited or no experience in marketing products. If the Corporation cannot successfully market and cause acceptance of its products, the Corporation will be unable to execute its business plan.*

The Corporation has limited or no experience in marketing its products and has developed a strategy to out-license the marketing to one or more partners, such as major diagnostic or pharmaceutical companies. On December 28, 2006, the exclusive marketing and distribution rights to PREVU\* reverted back to the Corporation as a result of McNeil Consumer Healthcare's ("McNeil") termination of their agreements with the Corporation. As a result, the Corporation plans to market some of its products directly and to continue to develop partnerships. The Corporation may not be able to market its own products and if the Corporation relies on third parties to market its products, the commercial success of such products may be outside of its control.

Moreover, there can be no assurance that providers, payers or patients will accept the Corporation's products, even if they prove to be safe and effective and are allowed for marketing by the HPB, the FDA and other regulatory authorities. The Corporation's ability to achieve significant market share for each of its products could be affected by reimbursement difficulties with government agencies and third-party insurers, which could hamper the speed with which the Corporation's products are adopted by the medical community and by the public. Market penetration of the Corporation's products will be influenced by factors including the cost-effectiveness and the overall economic benefits that they offer.

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*If the Corporation is unable to generate significant revenues and become profitable in the near future, its business could fail.*

To date, the Corporation has not generated significant ongoing revenues to offset its research and development costs and operating costs and accordingly has not made an operating profit. The Corporation has historically benefited from the inclusion of Canadian federal and provincial refundable scientific investment tax credits (“ITCs”) in its annual operating results. To date, the Corporation has received \$2,075,000 in ITCs. ITCs are tax credits that the Corporation receives from the Canadian federal and provincial governments as a result of conducting applied scientific research in Canada. There can be no assurance that ITCs will continue to be available to the Corporation or, if so, at what levels.

In May 2004, the Corporation licensed the worldwide marketing and distribution rights for its skin cholesterol tests to McNeil. In 2006, the Corporation recorded \$7,000 in sales of PREVU\* to McNeil prior to the termination of the agreement on December 28, 2006. Although the Corporation anticipates finding new marketing partners for the PREVU\* product line in 2007, there is no assurance that sales and license revenues from such agreements will be sufficient to generate a profit for the Corporation in the near future.

*The Corporation’s success depends in part on obtaining and maintaining meaningful patent protection on our products and technologies.*

The Corporation may not have sufficient protection for its intellectual property through its current portfolio of patents. The protection offered by the Corporation’s patents and patent applications may be challenged, invalidated or circumvented by our competitors, and there is no guarantee that we will be able to obtain or maintain patent protection for our products or product candidates. In addition, the Corporation’s petition to reinstate two of its U.S. patents was denied by the U.S. PTO and, accordingly, we could face additional competition from companies seeking to exploit the intellectual property that was previously covered by these patents.

In August 2004, the Corporation learned that two of its U.S. patents had been listed as abandoned by the United States Patent and Trademark Office (“U.S. PTO”) for failure to pay maintenance fees. The failure to pay these maintenance fees occurred when the files were transferred between U.S. and Canadian patent agents. The Corporation filed a petition for reinstatement of the patents. In response to this petition, in February 2005 the U.S. PTO identified specific items that the Corporation should address, specifically regarding the credentials and procedures of the Corporation’s patent agents and their performance of clerical functions related to the payment of the maintenance fees. In June 2005, the Corporation filed a request for consideration.

On December 23, 2005, the U.S. PTO notified the Corporation of its decision not to reinstate the two patents. In February 2006, the Corporation filed a request for reconsideration with the U.S. PTO which was subsequently denied. The Corporation has authorized legal action against the law firm that was responsible for managing its patent portfolio at the time when the maintenance fees for the two patents in question should have been paid. The U.S. PTO found that the patents lapsed as a result of the law firm’s failure to use its established docketing procedures regarding payment of the maintenance fees. No resolution has been reached regarding this maintenance fees error and even if there is a resolution, there is no assurance that the Corporation will benefit from any resolution that may occur.

The two patents in question are in force in all other jurisdictions. In the U.S., the Corporation has an additional two patents in force covering other aspects of the technology as well as two patents pending. Although management believes that it would be difficult for a competitor to develop a similar product, there can be no assurance that others will not independently develop a similar product.

*The Corporation may be required to obtain licenses under patents or other proprietary rights of third parties. No assurance can be given that any licenses required under any such patents or proprietary rights will be available on*

*terms acceptable to the Corporation or that such licenses will be available at all.*

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If the Corporation does not obtain such licenses, it could encounter delays in introducing one or more of its products to the market while it attempts to design around such patents, if the Corporation is unable to design around such patents it could find that the development, manufacture or sale of products requiring such licenses may be foreclosed. In addition, the Corporation could incur substantial costs in defending itself in suits brought against it on such patents or in suits in which the Corporation attempts to enforce its own patents against other parties. Furthermore, the Corporation could be liable for damages or an accounting of profits if it were unsuccessful in defending itself in a suit for infringement of a patent.

Subsequent to the year end, on January 5, 2007, the Corporation settled litigation relating to the ColorectAlert™ License Agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11 AG, the Corporation agreed to pay \$175,000 to Med-11 AG ("Med-11") and amended the agreements to replace Dr. Shamsuddin with Med-11 as the licensor. The amendment also reduced the royalty payable by the Corporation from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Corporation may have been required to pay under the initial agreements. There is no assurance that litigation similar to this will not arise from time to time, thereby distracting management and causing the Corporation to incur costs and time on items not related to the Corporation's business plan.

*The Corporation relies on third parties to manufacture some of its products and any delay, volume constraints, or mistakes on the part of such manufacturers could result in cancelled orders and a loss of revenues for the Corporation.*

The Corporation relies on third parties to manufacture and formulate some of its products for clinical trials and for eventual commercial sale. Currently, the Corporation's skin cholesterol products are manufactured by Diagnostic Chemicals Limited ("DCL"), Southmedic Inc. and Jabil Circuit, Inc., while X-Rite, Inc. supplied the corded color measurement instrument used in connection with the tests. While the history is limited, to date, the Corporation has not experienced any material problems, such as disruptions of supply, with these manufacturers. The Corporation's other products, relating to its cancer technologies, are all manufactured (for clinical trial purposes) by the Corporation itself in its laboratory located at McMaster University.

The ability to ensure a continued supply of products on a timely basis is not entirely within the Corporation's control. If the Corporation cannot obtain materials in a timely fashion, the progress of its clinical trials and product sales will be negatively affected.

*If the Corporation cannot obtain additional financing required to support business growth, it will be unable to fund its continuing operations in the future.*

Management believes that, based on historic cash expenditures and the current expectation of further revenues from product sales and/or royalties, the Corporation's existing cash resources together with the investment tax credits ("ITCs") receivable of \$200,000 will be sufficient to meet its current operating and capital requirements through at least 2008.

However, the Corporation's future capital requirements will depend on many factors, including revenue from the successful commercial launch of its products, continued progress in diagnostic development programs, pre-clinical and clinical evaluation, time and expense associated with regulatory filings, prosecuting and enforcing its patent claims, and costs associated with obtaining regulatory approvals. If additional financing is required, the Corporation will consider out-licensing its products under collaborative research and development arrangements, and additional public or private financing (including the issuance of additional equity securities) to fund all or a part of particular programs. There can be no assurance that additional funding will be available or, if available, that it will be available on acceptable terms. If such funding is not available, the Corporation may be forced to reduce or eliminate expenditures relating to specific programs relating to the development, testing, production or marketing of its



proposed products, or may have to obtain funds through arrangements with corporate partners that require the Corporation to relinquish rights to certain of its technologies or products. The Corporation may not be able to raise additional capital if its capital resources are exhausted.

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*The Corporation faces potential risks of product liability which may divert funding from ongoing operations and harm operating results.*

The sale and use of products under development by the Corporation entails risk of product liability. The Corporation has also agreed to indemnify numerous clinical trial sites, including The Cleveland Clinic Foundation, St. Michael's Hospital, St. Paul's Hospital, St. Joseph's Hospital, The Hamilton General Hospital, University of California, University Health Network (Princess Margaret Hospital), Hamilton Health Sciences Corporation, University of Wisconsin Medical School, Johns Hopkins University Medical Center, and AtheroGenics, Inc. (as well as under the previous agreements with McNeil) under their respective clinical trial and/or marketing agreements for such liability.

The Corporation maintains product liability insurance relating to the clinical trials that it conducts on its technologies, and believes that such insurance would be reasonably adequate to cover any torts claims that may arise against the Corporation at present. Upon commercialization of its products, the Corporation will expand its insurance coverage to include the commercial sale of the Corporation's products in the relevant territories. In addition, the Corporation maintains property, commercial general liability and tenant's legal liability insurance.

As the Corporation expands, there can be no assurance that it will be able to obtain appropriate levels of product liability insurance prior to any use of its products in clinical trials or for commercial sale. An inability to maintain insurance on economically feasible terms or to otherwise protect against potential product liability claims could inhibit or prevent the commercialization of products developed by the Corporation. The obligation to pay any product liability claim, or finance the costs of a recall of a product, could have a material adverse effect on the business, financial condition and future prospects of the Corporation.

*If the Corporation is unable to acquire future technology necessary for its products, it may be unable to commercialize new products.*

The Corporation's business depends on its ability to identify or negotiate the acquisition of or licenses for future technologies. For example, the Corporation's cancer technologies are the subject of licenses to use the technologies. The Corporation may not be able to continue to successfully identify, acquire or license technologies in the future to add to its pipeline of products.

*The loss of any key employee could impair the Corporation's ability to execute its business plan.*

The Corporation's ability to develop products will depend, to a great extent, on its ability to attract and retain highly qualified personnel. Competition for such personnel is intense. The Corporation is highly dependent on the principal members of its management and scientific staff and the loss of their services might impede the development objectives. The persons working with the Corporation are affected by a number of influences outside of the control of the Corporation. The loss of key employees may affect the speed and success of product development.

To date, the Corporation has not experienced high rates of employee turnover. As an example, the Corporation's President and Chief Executive Officer, Executive Vice President of Clinical and Regulatory Affairs, Vice President Finance and Chief Financial Officer, and Vice-President, Corporate Development, have been employed by the Corporation for 14, 10, nine and seven years, respectively. While the Corporation believes that it has been successful to date in employee retention, the Corporation may not be able to continue to attract and keep key employees.

*The Corporation is exposed to financial market risks such as interest rates and foreign exchange fluctuations.*

The Corporation is exposed to market risk related to changes in interest and foreign currency exchange rates, each of which could adversely affect the value of our current assets and liabilities. Its cash is invested in short-term,

high-grade securities with varying maturities. Since the Corporation's intention is to hold these securities to maturity, adverse changes in interest rates would not have a material effect on the Corporation's results of operations.

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The Corporation also makes commitments with foreign suppliers for clinical trials and other services. Adverse changes in foreign exchange rates could increase the costs of these services.

Changes in foreign exchange could also affect our ability to repay the convertible debentures since they are repayable in U.S. dollars on maturity in August 2009.

*Investors may encounter difficulties in enforcing civil liabilities against the Corporation in the United States.*

The Corporation is a Canadian corporation and a subsidiary, PreMD International Inc. (Switzerland), is a Swiss corporation. Substantially all of the assets of the Corporation or its subsidiaries are located in either Canada or in Switzerland and similarly, all of the executive officers, a majority of the directors of the Corporation and a majority of the experts named in this Annual Report also reside in Canada. As a result, it may be difficult for an investor to effect service of process within the United States upon the Corporation or its subsidiary, or upon such directors, executive officers and experts. Execution by U.S. courts of any judgment obtained against the Corporation, its subsidiary, or its directors or executive officers or the experts named in this Annual Report in U.S. courts would be limited to the assets of the Corporation or of such persons, as the case may be, in the United States. There is doubt as to the enforceability in Canada or in Switzerland of U.S. judgments or liabilities in original actions in Canadian or Swiss courts predicated solely upon the civil liability provisions of the federal securities laws of the United States.

### **Risks Related to the Corporation's Industry**

*Intense competition in the diagnostics industry may harm the Corporation's ability to license and develop its products.*

Technological competition in the diagnostics industry is intense. The Corporation competes with other companies to license and develop products aimed at diagnosing similar conditions. Many of these companies have substantially greater resources than the Corporation. The Corporation may not be able to continue to license the technology that it needs to stay competitive. Further, technological developments by others may render the Corporation's products or technologies non-competitive. See "Business Overview - Coronary Artery Disease Risk Assessment", "Business Overview - Colorectal Cancer Tests", "Business Overview - Lung Cancer Test", "Business Overview - Breast Cancer Test", "Business Overview - Competition" and "Business Overview - Patent and Proprietary Protection".

*Any inability by the Corporation to develop its products and comply with government regulations may hinder or prevent the development and sale of the Corporation's products.*

Prospects for emerging companies in the human diagnostics industry generally may be regarded as uncertain given the inherent nature of the industry and, accordingly, investments in such companies should be regarded as speculative. To achieve profitable operations, the Corporation, alone or with others, must successfully develop, introduce, secure regulatory clearance for, and market its products. As at the date hereof, only PREVU\* POC has received regulatory clearance from the FDA and HPB and is CE marked in Europe.

Securing regulatory clearances for the marketing of diagnostics products from the HPB in Canada and the FDA in the U.S. can be a long and expensive process, which can delay product development. In this regard, the Corporation has identified a U.S.-based regulatory affairs consultant to advise the Corporation on its regulatory applications. In order to obtain regulatory approval for a particular product, human clinical trials conducted by the Corporation must demonstrate that the product is safe for human use and shows efficacy. Unsatisfactory results obtained from a particular study relating to a program may cause the Corporation to abandon its commitment to that program. No assurances can be provided that any future human trials, if undertaken, will yield favorable results or that regulatory

approval will be granted at all. In addition, if the Corporation obtains regulatory approval for a product it may only be for limited applications, thereby hindering the Corporation's ability to widely market a product. Such events would have a material adverse effect on the Corporation's sales and profitability.

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*The Corporation may not be able to obtain reimbursement for its products as governments attempt to control rising healthcare costs.*

Reimbursement for new products has come under scrutiny in an effort to control rising health care costs. In addition to research into a product's safety and efficacy, research must also be carried out to demonstrate cost-effectiveness for reimbursement purposes. This information is required for either government (Canada or E.U.) or third-party insurer purposes (U.S.). Failure to achieve enlistment in reimbursement schedules can have a dramatic impact on a product's market penetration in the professional or laboratory market.

Recent policy initiatives in both the U.S. and Canada have advocated broader screening for the risk of cardiovascular disease and cancer. As a result, medical devices for screening and/or risk assessment for these types of disease may face an increased market potential. The Corporation may need to develop economic studies to demonstrate the cost-effectiveness of its products in identifying the risk of disease at an earlier stage.

### **Risks Related to the Corporation's Common Stock**

*The Corporation's performance and general market volatility may cause the price of the common shares to decrease.*

The volatility of the Corporation's share price may affect the trading market for the Corporation's common shares. There can be no assurance that an active trading market for the common shares will be sustained. Our share price could fluctuate significantly in the future for a number of reasons, including, among others, future announcements concerning the Corporation, quarterly variations in operating results, the introduction of competitive products, reports of results of clinical trials, regulatory developments, and intellectual property developments.

In addition, stock markets, in general, and the market for shares of biotechnology and life science companies, in particular, have experienced extreme price and volume fluctuations in recent years that may be unrelated to the operating performance or prospects of the affected companies. These broad market fluctuations may affect the market price of the Corporation's common shares.

The common shares are speculative securities. If the Corporation performs poorly in the marketing, manufacturing or sales of its products or in other areas of its business as highlighted in this section, it may cause the market price of the common shares to decline. In addition, there can be no assurance that an active trading market for the common shares will be sustained or that the trading price of the common shares will not be subject to significant fluctuations. Accordingly, an investment should be considered only by those investors who are able to make a long-term investment and can afford to suffer a total loss of their investment in the common shares. An investor should consider the merits of an investment in the common shares and should consult professional advisers to assess income tax, legal and other aspects of such an investment.

*The Corporation does not currently meet, and may not be able to regain compliance with, the continued listing standards of the American Stock Exchange (the "AMEX"). Being delisted from the AMEX could have an impact on the Corporation's ability to conduct a financing...*

The Corporation was notified in April 2007 that it was below certain of the AMEX's continuing listing standards. PreMD does not meet the AMEX requirements of Sections 1003 (a)(i) of the AMEX Company Guide for the Corporation's failure in regards to shareholders' equity of less than US \$2,000,000 and losses from continuing operations and/or net losses in two out of its three most recent fiscal years; section 1003(a)(ii) of the Company Guide with shareholders' equity of less than US \$4,000,000 and losses from continuing operations and/or net losses in three out of its four most recent fiscal years; and section



1003(a)(iii) of the Company Guide with shareholders' equity of less than US \$6,000,000 and losses from continuing operations and/or net losses in its five most recent fiscal years. The Corporation submitted a plan for regaining compliance with the AMEX continued listing standards on May 18, 2007.

The Corporation received notice on June 15, 2007 that the AMEX had accepted its plan to regain compliance with the continued listing standards, and that the Corporation's listing will be continued pursuant to an extension. The Corporation will be subject to periodic review by the AMEX Staff during the extension period, which ends on October 24, 2008. Failure to make progress consistent with the plan or to regain compliance with the continued listing standards by the end of the extension period could result in the Corporation being delisted from the AMEX.

PreMD's continued listing is contingent on its continuation to provide the AMEX Staff with updates in conjunction with the initiatives of its plan, as appropriate or upon request, but no later than at each quarter completion concurrent with the Corporation's appropriate filing with the Securities and Exchange Commission. In addition, the AMEX Staff will review PreMD periodically for compliance with its plan and progress consistent with its plan.

*The Corporation does not anticipate paying dividends on its common shares, which may affect investors who require a certain amount of liquidity on their investment.*

The Corporation does not intend to pay dividends on its common shares in the foreseeable future, and thus the only return on an investment in the common shares will come from an increase, if any, in the price of the common shares. Investors who require dividend income should not depend on or expect to receive dividends on the common shares.

#### **ITEM 4. *Information on the Corporation.***

##### **Trademarks**

PreMD™, Predict to Prevent™, Cholesterol 1,2,3™, ColorectAlert™, LungAlert™, ColoPath™, and PREVU\* (in Canada) registered trademarks of the Corporation. All other trademarks or service marks appearing in this Form 20-F are the trademarks or service marks of the companies that own them.

##### **A. *History and Development of the Corporation***

The Corporation was originally incorporated as IMI Diagnatech Inc. under the Canada Business Corporations Act on November 9, 1992. On November 3, 1997, the Corporation changed its name to IMI International Medical Innovations Inc. The Corporation was amalgamated with its wholly-owned subsidiary 2860601 Canada Inc. pursuant to the Canada Business Corporations Act on February 1, 1999. On September 27, 2005, the name of the Corporation was changed from IMI International Medical Innovations Inc. to PreMD Inc. The only material subsidiary of the Corporation is its wholly-owned subsidiary, PreMD International Inc., a corporation incorporated under the laws of Switzerland. The Corporation's head office and principal place of business is located at 4211 Yonge Street, Suite 615, Toronto, Ontario, Canada M2P 2A9, and its telephone number is 416-222-3449. The Corporation currently rents 3,500 square feet of office space at this location and 1,100 square feet of laboratory facilities at McMaster University in the new Biociences Incubation Centre, part of the Michael G. DeGroot Centre for Learning and Discovery, in Hamilton, Ontario.

To the knowledge of management of the Corporation, there have been no indications of any public takeover offers by third parties in respect of its shares or by the Corporation in respect of other companies' shares during the last and current fiscal year.



For information concerning the Corporation's capital expenditures and methods of financing, see "Operating and Financial Review and Prospects."

## **B. Business Overview**

The Corporation is a predictive medicine company dedicated to improving health outcomes with non- or minimally invasive tools for the early detection of life-threatening diseases, particularly cardiovascular disease and cancer. The Corporation's products are designed to identify those patients at risk for disease. With early detection, cardiovascular disease and cancer can be more effectively treated, or perhaps even prevented altogether. The Corporation is developing easy-to-use, accurate and cost-effective tests designed for use right at the point of care, in the doctor's office, at the pharmacy, and eventually, in some cases, right at home.

The Corporation's current pipeline of products includes:

- Coronary Artery Disease Risk Assessment Technology<sup>1</sup>
  - PREVU\* Point of Care (POC) Skin Cholesterol Test, which is cleared for sale in Canada, U.S. (CLIA-exempt) and CE-marked in Europe
  - PREVU\* LT Skin Cholesterol Test (lab-processed format), which is cleared for sale in Canada, CE marked in Europe and will be under review by the FDA in the US.
    - PREVU\* PT Skin Cholesterol Test (home, or more user friendly format), currently in development
- Cancer Technologies
  - ColorectAlert™, currently in clinical studies
  - LungAlert™, currently in clinical studies
  - Breast cancer test, currently in clinical studies

<sup>1</sup>PREVU\* POC was formerly known as Cholesterol 1,2,3™

## **Key Relationships**

### ***Strategic Relationship: McNeil Consumer Healthcare***

On May 10, 2002, The Corporation entered into an agreement, as amended on December 20, 2002 and December 9, 2005, with McNeil, to market and distribute PREVU\*, the Corporation's test for coronary artery disease, in Canada, and for the insurance laboratory field in the United States and Mexico. The amended agreement provided McNeil with exclusive rights, in these fields and territories, to the skin cholesterol test system and the future version for consumer use. The term of the agreement was 15 years and required McNeil to purchase PREVU\* and to pay ongoing royalties to the Corporation on sales, in addition to a series of financial milestone payments of up to \$3.3 million which were based on McNeil's achievement of specified annual sales levels of the licensed products.

On May 28, 2004, the Corporation completed an exclusive worldwide licensing agreement, as amended on December 9, 2005, with McNeil to sell the Corporation's skin cholesterol tests under the brand name PREVU\* Skin Sterol Test, expanding on the previous agreement.

On December 28, 2006, the agreements with McNeil were terminated and all sales and marketing rights reverted back to the Corporation. The balance of the deferred revenue, which had been received as an up-front payment, of \$2,297,400 was recorded as license revenue in 2006. In addition, the Corporation received additional license revenue of \$221,000 related to annual minimum sales levels and purchased other assets from McNeil for \$221,000, including the PREVU\* trademark for \$150,000.

The Corporation is currently pursuing several options to market the PREVU\* skin cholesterol test, including direct sales in certain markets, marketing licenses to multinational healthcare companies and distribution agreements in

specific marketing territories.

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**Research Agreement: ColorectAlert™**

Subsequent to the year end, on January 5, 2007, the Corporation settled litigation relating to the ColorectAlert™ License Agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11 AG (“Med-11”), the Corporation agreed to pay \$175,000 to Med-11 and amended the agreements to replace Dr. Shamsuddin with Med-11 as the licensor. This amount was expensed in 2006 as general and administration expense. The amendment also reduced the royalty payable by the Corporation from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Corporation may have been required to pay under the initial agreements.

**Convertible Debenture Financing**

On August 30, 2005, the Corporation completed a private placement financing of convertible debentures, maturing on August 30, 2009, for gross proceeds of \$9,828,000 (US\$8,210,000) less issue fees and expenses of \$913,000 (resulting in net proceeds of \$8,915,000). The unsecured debentures bear interest at an annual rate of 7% (effective rate of 12.75% on the liability component) payable quarterly in cash or common shares at the Corporation’s option. The number of common shares issuable in satisfaction of interest payments is dependent on the trading price of common shares at the time of the applicable interest date. The debentures are convertible into common shares at any time during the term, at the option of the holder, at \$3.47 per share (subject to adjustment). If all the debentures were converted to common shares, it would result in the issuance of an additional 2,882,195 common shares. Purchasers of the convertible debentures also received warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per common share (subject to adjustment). At any time after one year from the date of issuance of the warrants, the warrants may also be exercised by means of a cashless exercise by the holder. On August 25, 2006, \$475,441 (US \$430,000) of the debentures were converted into 150,877 common shares of the Corporation, which resulted in a reclassification of \$357,304 of the liability, \$140,137 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital.

Under Canadian GAAP, the convertible debentures are bifurcated into separate liability, equity and warrant components, net of pro rata issue fees and expenses, as described in note 5 to the consolidated financial statements.

Under U.S. GAAP, the conversion feature of the convertible debentures is recorded on the consolidated balance sheet as a derivative liability with subsequent changes in value recorded through earnings, as described in note 10 to the consolidated financial statements.

**March 2007 Private Placement**

On March 27, 2007, the Corporation completed a private placement for gross proceeds of \$3,879,965. Under the terms of the private placement, PreMD issued 2,917,268 units at a price of \$1.33 per unit, each unit consisting of one common share and one half of one common share purchase warrant. Each whole warrant is exercisable at a price of \$1.66 per share for a period of three years from the closing date. The proceeds from the private placement are to be used for general corporate purposes.

The placement occurred with Midsummer Investment, Ltd. and several additional existing institutional investors. The common shares issued at closing and the shares issuable upon exercise of the warrants are subject to a Canadian statutory hold period for four months and a day after the closing date. In addition, the common shares issued at closing and the shares issuable upon exercise of the warrants were not registered with the United States Securities and Exchange Commission (the “SEC”) or the securities commission of any state, in reliance upon one or more exemptions from the securities registration requirements pursuant to the Securities Act of 1933, as amended (the “Securities Act”). In connection with the placement the Corporation has agreed to prepare, and use its commercially

reasonable best efforts to file with the SEC, on or before the date which is 120 days after the closing date of the transaction, a registration statement covering the resale of all of the common shares issuable at closing and the common shares issuable upon exercise of the warrants (the "Registrable Securities"). PreMD has agreed to use its

commercially reasonable best efforts to cause the registration statement to be declared effective under the Securities Act as promptly as possible after the filing of the registration statement, and will use its commercially reasonable best efforts to keep the registration statement continuously effective under the Securities Act until all Registrable Securities have been sold or may be sold without volume restrictions pursuant to Rule 144(k). PreMD is subject to material penalties if it is unable to fulfill these obligations pursuant to a registration Rights Agreement associated with this financing.

## **Business Strategy**

### *Identify and Target Significant Markets with Unmet Needs*

The Corporation focuses its efforts on medical conditions where there is a well-defined global need and demand for tests to detect serious or life-threatening diseases. The Corporation's products address cardiovascular disease ("CVD") and cancer, diseases where early detection, intervention and ongoing monitoring can significantly improve patient outcomes. CVD claims the lives of 17 million people worldwide each year, and has no geographic, gender or socio-economic boundaries (*World Health Organization World Health Report, 2004*). Colorectal, lung and breast cancers combined kill approximately 2 million people annually worldwide (*Globocan 2002, Cancer Incidence, Mortality and Prevalence Worldwide. International Association for Cancer Research (IARC), Cancer Base No. 5, Version 2.0, IARC Press, Lyon, 2004*).

### *Ensure a Multiple Product Pipeline*

The Corporation pursues sustained development by building and maintaining a portfolio of products at different stages, which helps to mitigate risk while enhancing opportunities to generate value for stakeholders. The Corporation continuously assesses other possible applications of its technologies. In addition, the Corporation continues to seek out and evaluate new, proprietary technologies that have undergone initial proof-of-principle tests and that offer clear cost/benefit trade-offs to products currently available. After identifying and evaluating an appropriate technology, the Corporation purchases or in-licenses the related patents and know-how, completes the development of prototypes and defines the manufacturing protocols. Where appropriate, the Corporation conducts clinical trials to obtain regulatory approval and registers the product for sale.

The Corporation invests substantially all of its funds in product and clinical development, as opposed to basic research. By investing in this phase of development, management of the Corporation believes that it can add value for its shareholders and avoid the more expensive, riskier research stage of the product development cycle.

### *Maintain a Strong Clinical Program*

The Corporation maintains a strong clinical program. The Corporation's objectives are to advance product development and to build a critical mass of data to support new regulatory claims and indications for use. The Corporation's clinical program, along with the publications and presentations it generates, enhances the scientific validation and credibility of the Corporation's products. In turn, this validation improves strategic partnering opportunities and helps to expand the potential commercial market for the Corporation's tests.

### *Pursue Strategic Relationships*

The Corporation pursues a strategy of building collaborative relationships with leading companies to conduct clinical trials and to assist with the development of its products. The Corporation also seeks, at the appropriate time, to out-license its products to major diagnostic, pharmaceutical or consumer goods companies, which could be responsible for any or all of the related marketing, sales, manufacturing and distribution. Such out-licenses could include research and development support, upfront and milestone payments and an ongoing royalty interest on the

sales of these products. This strategy allows the Corporation to minimize the expenses and risks of commercialization. In addition, through these relationships, the Corporation gains the benefit of others' expertise, which enhances the ability of the Corporation to pursue multiple product opportunities.

*Establish and Maintain Strong Intellectual Property Portfolio*

Patents and other proprietary rights are essential to the Corporation's business. The Corporation continuously seeks to file patent applications to protect technology, inventions and improvements to technology or inventions that are considered important. Such applications may cover composition of matter, the production of active ingredients and their novel applications. The Corporation has acquired, by license or assignment, rights to patents and applications filed in Canada, the U.S. and internationally. The Corporation also relies upon trade secrets, non-patented proprietary know-how and continuing technological innovation to develop and maintain its competitive position.

The Corporation currently owns patents for technology for coronary artery disease ("CAD") risk assessment that measures skin tissue cholesterol to help determine an individual's risk of CAD, and has acquired a license to technologies used to detect the presence of a marker intended for use in colorectal, lung and other cancers. In addition, the Corporation has patents pending for color measurement in biological reactions and skin striping for cholesterol measurement (See "Business Overview - Patent and Proprietary Protection"). The Corporation believes that these innovative technologies will fulfil market needs through their ease-of-use and by contributing to cost-effective patient health management.

*Leverage Management's Scientific, Product Development and Commercialization Expertise*

The Corporation is led by an experienced group of individuals with significant industry expertise in the areas of research, regulatory affairs, new product launches, sales and marketing, and finance.

**Industry Overview**

*The Market for Disease Detection or Biomarkers*

According to the most recent United States Census Bureau data, published in 2000, the U.S. population aged 65 and older is projected to double by 2030 from an estimated 35.3 million, or approximately 12% of the population, in 2003. The Census Bureau projects that the 65-plus population will number 39.7 million people in 2010, 53.7 million in 2020 and 70.3 million, or 20% of the U.S. population, in 2030. The number of Americans above the age of 65 in 1940 was approximately 8.9 million, or about 7% of the population at that time. As people age, the incidence of disease, including cardiovascular disease and cancer, increases.

The aging population has contributed to a dramatic growth in total healthcare spending. In 2004, U.S. health care spending accounted for approximately 15.3% (U.S. Department of Health and Human Services, as cited in the New York Times, January 9, 2004).

As a result of increasing expenditures, cost containment strategies are being evaluated and implemented by governments and private payers around the world. Management believes that technologies that help to detect disease early and reduce health care costs, especially if quality of care is not adversely impacted, should represent a significant market opportunity. Healthcare cost containment efforts are also shifting treatment focus away from hospitals to less expensive alternative care sites.

Technological advances have created more effective, easy-to-use devices that have allowed risk assessment to be moved closer to the patient. This has resulted in the earlier identification and the initiation of therapy or prevention at an earlier stage in the healthcare process. Management believes that point-of-care or self-testing is optimal because it permits immediate feedback to the patient or medical practitioner, rather than requiring additional and delayed patient contact to provide and explain results. It also reduces the need for costly return visits to the doctor and avoids the expense of specimen collection, preservation, transportation, processing and results reporting by laboratories. In some cases, hospitals, health maintenance organizations ("HMOs"), health departments and corporations view screening as an



effective way to reduce overall medical costs.

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As a result, the use of screening and monitoring diagnostics for early intervention, improved treatment and monitoring is becoming an important component of managed health care. This trend toward greater use of point-of-care and self-diagnosis began in the early 1980s and is expected to continue. Examples of such tests include those for cholesterol, glucose, pregnancy, ovulation and various urine components. Management believes that the factors discussed above will lead to increases in the use of devices of the type that the Corporation currently intends to commercialize.

Several large companies, including Abbott Laboratories Limited, Bayer Inc., Beckman Coulter Inc., Becton Dickinson, Johnson & Johnson and Roche Diagnostics Systems, dominate the medical device and diagnostics industry. Relative to the pharmaceutical industry, product development is generally characterized by lower development costs, shorter regulatory timelines and a shorter time to market. These advantages may be offset by somewhat lower margins as compared to the pharmaceutical industry.

### ***The Point-of-Care Market***

Theta Reports projected strong growth in the worldwide market of total point-of-care tests performed in a professional setting (in a physician's office, at a pharmacy, etc.) from 2000 to 2005. Specifically, in 2000, Theta Reports (*Theta High Growth Diagnostic Markets, Report No. 1045, Sept. 2000*) projected the worldwide market of total point-of-care tests performed in a professional setting (in a physician's office, at a pharmacy, etc.) to be almost US\$2.3 billion. For 2005, Theta projected this market to increase to approximately US\$3.8 billion. Approximately 50% of these point-of-care tests are sold in North America and approximately 25% are sold in Western Europe.

### ***The Home Testing Market***

Complementing the trend towards increased use of point-of-care diagnostics is the expanding market for self-testing and home-use diagnostic tools which are generally available at pharmacies as over-the-counter products. The growth of this market has been attributed to the following four main factors:

- greater awareness of personal wellness and the increasing role by individuals in health maintenance;
- a health-conscious and aging population which is placing a growing emphasis on preventative care;

• technological advances that have improved both the ease-of-use and accuracy of diagnostic products, thereby gaining greater support from medical practitioners; and

- availability of over-the-counter ("OTC") products and other therapies to treat serious diseases.

New emerging diagnostic and monitoring trends are expected to help to detect disease early, thereby speeding patient recovery and reducing long-term medical expenses. Between 2002 and 2007, the global OTC market for home diagnostic testing is expected to increase by 49%, at a compound annual growth rate of 8.3% (*PJP Publications Ltd., 2003*). The U.S. dominates the global market for OTC diagnostic testing. In 2002, the total U.S. home testing market was valued at US\$2.65 billion (*Greystone Associates, Cholesterol Monitoring: Self-Testing Markets and Opportunities, 2003*).

### ***Channels of Distribution***

Until recently, most complex diagnostic procedures were performed in hospitals with in-house laboratories and in centralized clinical laboratories. As a result, sales and distribution efforts by manufacturers of diagnostic products have focused on such laboratories. This market has been, and continues to be, serviced almost entirely by large,

integrated marketing and distribution companies. These

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large companies maintain strong sales and marketing departments including salespeople calling directly on physicians' offices. However, technological advances resulting in new and/or improved product offerings are changing the market. This product innovation has allowed for expanded use of complex diagnostic products in doctors' offices, corporate health centres and the home. The result is a greatly expanded set of potential markets with a similarly expanded set of distribution channels.

Management of the Corporation anticipates that several of the Corporation's products will extend into these new market segments. With its initial products, the Corporation anticipates establishing strategic alliances with pharmaceutical, diagnostic or consumer goods companies. Such companies would ideally offer conventional distribution networks supplemented by direct selling to select markets such as work sites, community health centres, preventive care facilities or home care networks.

### **Coronary Artery Disease ("CAD") Risk Assessment: The Role of Skin Cholesterol**

#### *Skin Cholesterol Pathology*

Coronary artery disease caused by atherosclerosis (the hardening and narrowing of the arteries) remains the number one cause of morbidity and mortality in North America and many other parts of the world. Prevention and intervention require the cost-effective identification of those individuals not only having the disease but also those at risk of developing the disease. A desired goal is a simple and widely available method for identifying high-risk individuals. Therefore, there is currently much interest in determining levels of marker molecules that are able to predict risk of atherosclerotic disease.

Traditionally, methods of blood plasma total cholesterol levels have been widely used to determine risk of atherosclerosis. Cholesterol is a soft, waxy substance that is produced by the body, as well as obtained from eating certain foods, such as meat, eggs, and other animal products. The deposit of cholesterol on to damaged blood vessel walls results in the development of a lesion that eventually reduces the intravascular space as well as the flexibility of the afflicted blood vessel wall. The resulting condition is known as atherosclerotic plaque, which contributes to increased risk for coronary artery disease, angina pectoris, sudden cardiac death, stroke and peripheral vascular disease.

Plasma total cholesterol levels ("TC") (sometimes referred to as serum lipid levels), alone do not accurately predict risk of atherosclerosis. Better results have been obtained through measurement of plasma lipoproteins. Cholesterol is transported in the blood by plasma lipoproteins. Four major lipoprotein classes can be identified on the basis of their physiochemical properties: chylomicrons, very low-density lipoproteins, low density lipoproteins ("LDL") and high-density lipoproteins ("HDL"). For example, LDL fractions contain 75% of the blood cholesterol and are associated with deposits on artery walls. In contrast, HDL fractions bind to some of the cholesterol in blood and transport it to the liver where it is metabolized. Thus, in general, elevated LDL, in the absence of elevated HDL, is associated with atherosclerosis whereas elevated levels of HDL, alone are associated with lower levels of disease.

High cholesterol and other lipid disorders are among the world's most widespread chronic health problems. In the United States, the National Cholesterol Education Program ("NCEP") was launched by the United States National Institutes of Health (the "NIH") in 1985 as part of a nationwide effort to reduce the prevalence of high blood cholesterol. The NIH recommends that the least expensive way to reduce CAD is through a public health approach that targets the entire population to reduce the major risk factors for heart disease, including cholesterol from dietary intake. Most Americans are now aware that high cholesterol levels increase their risk of having heart disease.

Although the NCEP ATP III experts' panel (NCEP Report of the Expert Panel on Detection, Evaluation and Treatment of High Blood Cholesterol in Adults, (Adult Treatment Panel III) 2001) recommends that all Americans

over the age of 20 have their blood cholesterol measured at least once every five years, standard tests may not adequately predict the risk of cardiovascular disease.

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Additionally, all plasma measurements require blood sampling after a long period of fasting so that dietary cholesterol does not interfere. The sampling is invasive, uncomfortable and carries some small risk of infection. These tests may be highly variable in results over a series of days. Furthermore, analysis of the sample requires complicated and expensive equipment.

In many cases, the levels of plasma cholesterol and lipoproteins do not correlate with the extent of atherosclerotic disease. There is a need for assaying other marker molecules that reflect the extent of atherosclerosis and provide a risk assessment of cardiovascular disease. Significant amounts of cholesterol occur in tissue in addition to the cholesterol found in plasma. Increased levels in tissue have been shown to reflect the presence and extent of atherosclerosis.

*Market*

NIH guidelines provide that individuals (all adults over 20 years of age and children over the age of two with a family history of high total cholesterol or heart disease) with satisfactory total cholesterol values should have their cholesterol tested every five years, individuals with borderline high TC should have a lipid test repeated annually, and those with high TC should have at least three lipoprotein tests conducted to confirm their values and to help their physician decide what therapy, if any, should be instituted. Individuals receiving diet or drug therapy may be re-tested every three to six months to track the effectiveness of the therapy.

Since the inception of the NCEP, the market for cholesterol and other risk assessment tests has experienced significant growth. A study in the “Morbidity and Mortality Weekly Review”, United States Center for Disease Control, September, 2000, reported that the percentage of Americans who have had their cholesterol checked jumped from 67% in 1991 to 71% in 1999. In a 2006 report, the American Heart Association estimates that approximately 100 million American adults, representing nearly half the U.S. adult population, had elevated cholesterol levels and about 35 million American adults had cholesterol readings over the danger level (240 mg/dL or higher). Clinical laboratories in the U.S. are estimated to perform approximately 250 million cholesterol tests per year and another 290 million clinical laboratory tests are performed in the rest of the world.

The economic impact of cardiovascular disease on the U.S. health care system is growing larger as the population ages. The American Heart Association projects the total cost (including direct health expenditures as well as lost productivity) of cardiovascular diseases to reach US\$403 billion (*American Heart Association, Heart Disease and Stroke Statistics, 2006*). In 2003, the total cost of cardiovascular disease was estimated at US\$351 billion (*National Center for Chronic Disease Prevention and Health Promotion*).

While blood cholesterol remains an important risk factor for heart disease, it is widely accepted that several risk factors for CAD must be considered to provide an accurate picture of absolute risk of disease. Absolute cardiovascular disease risk is determined by a combination of all cardiovascular risk factors present, and accurate assessment of risk level is key to effective treatment and risk management. Other traditional risk factors include:

- gender
- increasing age
- heredity
- tobacco smoking
- high blood pressure
- physical inactivity
- diet
- obesity
- diabetes mellitus



A number of other emerging factors that have demonstrated a link to heart disease include C-reactive protein (“CRP”), homocysteine, carotid intima-media thickness (“CIMT”), electron-beam tomography for coronary calcium, ankle/brachial blood pressure index and soluble intercellular adhesion molecule (“ICAM-1”), among others.

Many of these factors are costly to measure or assess, are resource intensive and inappropriate for a primary care setting, and require invasive procedures. The Corporation has developed a more reliable, patient-friendly and cost-effective tool, PREVU\* Point of Care (“POC”) Skin Cholesterol Test, that assesses patients at high risk of coronary artery disease and can be used to monitor their risk status over time.

The Corporation has adapted the PREVU\* technology into a lab-processed format, called PREVU\* LT, aimed primarily at the life insurance testing industry. Like PREVU\* POC, PREVU\* LT is administered painlessly and rapidly, without fasting, needles or blood sample required. The testing procedure samples surface skin cells from the palm of the hand using a specially designed adhesive tape, which is then sent to a laboratory where the surface is assessed for skin cholesterol levels. This test is currently in clinical trials.

A third product designed for home use, PREVU\* PT Skin Cholesterol Test, is undergoing internal validation and stability studies.

### *The Opportunity*

Most patients who develop CAD have at least one major risk factor that exceeds recommended levels. These higher-risk patients can benefit the most from additional risk stratification testing. Emerging evidence supports the use of non-invasive tests, such as skin cholesterol, to detect subclinical, or hidden, disease. Identifying patients with high subclinical cardiovascular disease is key to preventing a first cardiac event and reducing the overall burden of heart disease. The Corporation believes that PREVU\* Point of Care Skin Cholesterol Test is a valuable tool for risk stratification in the primary, or point of care, prevention of CAD. See “Information on the Corporation - Business Overview - Coronary Artery Disease (CAD) Risk Assessment”.

### *Skin Cholesterol Pathology*

In 1993, PreMD acquired the patent rights underlying PreMD’s skin cholesterol technology for the U.S., Canada and Western Europe and later expanded its intellectual property rights covering such technology. See “Business Overview - Patents and Proprietary Protection”.

Since the mid-1960s, scientists have tried to measure skin cholesterol as a marker for cardiovascular disease, recognizing it had the potential to provide additional information about CVD risk. Skin contains over 11% of the body’s cholesterol and ages in parallel with vascular connective tissue. Thus, as blood vessel walls accumulate cholesterol, it is believed that skin accumulates cholesterol. This has led to the hypothesis that skin may be a better source of estimating CAD than blood cholesterol testing. A number of studies carried out in the 1970s and early 1980s, largely in Europe, have provided evidence in support of this hypothesis. The results of these studies indicate that:

- skin cholesterol levels were found to be higher in individuals with abnormal coronary angiograms than in those with normal coronary angiograms;

- skin cholesterol levels were found to be elevated in individuals with hyperlipoproteinemia compared to those with normal serum lipid levels; and

-



skin cholesterol levels were elevated in individuals having coronary bypass surgery compared to age-matched healthy controls.

In most of the prior studies, skin cholesterol was estimated after extraction from tissue sample using organic solvents. Thus the nature of the sample precluded its use in general clinical practice.

*The Corporation's Cardiovascular Products*

PREVU\* POC Skin Cholesterol Test, formerly known as Cholesterol 1,2,3™, is a non-invasive test that evaluates the amount of cholesterol accumulated in a patient's epidermis (skin) surface. The test is conducted in three minutes in two separate steps on the palm of the hand. In the first step, a drop of chemical solution consisting of a cholesterol-binding agent and an enzyme, linked together by a synthetic copolymer, is placed on the hand for one minute. This solution binds to the skin's cholesterol-rich surface layer. After one minute the excess solution is blotted dry, leaving only that part of the solution that is bound to epidermal cholesterol. In the second step, a drop of indicator solution, containing a dye in a colorless form, is placed on the same area of the hand and reacts when it contacts the enzyme, which is bound to epidermal cholesterol. As a result, a color change reaction is created. After only two minutes, a hand-held color measurement instrument, that is connected to a computer, reads this reaction and produces a numerical result.

PREVU\* POC is packaged in a 40-test kit that contains three dropper bottles consisting of a binding solution, an indicator solution and a positive control, as well as 40 adhesive-backed pads. In addition, a patented hand-held instrument is used to measure the color change and provides a skin cholesterol value. The results of this test give an indication of the patient's CAD risk.

PREVU\* POC has a shelf life of 24 months. Management of the Corporation believes that this test is inexpensive to produce and will be cost competitive with current alternative tests. PREVU\* POC is designed for use at the point of care and is being marketed to the professional medical community, including physicians, laboratories, clinics and pharmacies.

*Development History and Clinical Findings*

Validation of the synthesis of the chemicals comprising the binding solution of PREVU\* POC was conducted at McMaster University, Hamilton, Ontario ("McMaster"), pursuant to a research service agreement executed in April 1997, as amended in October 2000, between McMaster and the Corporation. From November 2000 until October 31, 2005, the Corporation provided research and development sponsorship funding to McMaster. In consideration for this sponsorship, the Corporation had the right to use of laboratory facilities at McMaster as well as the right of first refusal for a license for any intellectual property created as a result of the funding. The Corporation is currently evaluating several new technologies generated by the research program. On November 17, 2005, the Corporation leased new laboratory facilities at McMaster University in the new Biosciences Incubation Centre, part of the Michael G. DeGroot Centre for Learning and Discovery.

The following table summarizes the key development and clinical evaluations of the Corporation's skin cholesterol test to date:

| DESCRIPTION   | INVESTIGATOR        | PRIMARY STUDY SITE   | OBJECTIVES   | OUTCOME  | PUBLICATIONS/PRESENTATIONS   |
|---|---------------------|--|--|--|--|
| <b><u>PREVU* Skin Cholesterol Test: Completed Studies</u></b> |                     |  |  |  |  |
| Skin cholesterol and stress test                              | Dr. Dennis Sprecher | The Cleveland Clinic Foundation  | Determine relationship between skin cholesterol and serum lipid levels; measure correlation of skin cholesterol to stress test outcome | Skin cholesterol shown to correlate with presence of cardiovascular disease (as measured by stress test outcome) “independent[ly] of serum lipids”. Researchers concluded that skin cholesterol may be a better predictor of stress test outcome than serum cholesterol. | Presented at 31st Annual Oak Ridge Conference, 1999. Published in <i>Journal of Clinical Chemistry</i> in 2001                                       |
| Skin cholesterol and response to therapy                      | Dr. Dennis Sprecher | The Cleveland Clinic Foundation  | Determine ability of skin cholesterol to monitor patient response to lipid-lowering medications  | Skin cholesterol may have utility in monitoring response to cholesterol-lowering therapies   | Presented at American Association for Clinical Chemistry annual meeting in 1999  |
| Measuring skin cholesterol levels to assess CAD               | Dr. Dennis Sprecher | The Cleveland Clinic Foundation; The Canadian Heart Research Centre; The | Correlation between skin cholesterol and angiography outcome   | Skin cholesterol shown to increase with extent of disease as measured by coronary angiography, the gold standard for diagnosis of CAD, and to provide new  | Presented at American Heart Association (AHA) annual meeting, 2000; presented at Arteriosclerosis, Thrombosis and Vascular Biology annual meeting in |

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information with respect to risk assessment for CAD. Skin cholesterol and serum levels of total cholesterol were not correlated. Additionally, patients with a history of myocardial infarction had a significantly higher skin cholesterol level.

2002; published in journal *Atherosclerosis* in 2003; presented at Arteriosclerosis, Thrombosis and Vascular Biology annual meeting in 2005; published in *Atherosclerosis* in August 2005

Skin cholesterol and other markers of CAD risk

Dr. John Mancini

University of British Columbia; St. Paul's Hospital

Determine correlation of skin cholesterol to other measures of CAD risk, including carotid sonography, flow-mediated brachial vasoactivity and serum markers.

Skin cholesterol correlates to Framingham Global Risk Score and inflammatory markers, notably ICAM-1

Published in *American Journal of Cardiology* in 2002

| DESCRIPTION                      | INVESTIGATOR           | PRIMARY STUDY               |  |  | PUBLICATIONS/<br>PRESENTATIONS   |
|----------------------------------|------------------------|-----------------------------|--|--|--|
|                                  |                        | SITE                        | OBJECTIVES   | OUTCOME  |  |
| Pediatric skin cholesterol study | Dr. Katherine Morrison | St. Joseph's Hospital       | Examine skin cholesterol levels in children with hypercholesterolemia          | Skin cholesterol can be reliably measured in children  | Presented at the 2003 Endocrine Society Annual Meeting   |
| Skin cholesterol and statins     | Dr. Marcus Reiter      | University of Vienna        | Examine skin cholesterol response to certain cholesterol-lowering medications  | Patients treated with statins experienced decreases in skin cholesterol values as well as in blood cholesterol; initial data shows that skin cholesterol may be a useful monitoring tool for patients taking statins | Data published in <i>Journal of Clinical Chemistry</i> in January 2005   |
| Skin cholesterol and carotid IMT | Dr. James Stein        | University of Wisconsin     | Measure relationship between skin cholesterol and CAD using carotid IMT (CIMT) | Skin cholesterol has strong correlation to increased CIMT, an established risk predictor of heart attack and stroke  | Data presented at American College of Cardiology annual meeting, March 2005; published in <i>American Heart Journal</i> , December 2005                |
| PRACTICE                         | Dr. Milan Gupta        | William Osler Health Centre | Examine skin cholesterol levels in South Asians                                | Interim data confirmed that skin cholesterol provides new information about a patient's risk of CAD. Skin cholesterol may have value in stratifying patients with established CAD who have been treated with         | Data presented at Canadian Cardiovascular Congress in October 2004; further data presented at Canadian Cardiovascular Congress in October 2005 and the |

cholesterol-lowering medications. Further data presented in 2005 showed that patients who have both high skin cholesterol and high levels of C-reactive protein have an increased risk of metabolic syndrome

Arteriosclerosis, Thrombosis and Vascular Biology conference in April 2006

**PREVU\***  
**Skin**  
**Cholesterol**  
**Test:**  
**Ongoing**  
**Studies**

|         |   |   |  |   |                           |
|---------|---|---|--|---|---------------------------|
| PREPARE | Dr. David Waters;<br>Dr. Dennis Sprecher;<br>Dr. John Mancini | Various, in life insurance testing industry | Relationship between skin cholesterol (PREVU* LT) and risk of CVD as estimated by Framingham score | Data has been used for regulatory submissions | Manuscript being prepared |
|---------|---|---|--|---|---------------------------|

| DESCRIPTION  | INVESTIGATOR                   | PRIMARY STUDY SITE   | OBJECTIVES  | OUTCOME                       | PUBLICATIONS/ PRESENTATIONS |
|--|--------------------------------|--|---|-------------------------------|-----------------------------|
| PASA   | Dr. James Stein                | University of Wisconsin and five other U.S. sites                  | Relationship between skin cholesterol (PREVU* POC and PREVU* LT) and CAD using carotid IMT in a screening population  | 510 (K) submitted to U.S. FDA | Manuscript being prepared   |
| ARISE<br>(Aggressive Reduction in Inflammation Stops Events) | Dr. Rob Scott                  | AtheroGenics, Inc.; study conducted at multiple sites around world | Study will examine skin cholesterol (PREVU* POC) changes in response to AtheroGenics' AGI-1067 therapy. Trial will also provide data on relationship between skin cholesterol and primary cardiovascular events | Anticipate data in Q3 2007    |                             |
| Correlation study  | Dr. Jean-Claude Tardif         | Montreal Heart Institute   | Trial will evaluate the correlation between PREVU* POC and PREVU* LT.   | Anticipate data in Q3 2007    |                             |
| Skin cholesterol and new CAD risk markers                    | Dr. John Mancini;<br>Dr. Sammy | University of British Columbia                                     | Study will examine relationship   | Anticipate data in Q3 2007    |                             |

Chan;  
Dr. Jiri Frolich

between skin cholesterol (PREVU\* POC and PREVU\* LT) and a variety of new and established cardiovascular risk markers in high-risk patients. It will also examine how skin cholesterol responds to various therapies

MESA (Multi-Ethnic Study of Atherosclerosis) sub-study

Dr. Pamela Ouyang

National Heart, Lung and Blood Institute; Johns Hopkins Bayview Medical Center

Study examining correlation of skin cholesterol (PREVU\* POC) to early markers of CAD across different ethnic groups

Interim data demonstrated that skin cholesterol levels correlated with the presence and extent of coronary calcification

Interim data presented at American Heart Association in 2003; interim data published in *Atherosclerosis* in July 2005

All Comers' study

Dr. Dennis Sprecher

The Cleveland Clinic Foundation

Study examining relationship between skin cholesterol and Framingham Global Risk Score and other markers of CAD in patients suspected of having CAD. Trial includes PREVU\* POC and PREVU\* LT

Study completed





### *Regulatory Clearance*

In January 2001, regulatory clearance was granted by the HPB for sale of PREVU\* POC in Canada for risk assessment of coronary artery disease.

In June 2002, the Corporation received FDA clearance for sale of PREVU\* POC in the U.S. as part of risk assessment for coronary heart disease in persons with a history of myocardial infarction and/or persons suspected of having significant multi-vessel coronary artery disease (>50% stenosis in >1 vessel as diagnosed by coronary angiography) where further diagnostic evaluation is being considered. Test results, when considered in conjunction with clinical evaluation, blood cholesterol tests and other risk factors identified for coronary artery disease, will aid the physician in focusing diagnostic and patient management options.

On September 5, 2002, the Corporation CE-marked PREVU\* POC, enabling the Corporation to sell this product in Europe as part of a risk assessment for coronary artery disease. The product was registered with the Competent Authority in the U.K. Registrations with Competent Authorities of other European Union Member States can follow after translation of the labelling for PREVU\* POC in their respective languages has been completed.

In 2006, the PREVU\* POC handheld spectrophotometer received FDA clearance, a class II license in Canada, and was CE-marked. PREVU\* LT received a class II license in Canada and was CE-marked.

### *Production and Services*

On May 14, 1999, the Corporation entered into a supply agreement (the “X-Rite Agreement”) with X-Rite, Inc. (“X-Rite”), a Michigan-based corporation, under which X-Rite agreed to develop and supply the Corporation with a hand-held instrument (the “X-Rite Instrument”) and related software for skin cholesterol testing in a professional setting. The X-Rite Instrument measures the color of the reagents on the palm of the hand and provides a quantitative skin cholesterol result. The X-Rite Agreement expired in May 2005, however, the Corporation will continue to order instruments from X-Rite as required.

On June 19, 2001, the Corporation entered into an exclusive agreement with Diagnostic Chemicals Limited (“DCL”) to manufacture and supply the Corporation with PREVU\* POC test kits for the U.S. and Canada. The term of the DCL agreement is five years, renewable annually thereafter, unless earlier terminated by either party upon the material breach by the other party or by the Corporation with 180 days’ notice or by DCL with 12 months’ notice.

On March 30, 2007, the Corporation entered into a manufacturing services agreement with Jabil Circuit, Inc. (“Jabil”) to manufacture and supply the Corporation with an electronic spectrophotometer. The term of the agreement is five years, renewable annually thereafter, unless earlier terminated by either party upon the material breach by the other party or with twelve months’ notice.

The Corporation adheres to Good Manufacturing Practices, or GMP, which is a critical component in ensuring quality. GMP, a universal concept throughout the medical device industry, refers to internationally accepted quality standards for ensuring that products are produced in a consistent and controlled way. GMP regulations are the minimum requirements that must be adhered to when manufacturing, processing, packing, or holding a medical device. Following these regulations gives assurance that the device has the required safety, identity, and quality characteristics.

The Corporation has established and maintains a quality system to ensure high standards of production and operational quality, and inventory management, which extends to third-party suppliers of components or services. Subsequent to fiscal year end, in February 2006, the Corporation received ISO 13485: 2003 Quality System

Certification from a Canadian Medical Device Conformity Assessment System (CMDCAS)-recognized registrar. This certification confirms that the Corporation meets the highest international standards for quality control and customer service. The Corporation previously received ISO 13488:1996 Quality System Certification in October 2003.

### *Marketing and Distribution*

In 2006, the Corporation's cardiovascular products were marketed by McNeil Consumer Healthcare under an exclusive, worldwide licensing agreement. Please see "History and Development of the Corporation - Key Relationships."

### *Competition*

The measurement of cholesterol is currently conducted through blood-based analysis. The Corporation is not aware of any other test currently marketed or in development that non-invasively measures skin cholesterol. The Corporation is aware that research has been undertaken using other testing approaches that employ body fluids. For example, Nymox Pharmaceutical Corporation is developing technology that uses saliva to determine cholesterol levels. Other researchers are examining testing approaches that employ tears. The stage of development of such approaches is unknown. See "Risk Factors".

The cholesterol testing market can be divided into three distinct segments: (i) the point-of-care segment; (ii) the clinical laboratory setting; and (iii) the home-use segment. Currently, the majority of cholesterol testing is performed in a clinical setting, which includes hospital-based and independent laboratories. These facilities employ sophisticated multi-test analyzers, which perform a wide range of blood-based diagnostic tests. These analyzers are manufactured by companies such as Beckman Coulter, Ortho Clinical Diagnostics, Roche Diagnostics Systems, Abbott Laboratories Limited and Bayer, Inc. They must be operated by skilled technicians, and, for certain tests, the pre-treatment of the blood samples is required.

In the point-of-care market, desktop analyzers have been developed, offering a more limited range of tests than clinical analyzers. These devices offer ease-of-use and immediacy of results as primary advantages over clinical analyzers, which are usually distantly located from the patient. These point-of-care tests are all invasive, requiring, at a minimum, a lancet puncture to the finger for blood to conduct the test. Some of the firms involved in the development or marketing of such products include Roche Diagnostics Systems, Lifestream Technologies, Inc. and Cholestech Corporation. Another U.S.-based company, Chematics, Inc., is marketing a point-of-care, three-minute blood-based test that is available on a mail-order basis.

The Corporation believes that its skin cholesterol tests will compete effectively in the point-of-care and laboratory-testing markets based on a combination of accuracy, ease-of-use, non-invasive, immediacy of results and cost effectiveness. The Corporation's technology is supported by strong scientific validation, including a number of published papers and presentations. This validation could play an important role in enhancing the endorsement and adoption of skin cholesterol testing by the medical community.

### *Key Markets*

The Corporation envisions the following markets or marketing strategies for its suite of PREVU\* tests:

***Risk assessment by physicians.*** This market includes primary care physicians, hospitals and managed care organizations as well as various healthcare providers and programs, such as screening and preventive cardiology clinics where cardiovascular risk assessment is conducted.

***Risk assessment outside physicians' offices.*** This market includes retail pharmacies and in-store health clinics, large employers that offer health and wellness programs, wellness clinics or service providers, and natural health clinics or service providers.

- ***Screening for insurance risk assessment.*** The market for insurance testing represents a significant opportunity for PREVU\* LT throughout North America. About 14 million new insurance policies are granted every year, approximately 6.25 million of which include screening performed using oral fluid testing and/or blood (*American Council of Life Insurers: Life Insurance Fact Book, 2004*).





### *Market*

The American Cancer Society projected that in 2006 there would be an estimated 148,610 new cases of colorectal cancer in the U.S. and more than 55,170 deaths (accounting for 10% of all cancer deaths) resulting from the disease. This relatively high mortality rate is due in part to the lack of accurate screening tests for the early detection of the disease (*American Cancer Society, Cancer Facts and Figures 2006*). The primary risk factor for colorectal cancer is age, with more than 90% of cases diagnosed in individuals over the age of 50. According to the most recent available data from the U.S. Census Bureau, published in 2000, there are approximately 80 million Americans over the age of 50. However, it is estimated that only about half of the people who should be screened for this deadly disease are actually screened. In 2003, 23% of people aged 50 and older had received an FOBT (home-based test) within the past two years. In 2003, 44% of people aged 50 and older had ever received a colorectal endoscopy (sigmoidoscopy or colonoscopy) (*National Cancer Institute Cancer Trends Progress Report - 2005 Update*).

On average, 13 person years of life are lost for each colorectal cancer death. In addition, treatments such as surgery, colostomies, chemotherapy and radiotherapy can also produce significant illness. Early detection of cancer is a high priority given the high cost of treatment and the costs associated with the premature death. The most prevalent test is FOBT but many patients and professionals generally do not want to perform the test because it involves smearing stool samples on a slide and because the test has relatively poor predictive values. Only 39% of colorectal cancers are discovered at an early, localized stage, mostly due to low rates of screening (*American Cancer Society, Cancer Facts and Figures, 2006*).

### *The Opportunity*

The Corporation's rectal mucus test ("ColorectAlert™") is a patented technology that detects a carbohydrate marker associated with cancerous and pre-cancerous conditions. Dr. A.K.M. Shamsuddin (the "ColorectAlert Inventor") of Baltimore, Maryland developed this technology at the University of Maryland School of Medicine. Pursuant to agreements (the "ColorectAlert License Agreement") dated March 27, 1998, May 1, 1998 and October 23, 2001 between the Corporation and the ColorectAlert Inventor, the Corporation acquired a license for all diagnostic applications and products which incorporate or make use of this technology as well as the license for the two existing U.S. patents and one Japanese patent. Pursuant to the terms of the ColorectAlert License Agreements, the Corporation would be is required to make payments upon achieving certain milestones leading up to FDA clearance of this test, and royalty payments based on revenues from sales of this technology. The ColorectAlert License Agreements do not provide for a fixed termination date and may only be terminated by the parties in the event of a material breach by the other party.

Subsequent to the year end, on January 5, 2007, the Corporation settled litigation relating to the ColorectAlert™ License Agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11, the Corporation agreed to pay \$175,000 to Med-11 and amended the agreements to replace Dr. Shamsuddin with Med-11 as the licensor. This amount was expensed in 2006 as general and administration expense. The amendment also reduced the royalty payable by the Corporation from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Corporation may have been required to pay under the initial agreements.

A second colorectal cancer test, ColoPath™, is a patented technology that detects another marker believed to be associated with cancer of the colon or rectum. The technology was developed by Procyon BioPharma Inc. ("Procyon"). The Corporation entered into an agreement with Procyon dated March 19, 2001, as amended, (the "Procyon License Agreement") whereby the Corporation licensed the intellectual property, including patent rights and trademarks of ColoPath and has the right to develop, manufacture, market and distribute the ColoPath technology exclusively on a global basis. Pursuant to the terms of the Procyon License Agreement, all new patents will be owned by the Corporation. Procyon is entitled to payments based on the completion of milestones as well as a royalty payment



based on sales of all mucus-based colorectal cancer tests. The Procyon License Agreement does not have a fixed termination date.

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*The Technologies*

The ColorectAlert test detects the presence of a specific sugar in the rectal mucus of individuals who may have colorectal cancer or, potentially, precancerous polyps. This sugar is detected by a chemical reaction performed on a specimen placed on a test membrane following routine digital rectal examinations and does not require a blood sample. The same technology is being adapted for the detection of lung cancer and breast cancer, and could potentially be adapted for the detection of additional cancers. ColoPath is a similar assay to ColorectAlert.

*Development History and Clinical Findings*

As summarized in the table below, the Corporation has conducted clinical trials to validate the ColorectAlert Inventor's data that had been collected on a few thousand patients:

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| DESCRIPTION                                    | INVESTIGATOR      | PRIMARY STUDY SITE      | OBJECTIVES   | OUTCOME   | PUBLICATIONS/PRESENTATIONS   |
|--|-------------------|-------------------------|--|---|--|
| ColorectAlert, FOBT, CEA and Colonoscopy Study | Dr. Norman Marcon | St. Michael's Hospital  | Compare ColorectAlert with FOBT and CEA in screening for cancerous and pre-cancerous conditions, using colonoscopy to determine the actual presence of disease in each patient | ColorectAlert demonstrated the best overall level of accuracy of the three tests. For the entire study population, all three tests detected 81 per cent of the cancers (sensitivity), but ColorectAlert was much more specific, which means it produced significantly fewer false positive results than either FOBT or CEA. | Presented at Digestive Diseases Week, May 2000; presented at the American Association for Clinical Chemistry, July 2000.                                       |
| Expanded ColorectAlert Studies                 | Dr. Norman Marcon | St. Michael's Hospital  | Compare ColoPath and ColorectAlert with FOBT and colonoscopy   | ColorectAlert demonstrated higher sensitivity for early-stage cancer than FOBT, the existing standard test. ColorectAlert was more sensitive than FOBT and CEA for early stage (A and B) cancers, and for cancers in asymptomatic patients.   | Presented at the American Association for Cancer Research, July 2003; published in the <i>Proceedings of the American Association for Cancer Research 2003</i> |
| U.S. National Cancer Institute EDNRN Study     | Dr. Dean Brenner  | University of Michigan; | Prospective cross-sectional cohort   | In progress   |  |

Dana validation trial  
Farber examining  
Cancer FOBT and  
Institute; other markers  
Dartmouth for colorectal  
Medical cancer  
School; St.  
Michael's  
Hospital;  
M.D.  
Anderson  
Cancer  
Center

### *Production and Services*

The Corporation's cancer-related technologies are all manufactured (for clinical trial purposes) in its laboratory located at McMaster University.

### *Competition*

FOBT is the most frequently used screening method for colorectal cancer. Although FOBT has been found to reduce death due to eventual cancer, the test does have limitations due to its relatively low levels of sensitivity.

FOBT has sensitivity of approximately 50% for cancer (Clinical Database "Should All People Over the Age of 50 have Regular Fecal Occult-Blood Tests?", April 6, 1998) and a positive predictive value of 2%-17% ("Fecal Occult Blood Testing for Colorectal Cancer, Can We Afford To Do This?" Alquist, D.A. Gastroenterol Clin. North Am., 1997). This predictive value leads to unnecessary cost and patient inconvenience and anxiety due to unnecessary colonoscopies. In addition, compliance with fecal occult blood testing procedures (e.g., dietary restrictions) is estimated to be only 35%-50% (Clinical Database, April 16, 1998). The single sample, or digital, fecal occult blood test that physicians often use to screen for colorectal cancer has been shown to miss 95% of malignancies and lesions likely to become cancerous ("Accuracy of Screening for Fecal Occult Blood on a Single Stool Sample Obtained by Digital Rectal Examination: A Comparison with Recommended Sampling Practice", *Annals of Internal Medicine*, January 18, 2005). The Corporation believes that many physicians are dissatisfied by fecal occult blood testing in general and would prefer to have an improved test. Recently available immunochemical FOBT tests may perform better than traditional FOBT tests but still face limitations: early cancers tend not to bleed and most blood found in stool samples is present for reasons other than cancer. Additionally, immunochemical FOBT tests still require patients to sample from a stool and/or toilet water, which the Corporation believes is a barrier to patient compliance.

Double contrast barium enema has a low sensitivity for detecting cancer. The National Polyp Study found that double contrast barium enema detected only 48% of adenomas greater than 1 cm ("How Do I Screen for Colorectal Cancer?" Ross, T.M. The Canadian Journal of Diagnostics, October 2003).

Sigmoidoscopy examines the lower colon and is expensive (US\$100-US\$200/test), may cause complications (bowel perforations) and is not well accepted by the patient. Sensitivity varies with the type of instrument and the skill of the physician. The best reported values are 40%-65%.

Colonoscopy is the most effective test for detecting cancerous and precancerous polyps, as the entire colon can be visualized. However, the use of colonoscopy as a screening technology is extremely limited due to the fact that it is a very invasive and expensive procedure.

Virtual colonoscopy can be done quickly, with no sedation, and at a lower cost than colonoscopy; however, it is not currently included among the tests recommended by the American Cancer Society for early detection of colorectal cancer. At this time there is not solid scientific evidence that it is as effective at finding early cancers compared with currently recommended screening tests.

Management of the Corporation is aware of other diagnostic tests under development that may be useful for the detection of all colorectal pathology and is currently monitoring their progress. Some of the firms involved in the development or marketing of such products include Enterix Inc., EXACT Sciences Corporation and E-Z-EM Inc.

In clinical studies to date, ColorectAlert has been shown to detect more than half of early-stage cancers (Duke's A and B stages). It is simple to perform and cost effective relative to other currently available alternatives. Management believes that these attributes represent an important competitive advantage.



*Key Markets*

ColorectAlert, following the appropriate regulatory clearance, could be used in the laboratory and, potentially, physicians' offices. In 2000, Theta estimated that the global market for all cancer detection products, including mammography, would grow from US\$2.0 billion in 1999 to US\$2.8 billion in 2005 (*Theta Reports, High Growth Diagnostic Markets, Report No 1045, September 2000*).

**Lung Cancer Test (LungAlert™)**

*Pathology*

Lung cancer is the number one cause of cancer-related death for both men and women in North America. In the majority of cases, lung cancer begins in the lining of the bronchi and slowly moves down to the lungs. Initially the cancer does not cause a solid mass tumor and results in few or no symptoms. More than 85% of lung cancer cases can be directly or partly attributed to smoking (*American Lung Association*).

There are two main types of lung cancer, Small Cell Lung Cancer ("SCLC") and Non-Small Cell Lung Cancer ("NSCLC"). SCLC can be further subdivided into two stages, limited stage and extensive stage. In limited stage, the tumor is confined to its original area and has not spread to other parts of the body. In extensive stage lung cancer, the tumor has metastasized.

NSCLC is classified under three subgroups and assigned to one of four stages. The subgroups are:

Squamous cell carcinoma: Always associated with smoking. Usually starts in bronchi.

Adenocarcinoma: Begins in mucus glands usually near the periphery of the lung.

Large-cell undifferentiated: May appear in any part of the lung. Tends to grow and spread quickly.

Lung cancer stages are:

T1: Tumor is smaller than 3 cm and has not spread to the main branches of the bronchus.

T2: Tumor is larger than 3 cm. Cancer has spread to the main bronchus. Cancer partially clogs airway but does not cause pneumonia.

T3: Tumor has spread to the chest wall and/or the diaphragm. The cancer is within 2 cm of the trachea. One or both lungs collapse.

T4: Metastatic spread. Two or more tumor modules are present in the same lobe with malignant pleural effusion.

Common symptoms of advancing lung cancer include an excessive cough, worsening breathlessness, weight loss and fatigue.

#### *Lung Cancer Screening*

Lung cancer screening is not currently conducted in any country, with the exception of Japan, due to the poor health economic results of previous screening initiatives. The Japanese government covers costs relating to an annual X-ray and sputum cytology for those in the “high risk” category. This group is defined as individuals over the age of 45 and who have been heavy smokers for the past 20 years or longer.



Although a number of tests are available, they cannot be used cost effectively to identify lung cancer in the early stages. Since the determination of stage has important therapeutic and prognostic implications, careful initial diagnostic evaluation defining the location and extent of primary tumor is critical for the appropriate care of the individual. In the absence of an effective treatment for advanced stage disease, management believes that early detection for lung cancer is critical. To be effective, screening must accurately identify early stage disease in asymptomatic individuals. Screening must also be cost effective and socially acceptable to ensure compliance. Management is aware of five diagnostic options available to screen for lung cancer: X-rays, conventional sputum cytology, spiral CT, Positron Emission Tomography and bronchoscopy.

1. An X-ray is a simple and safe procedure that is relatively ineffective. Less than 40% of all lung cancers can be detected by this screening method.
2. Conventional Sputum Cytology has been used for over 50 years; however it is the least sensitive and only able to identify 20% of lung cancer cases.
3. Spiral CT has been hailed as the technology that holds the greatest promise for cost effectively screening for lung cancer. Although it holds the ability to detect approximately 70% of lung cancers, it has a high cost which translates into US\$300-\$1,000 per test.
4. Positron Emission Tomography is the most accurate screening test available at over 90% sensitivity. Since it is extremely expensive at US\$2,500 per patient, widespread use would be unfeasible.
5. Bronchoscopy is used as a final diagnostic option prior to surgery. It is highly invasive and results in a 0.2% mortality rate with the majority of patients unable to return to daily routines for several weeks or months.

#### *Market*

According to the American Cancer Society, in the U.S. in 2006 there would be an estimated 174,470 new cases of lung cancer and an estimated 162,460 lung cancer deaths, representing 29% of all cancer deaths (*American Cancer Society, Cancer Facts and Figures, 2006*). Lung cancer causes more deaths in both North American men and women than any other cancer, with a five-year survival rate for all stages combined of just 15%. The survival rate is 50% for cases detected when the disease is still localized. However, only 16% of lung cancers are diagnosed at an early, localized stage (*American Cancer Society, Cancer Facts and Figures, 2006*).

#### *The Opportunity*

LungAlert is based on a modified version of the ColorectAlert technology, using a sputum sample instead of a rectal mucus sample. See “Information on the Corporation - Business Overview - Colorectal Cancer Tests - The Opportunity” for licensing and technology information.

#### *Development History and Clinical Findings*

As summarized in the table below, the Corporation has conducted clinical studies with LungAlert:

| DESCRIPTION  | INVESTIGATOR                   | PRIMARY STUDY SITE         | OBJECTIVES   | OUTCOME  | PUBLIC PRESEN   |
|--|--------------------------------|----------------------------|--|--|---|
| LungAlert Pilot Study  | Drs. John Miller and Gerry Cox | St. Joseph's Hospital      | A blinded study examining LungAlert in a population with healthy patients, patients with benign lung disease and patients with cancer.   | LungAlert detected 20 of 23 cancers.   | Presented American Society, M published <i>Journal of Ligand A Society, 2</i> |
| LungAlert Smokers' Study                                       | Drs. John Miller and Gerry Cox | St. Joseph's Hospital      | Determine LungAlert's effectiveness in detecting early-stage cancers, particularly in smokers, and to establish the relationship between LungAlert values and the stage and size of tumors | Interim data show that LungAlert's reactivity in sputum samples may be useful as an initial screening test to identify high-risk subjects who would benefit from other tests, such as spiral computed tomography. Patients with cancer had significantly higher values than those who did not. | American Association Cancer R July 2003 Thoracic May 2004                     |
| I - E L C A P (International Early Lung Cancer Action Program) | Dr. Heidi Roberts              | Princess Margaret Hospital | Determine the ability of LungAlert to detect cancers among a high-risk population as well as relationship between LungAlert values   | In progress  |   |

and the stage and location of cancer. High-risk patients (1,000) undergo CT scans twice - once at baseline and once at one-year follow-up - and are tested with LungAlert. Another 1,500 patients are tested at baseline.

*Production and Services*

The Corporation's cancer-related technologies are all manufactured (for clinical trial purposes) by the Corporation itself in its laboratory located at McMaster University.

*Competition*

To the Corporation's knowledge, there are no FDA-approved tumor markers for lung cancer, although several are believed to be in development.

Several tests for lung cancer exist but due to their low ability to detect cancer, or their high cost, management believes that they are not suitable for cancer screening.

Management of the Corporation is aware of other diagnostic tests under development that may be useful for the detection of lung cancer and is currently monitoring their progress. Some of the firms involved in the development or marketing of such products are Biomoda Inc., Xillix Technologies Corp. and Perceptronix Medical Inc.

*Key Markets*

The LungAlert test may be suitable for use in both the laboratory and potentially the physician's office with the appropriate regulatory clearance for each use. The initial target population are smokers and former smokers as smoking causes more than 85% of lung cancer cases (*American Lung Association*).

**Breast Cancer Test**

*Pathology*

Breast cancer is the most frequently diagnosed cancer among women. It is the second leading cause of cancer death in women, after lung cancer (*American Cancer Society, Cancer Facts and Figures, 2005*).

Breast cancer may be non-invasive or invasive. The most common type of non-invasive breast cancer is ductal carcinoma in situ, which is confined to the lining of the breast ducts. The most common type of invasive breast cancer is infiltrating ductal carcinoma ("IDC"), which starts in a milk passage or duct, breaks through the wall of the duct, and invades the fatty tissue of the breast. IDC accounts for about 80% of invasive breast cancer (*American Cancer Society*).

Breast cancer is categorized into the following stages:

*Stage 0:*

- Non-invasive carcinoma

*Stage I:*

- The tumor is no more than about an inch across and cancer cells have not spread beyond the breast.

*Stage II:*

- Tumor in the breast is less than 1 inch across and the cancer has spread to the lymph nodes under the arm; or
- Tumor is between 1 and 2 inches (with or without spread to the lymph nodes under the arm); or

- Tumor is larger than 2 inches but has not spread to the lymph nodes under the arm.

*Stage III:*

- Tumor in the breast is large (more than 2 inches across) and the cancer has spread to the underarm lymph nodes; or
- Cancer is extensive in the underarm lymph nodes; or
- Cancer has spread to lymph nodes near the breastbone or to other tissues near the breast.

*Stage IV:*

- Metastatic cancer

Common symptoms of breast cancer include a swelling of part of the breast; skin irritation or dimpling, nipple pain or redness, nipple discharge or a lump in the underarm area. However, early stage breast cancer frequently has no symptoms.

*Breast Cancer Screening*

American Cancer Society guidelines for the early detection of breast cancer recommend an annual mammogram for women age 40 and older and a clinical breast examination (“CBE”) for women in their 20s and 30s every three years and annually for women in their 40s. Breast self-examination may also help to detect changes in the breast.

Numerous studies have shown that early detection of breast cancer saves lives and increases treatment options. According to the American Cancer Society, the recent decline in breast cancer mortality has been attributed to the regular use of screening mammography and to improvements in treatments. Mammography, however, has some limitations. It misses some cancers and sometimes leads to unnecessary additional testing in women who do not have breast cancer.

*Market*

About 212,920 women in the U.S. are expected to be diagnosed with invasive breast cancer in 2006, and about 40,970 women will die from the disease (*American Cancer Society, Cancer Facts and Figures, 2006*). There are slightly over 2 million women living in the U.S. who have been treated for breast cancer. Breast cancer is the second leading cause of death in women, after lung cancer. When breast cancer is found at a localized stage, the five-year survival rate is 98%.

The incidence of breast cancer is very low for women in their 20s, gradually increases and plateaus at the age of 45 and increases dramatically after 50. Fifty percent of breast cancer is diagnosed in women over 65.

*The Opportunity*

The Corporation’s breast cancer test is based on a modified version of the ColorectAlert and LungAlert technology but uses a sample of nipple-aspirate fluid, which is derived from the mammary ducts and expressed through the nipple.

*Development History and Clinical Findings*

The Corporation has developed a prototype of the breast cancer test suitable for clinical evaluation:



| DESCRIPTION   | INVESTIGATOR      | PRIMARY STUDY SITE                       | OBJECTIVES   | OUTCOME  | PUBLICATIONS/ PRESENTATIONS  |
|---------------|-------------------|--|--|--|--|
| Pilot Study   | Dr. Anees Chagpar | University of Texas M.D. Anderson Center | Determine ability of the breast cancer test to distinguish between cancerous and non-cancerous breast samples. | Data showed that the test demonstrated a statistically significant difference between early-stage breast cancer and non-cancerous samples, which demonstrates the test's effectiveness in identifying early-stage disease. | Presented at American Association for Cancer Research, July 2003; published in <i>Cancer</i> , July 2004 |
| Pivotal Study | Dr. Anees Chagpar | University of Louisville                 | Confirm and extend findings of pilot study.  | In progress  |  |

#### *Production and Services*

The Corporation's cancer-related technologies are all manufactured (for clinical trial purposes) by the Corporation in its laboratory located at McMaster University Medical Center.

#### *Competition*

Other companies are developing and/or marketing proteomic-based and genomic-based screening tests for cancer using nipple aspirate fluid, including Power3 Medical, Cytoc Corporation and NeoMatrix LLC. Other screening technologies in the breast cancer risk assessment field include serum screening, serum progression, tissue progression and a variety of imaging technologies to be used as adjuncts to mammography. Given the relatively high cost of such tests, the Corporation believes that such technologies would likely be complementary rather than competitive to the Corporation's test.

#### *Key Markets*

The breast cancer test, following the appropriate regulatory clearance, could be used in physicians' offices as part of risk assessment for breast cancer.



### **Other Product Development Programs**

To date, the Corporation has identified a number of other technologies, several of which are under evaluation. The Corporation is currently assessing likely proprietary position and market potential for these technologies as well as evaluating the technological and regulatory obstacles that must be overcome with each program.

### **Patent and Proprietary Protection**

The Corporation seeks to acquire processes and/or products or acquire licenses for processes and/or products, which may have existing intellectual property protection. If patents have not yet been issued on a technology, the Corporation will review the patent applications, if any, and examine the patentability of the technology in question. In some cases, the Corporation may actually file patent applications for technologies that it owns or in respect of which it has acquired a license and subsequently developed. Such applications may cover composition of matter, the production of active ingredients and their novel applications. The Corporation has acquired, by license or assignment, rights in patents and applications filed in Canada, the U.S. and internationally.

The Corporation retains independent patent counsel where appropriate. Management of the Corporation believes that the use of outside patent specialists ensures prompt filing of patent applications and patent maintenance as well as the ability to access specialists in various areas of patents and patent law to ensure complete patent filing.

Patent positions can be uncertain and involve many complex legal, scientific and factual questions. While the Corporation intends to protect its valuable proprietary information and believes that certain of its information is novel and patentable, there can be no assurance that: (i) any patent application owned by or licensed to the Corporation will be approved in all countries; (ii) proceedings will not be commenced seeking to challenge the Corporation patent rights or that such challenges will not be successful; (iii) proceedings taken against a third party for infringement of patent rights will be successful; (iv) processes or products of the Corporation will not infringe upon the patents of third parties; or (v) the scope of patents issued to or licensed by the Corporation will successfully prevent third parties from developing similar and competitive products. It is not possible to predict how any litigation may affect the Corporation's efforts to develop, manufacture or market products. The cost of litigation to uphold the validity and prevent infringement of the patents owned by or licensed to the Corporation may be significant.

Issues may arise with respect to claims of others to rights in the patents or patent applications owned by or licensed to the Corporation. As the industry expands, and more patents are issued, the risk increases that the Corporation's processes and products may give rise to claims that they infringe the patents of others. Actions could be brought against the Corporation or its commercial partners claiming damages or an accounting of profits and seeking to enjoin them from clinically testing, manufacturing and marketing the affected product or process. If any such action were successful, in addition to any potential liability for damages, the Corporation or its commercial partners could be required to obtain a license in order to continue to manufacture or market the affected product or use the affected process. There can be no assurance that the Corporation or its commercial partners could prevail in any such action or that any license required under any such patent would be made available or, if available, would be available on acceptable terms. If no license is available, the Corporation's ability to commercialize its products may be negatively affected. There may be significant litigation in the industry regarding patents and other intellectual property rights and such litigation could consume substantial resources. If required, the Corporation may seek to negotiate licenses under competitive or blocking patents that it believes are required for it to commercialize its products.

Although the scope of patent protection ultimately afforded by the patents and patent applications owned by or licensed to the Corporation is difficult to quantify, management of the Corporation believes that such patents will afford adequate protection for it to ensure exclusivity in the conduct of its business operations as described herein. The Corporation also intends to rely upon trade secrets, unpatented proprietary know-how and continuing technological innovation to develop and maintain its competitive position. To protect these rights, the Corporation requires all employees and consultants to enter into confidentiality agreements with the Corporation. There can be no assurance, however, that these agreements will provide meaningful protection for the Corporation's trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure. Further, in the absence of patent protection, the Corporation's business may be adversely affected by competitors who independently develop substantially equivalent technology.

In August 2004, the Corporation learned that two of its U.S. patents, #5,489,510 and #5,587,295, had been listed as abandoned by the U.S. PTO for failure to pay maintenance fees. The failure to pay these maintenance fees occurred when the files were transferred between U.S. and Canadian patent agents. The Corporation filed a petition for reinstatement of the patents. In response to this petition, in February 2005 the U.S. PTO identified specific items that the Corporation should address, specifically regarding the credentials and procedures of the Corporation's patent agents and their performance of clerical functions related to the payment of the maintenance fees. In June 2005, the Corporation filed a request for consideration.

On December 23, 2005, the U.S. PTO notified the Corporation of its decision not to reinstate the two patents. In February 2006, the Corporation filed a request for reconsideration with the U.S. PTO which was subsequently denied. The Corporation has authorized legal action against the law firm that was responsible for managing its patent portfolio at the time when the maintenance fees for the two patents in question should have been paid. The U.S. PTO

found that the patents lapsed as a result of the law firm's failure to use its established docketing procedures regarding payment of the maintenance fees.

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The two patents in question are in force in other jurisdictions. In the U.S., the Corporation has an additional two patents in force covering other aspects of the technology as well as two patents pending. Consequently, management believes that it would be difficult for a competitor to develop similar products using this technology. However, there can be no assurance that others will not independently develop similar products.

The Corporation's success depends, in large part, on its ability to obtain patents, maintain its trade secrets and operate without infringing the proprietary rights of third parties.

A summary of the Corporation's portfolio of patents and patents pending is included below:

### Patents and Patent Applications

#### *Coronary Artery Disease (CAD) Risk Assessment Technology*

| Patent Status | Title   | Jurisdiction  | Patent Number   | Grant Date   | Expiry Date   |
|---------------|---|---|---|--|---|
| Granted       | Method for producing affinity-enzymatic compounds for visual indication of cholesterol on skin surface  | Canada  | 1,335,968   | June 20, 1995  | June 20, 2012   |
| Granted       | Method of producing affinity-enzymatic compounds for the visual detection of cholesterol on the surface of the skin of a patient, based on a detecting agent with an affinity for cholesterol and a visualization agent | Europe<br>Austria<br>Great Britain<br>France<br>Germany<br>Italy<br>Sweden<br>Switzerland | 0 338 189   | April 24, 1996   | January 18, 2009  |
| Granted       | Multilayer Analytical Element   | Australia<br>South Korea<br>United States<br>Canada<br>China<br>Europe<br>Belgium         | 702,663<br>235,211<br>6,605,440<br>2,207,555<br>95,197,367.3<br>0797774 | June 3, 1999<br>September 21, 1999<br>August 12, 2003<br>February 24, 2004 | December 14, 2015<br>December 14, 2015<br>December 14, 2015 |

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|               |        |                   |                   |
|---------------|--------|-------------------|-------------------|
| Germany       |        | June 23, 2004     | December 14, 2015 |
| Spain         |        |                   | December 14, 2015 |
| France        |        | November 10, 2004 | December 14, 2015 |
| Great Britain |        |                   |                   |
| Greece        |        |                   |                   |
| Italy         |        |                   | December 14, 2015 |
| Ireland       |        |                   |                   |
| Netherlands   |        |                   |                   |
| Portugal      |        |                   |                   |
| Sweden        |        |                   |                   |
| Mexico        | 227267 |                   |                   |
| Japan         | 375507 |                   |                   |

April 15, 2005  
January 6, 2006

December 14, 2015  
December 14, 2015

|         |                               |            |                           |  |     |
|---------|-------------------------------|------------|---------------------------|--|-----|
| Pending | Multilayer Analytical Element | PCT Brazil | CA95/00698<br>PI9510038-5 | N/A<br>Notice of Allowance Oct 4, 2005 | N/A |
|---------|-------------------------------|------------|---------------------------|--|-----|

| Patent Status | Title   | Jurisdiction         | Patent Number  | Grant Date         | Expiry Date      |
|---------------|---|----------------------|----------------|--------------------|------------------|
| Granted       | Method of Determining Skin Tissue Cholesterol   | United States        | 6,365,363      | April 2, 2002      | January 26, 2018 |
|               |   | Japan                | 369,324        | July 1, 2005       | January 26, 2018 |
|               |   | Canada               | 2281769        | March 21, 2006     | January 26, 2018 |
| Pending       | Method of Determining Skin Tissue Cholesterol   | PCT                  | RU98/00010     | Accepted in Canada | N/A              |
|               |   | Brazil               | PI9807594-2    |                    |                  |
|               |   | Europe               | 98901608.4     | June 8, 2005       |                  |
|               |   | Hong Kong            | 00105898.2     |                    |                  |
| Granted       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays<br><i>As it pertains to Skin Cholesterol Measurement</i> | Australia            | 781034         | August 18, 2005    | August 4, 2020   |
|               |   | Russia               |                | March 10, 2006     | August 4, 2010   |
|               |   | China                |                | Notice of Grant    |                  |
| Pending       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays<br><i>As it pertains to Skin Cholesterol Measurement</i> | PCT                  | PCT/CA00/00918 | N/A                | N/A              |
|               |   | Brazil               | PI0013096.6    |                    |                  |
|               |   | Europe               | 00954181.4     |                    |                  |
|               |   | Hong Kong            | 0310671.6      |                    |                  |
|               |   | India                | PCT/2002/00307 |                    |                  |
|               |   | Japan                | 2001-51596.4   |                    |                  |
| Pending       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays<br><i>As it Pertains to Skin Cholesterol Measurement</i> | United States        | 09/830,708     | N/A                | N/A              |
|               |   | continuation in part | 10/877,737     |                    |                  |
| Pending       | Direct Assay of   | Canada               | 2,465,427      | N/A                | N/A              |

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|         |  |                                |   |     |     |
|---------|--|--------------------------------|---|-----|-----|
|         | Cholesterol in Skin Samples Removed by Tape Stripping                        | PCT                            | PCT/CA2005/00642<br>Pub No.<br>WO2005/106018                |     |     |
|         |  | Australia                      | 2005238099  |     |     |
|         |  | Brazil                         | TBD   |     |     |
|         |  | China                          | 200580013893.2  |     |     |
|         |  | Europe                         | 5738502.3   |     |     |
|         |  | India                          | 3171/kolnp/2006   |     |     |
|         |  | Japan                          | TBD   |     |     |
|         |  | Hong Kong                      | 7101674.4   |     |     |
|         |  | Mexico                         | PA/a/2006/012326  |     |     |
|         |  | Russia                         | 2006137332  |     |     |
|         |  | United States                  | 10/835,397  |     |     |
|         |  | US-<br>continuation in<br>part | 11/116,412  |     |     |
| Pending | Direct Assay of Skin Protein in Skin Samples Removed by Tape Stripping       | United States<br>PCT           | 60/682,837<br>PCT/CA2006/00831<br>Pub No.<br>WO/2006/122430 | N/A | N/A |
| Pending | Method and Apparatus for Non-Invasive Measurement of Skin Tissue Cholesterol | United States<br><br>PCT       | 60/656,381<br><br>PCT/CA2006/00293                          | N/A | N/A |
| Pending | Apparatus for Non-Invasive skin sampling and testing                         | United States                  | 60/885,152  | N/A | N/A |

*ColorectAlert™*

| Patent Status | Title  | Jurisdiction | Patent Number  | Grant Date         | Expiry Date       |
|---------------|--|--------------|----------------|--------------------|-------------------|
| Granted       | Rectal Mucus Test and Kit for Detecting Cancerous and Precancerous Conditions      | USA          | 5,162,202      | November 10, 1992  | December 12, 2009 |
| Granted       | Screening Test and Kit for Cancerous and Precancerous Conditions                   | USA          | 5,348,860      | September 20, 1994 | October 15, 2011  |
| Granted       | Rectal Mucus Test and Kit for Detecting Cancerous and Precancerous Conditions      | Japan        | 2,990,528      | October 15, 1999   | April 27, 2010    |
| Granted       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays | Australia    | 781034         | August 18, 2005    | August 4, 2020    |
|               |  | Russia       | 2271539        | March 10, 2006     | August 4, 2020    |
|               | <i>As it Pertains to Cancer Detection</i>  |              |                |                    |                   |
| Pending       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays | PCT          | PCT/CA00/00918 | N/A                | N/A               |
|               |  | Brazil       | PI0013096.6    |                    |                   |
|               |  | China        | 00813497.9     |                    |                   |
|               |  | Europe       | 00954181.4     |                    |                   |
|               |  | Hong Kong    | 0310671.6      |                    |                   |
|               |  | India        | PCT/2002/00307 |                    |                   |
|               |  | Japan        | 2001 515964    |                    |                   |
|               | <i>As it Pertains to Cancer Detection</i>  |              |                |                    |                   |



| Patent Status | Title  | Jurisdiction         | Patent Number                   | Grant Date | Expiry Date |
|---------------|--|----------------------|---------------------------------|------------|-------------|
| Pending       | Spectrophotometric Measurement in Color-Based Biochemical and Immunological Assays | USA                  | 09/830,708                      | N/A        | N/A         |
|               |  | continuation in part | 10/877,757                      |            |             |
|               | <i>As it Pertains to Cancer Detection</i>  |                      |                                 |            |             |
| Pending       | Liquid-Phase Galactose Oxidase-Schiff's Assay                                      | USA<br>PCT           | 11,523/057<br>PCT/CA2006/001526 | N/A        | N/A         |

**ColoPath™**

| Patent Status | Title   | Jurisdiction | Patent Number | Grant Date        | Expiry Date      |
|---------------|---|--------------|---------------|-------------------|------------------|
| Granted       | Screening Test for the Early Detection of Colorectal Cancer | USA          | 6,187,591     | February 13, 2001 | March 16, 2019   |
| Granted       | Screening Test for the Early Detection of Colorectal Cancer | Australia    | 766,057       | January 29, 2004  | November 3, 2019 |
| Granted       | Screening Test for the Early Detection of Colorectal Cancer | Israel       | 139545        | April 25, 2005    | November 3, 2019 |
| Pending       | Screening Test for the Early Detection of Colorectal Cancer | Canada       | 2,352,184     | N/A               | N/A              |

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|         |  |         |                  |                   |                   |
|---------|--|---------|------------------|-------------------|-------------------|
| Pending | Screening Test for the Early Detection of Colorectal Cancer    | Brazil  | PI19915005       | N/A               | N/A               |
| Pending | Screening Test for the Early Detection of Colorectal Cancer    | Mexico  | 012243           | N/A               | N/A               |
| Pending | Screening Test for the Early Detection of Colorectal Cancer    | Korea   | 2001-7005707     | N/A               | N/A               |
| Pending | Screening Test for the Early Detection of Colorectal Cancer    | India   | INPCT/2001/00591 | N/A               | N/A               |
| Granted | Screening Test for the Early Detection of Colorectal Neoplasia | USA     | 5,416,025        | May 16, 1995      | November 29, 2013 |
| Granted | Screening Test for the Early Detection of Colorectal Neoplasia | Europe  | 0731914          | November 23, 1994 | November 23, 2014 |
| Granted | Screening Test for the Early Detection of Colorectal Neoplasia | France  | 0731914          | April 18, 2001    | November 23, 2014 |
| Granted | Screening Test for the Early Detection of Colorectal Neoplasia | Spain   | ES 2155513       | April 18, 2001    | November 23, 2014 |
| Granted |  | Germany | 69427131.4       | April 18, 2001    |                   |

Screening Test  
for the Early  
Detection of  
Colorectal  
Neoplasia

November 23,  
2014

| Patent Status | Title  | Jurisdiction  | Patent Number | Grant Date       | Expiry Date       |
|---------------|--|---------------|---------------|------------------|-------------------|
| Granted       | Screening Test for the Early Detection of Colorectal Neoplasia | Great Britain | 0731914       | April 18, 2001   | November 23, 2014 |
| Granted       | Screening Test for the Early Detection of Colorectal Neoplasia | Italy         | 0731914       | April 18, 2001   | November 23, 2014 |
| Granted       | Screening Test for the Early Detection of Colorectal Neoplasia | Australia     | 687,939       | March 5, 1998    | November 23, 2014 |
| Granted       | Screening Test for the Early Detection of Colorectal Neoplasia | South Africa  | 94/9290       | October 25, 1995 | November 23, 2014 |
| Pending       | Screening Test for the Early Detection of Colorectal Neoplasia | Canada        | 2,176,508     | N/A              | N/A               |

***LungAlert™ and Breast Cancer Test***

| Patent Status | Title  | Jurisdiction        | Patent Number     | Grant Date         | Expiry Date      |
|---------------|--|---------------------|-------------------|--------------------|------------------|
| Granted       | Screening Test and Kit for Cancerous and Precancerous Conditions | USA                 | 5,348,860         | September 20, 1994 | October 15, 2011 |
| Granted       | Spectrophotometric Measurement in                                | Australia<br>Russia | 781034<br>2271539 | August 18, 2005    | August 4, 2020   |

|         |   |   |  |                   |                   |
|---------|---|---|--|-------------------|-------------------|
|         | Color-Based<br>Biochemical and<br>Immunological<br>Assays   |   |  | March 10,<br>2006 | August 4,<br>2020 |
|         | <i>As it Pertains to<br/>Cancer Detection</i>   |   |  |                   |                   |
| Pending | Spectrophotometric<br>Measurement in<br>Color-Based<br>Biochemical and<br>Immunological<br>Assays | PCT<br>Brazil<br>China<br>Europe<br>Russia<br>Hong Kong<br>India<br>Japan | PCT/CA00/00918<br>PI0013096.6<br>00813497.9<br>00954181.4<br>RU 2002103517<br>0310671.6<br>PCT/2002/00307<br>2001 515964 | N/A               | N/A               |
|         | <i>As it Pertains to<br/>Cancer<br/>Detection</i>   |   |  |                   |                   |
| Pending | Spectrophotometric<br>Measurement in<br>Color-Based<br>Biochemical and<br>Immunological<br>Assays | USA<br><br>continuation in<br>part  | 09/830,708<br><br>10/877,737   | N/A               | N/A               |
|         | <i>As it Pertains to<br/>Cancer<br/>Detection</i>   |   |  |                   |                   |
| Pending | Liquid-Phase<br>Galactose<br>Oxidase-Schiff's<br>Assay  | USA<br>PCT  | 11/523,057<br>PCT/CA2006/001526  | N/A               | N/A               |

## **Competition**

The medical device industry is dominated by a few major companies which are involved in the research, development, manufacture and marketing of products. Beyond these major players, a number of relatively new firms have been established, with a focus on developing improved products. The industry is characterized by extensive research efforts, technological change and intense competition. Competition can be expected to increase as technological advances are made and new diagnostic tools are developed. Competition in the industry is primarily based on: (i) product performance, including efficacy and safety; (ii) price; (iii) acceptance by physicians and various payers such as governments and HMOs; (iv) marketing; and (v) distribution. The availability of patent protection in the U.S. and elsewhere, and the ability to obtain governmental approval for testing, manufacturing and marketing, are also important factors.

Other groups active in this industry include educational institutions and public and private research institutions. These institutions are becoming more active in seeking patent protection and licensing arrangements to collect royalties for use of technology that they have developed. They are also becoming increasingly competitive in recruiting personnel from the limited supply of highly qualified clinical physicians, academic scientists and other professionals.

Competitors of the Corporation may: (i) use different technologies or approaches to develop products similar to products which the Corporation is seeking to develop; (ii) develop new or enhanced products or processes that may be more effective, less expensive, safer or more readily available than any developed by the Corporation; and (iii) succeed in obtaining regulatory approval of such products before the Corporation obtains approval of its products. There can be no assurance that the Corporation's products will compete successfully or that research and development will not render the Corporation's products obsolete or uneconomical. See "Risk Factors" ..

In the long term, the Corporation believes that its ability to compete effectively will be based on its ability to create and maintain scientifically advanced technology, develop superior products, attract and retain scientific personnel with a broad range of technical expertise and capability, obtain proprietary protection for its products and processes, secure the required government approvals on a timely basis, identify and successfully pursue research and development projects for which significant market opportunities exist or are likely to develop, and manufacture and successfully market its products. The competition for personnel is intense and the Corporation cannot guarantee that personnel who are currently working on behalf of the Corporation will remain or that sufficiently qualified employees can be found to replace them. The loss of key employees and/or key contractors may affect the speed and success of product development. See "Risk Factors".

Once the products for which the Corporation has received patents are on the market, those products will compete directly with other products that have been developed for the same predictive testing purpose or therapeutic indication. When the patents covering these products expire, the products previously covered by the patents could face competition from generic products, which are usually priced much lower than the original products.

## **Raw Materials**

Although the Corporation manufactures a few components in its own laboratory, most of the raw materials used in the production of the Corporation's products are generic laboratory materials that are readily available to the Corporation from commercial sources. The prices of these various materials have remained stable over the past five years. Any volatility in the prices of these raw materials would not have a material impact on world markets or on the Corporation due to the widely available nature of these raw materials and the relatively small quantities that are used by the Corporation at any one time.

**Regulatory Requirements**

The Corporation develops novel diagnostic devices. These devices are regulated differently in each country in which the Corporation wishes to have its products sold. The regulations governing the sale and distribution of

devices and the time taken for this approval process can vary more widely than for the approval of pharmaceuticals. However, it is generally recognized that the requirements for diagnostic products such as those that the Corporation is in the process of developing are less arduous than those for pharmaceuticals.

### *Canada*

The Canadian health care industry is regulated by the HPB. This federal agency has a role similar to that of the FDA and has responsibility for regulating drugs for both human and animal use, cosmetics, medical devices, radiation emitting devices, foods and food additives, chemicals and other products affecting human health. A manufacturer is required to follow specific regulations referred to as current GMP regulations in the manufacture of such products. Regulations imposed by federal, provincial, state and local authorities in Canada and the U.S. as well as their counterparts in other countries, are a significant factor in the conduct of the development, manufacturing and eventual marketing activities for the proposed products.

### *United States*

As the most significant market for the Corporation's products is in the U.S., and it is generally accepted that the FDA has the most stringent device approval requirements, a general review of the FDA regulations follows.

If a device is considered to be substantially equivalent to existing devices already marketed, it may receive a 510(k) clearance. Under this clearance, the FDA will send the manufacturer a market clearance letter called a substantially-equivalent letter. Although this process can be as short as 60 days, it is typical for a 510(k) approval to take 90 to 120 days. If a device does not qualify for a 510(k), a pre-market approval ("PMA") process may be required. The length of the PMA process depends largely on the nature of the device and the diagnosis undertaken through the use of the device and the resulting impact on clinical trial endpoints and design. Increasingly, the FDA is creating a more user-friendly regulatory environment, and, as a result, even the PMA process can proceed expeditiously.

Many medical devices sold in the U.S. today have been cleared for commercial distribution and marketing by a PMA. A PMA must be submitted to the FDA if a company wants to introduce a device with a new intended use into commercial distribution. Under a PMA, the FDA is notified as to a company's intent to market a device. If the application is accepted, this signifies only acceptance of the application and not a clearance to sell the device. Under the PMA guidelines, the FDA requires the submission and review of valid scientific evidence to determine whether a reasonable assurance exists that the device is safe, effective and has clinical utility. The collection and evaluation of clinical data to demonstrate the safety and efficacy of a medical device are essential for the ultimate approval of that device. Valid scientific evidence as currently defined by the FDA is limited to well-controlled investigations, including (where applicable) blinding and randomization of clinical trials.

The products that the Corporation is currently developing may ultimately be subject to the demanding and time-consuming PMA approval procedure. The regulations defined by these procedures cover not only the form and content of the development of safety and efficacy data regarding the proposed product, but also impose specific requirements regarding manufacture of the product, quality assurance, packaging, storage, documentation and record keeping, labelling, advertising and marketing procedures. The process of conducting the clinical trials and gathering, compiling and submitting the data required to support a PMA or facility approval is expensive and time-consuming, and there can be no assurance that the FDA will approve a PMA or a manufacturing facility submitted to it in a timely manner, or at all. See "Key Information - Risk Factors".

In order to obtain approval, an applicant must submit, as relevant for the particular product, proof of safety, purity, potency and efficacy. In most cases, such proof entails extensive pre-clinical, clinical and laboratory tests. The testing, preparation of necessary applications and processing of those applications is expensive and time-consuming



and may take several years to complete. There is no assurance that the regulator will act favourably or quickly in making such reviews and approving products for sale. The Corporation may encounter difficulties or unanticipated costs in its efforts to secure necessary governmental approval or licenses, which could delay or preclude the Corporation from marketing its products. Conditions could also be placed on any such approvals that could restrict the commercial applications of such products. With respect to patented products or technologies,

delays imposed by the government approval process materially reduce the period during which the Corporation will have the exclusive right to exploit them. This occurs because patent protection lasts only for a limited time, beginning on the date the patent is first granted (in the case of U.S. patent applications) or when the patent is first filed (in the case of patent applications filed in the European Union and Canada).

Among the requirements for product approval is the requirement that prospective manufacturers conform to the FDA's and HPB's current GMP standards, which thereafter must be followed at all times. In complying with GMP standards, manufacturers must continue to expend time, money and effort in production, record keeping and quality control to ensure technical compliance. Continued compliance is necessary for all products with all requirements of the applicable legislation and the conditions laid out in an approved application, including, but not limited to, product specification, manufacturing process, labelling, promotional material, record keeping and reporting requirements. Failure to comply, or the occurrence of unanticipated adverse effects during commercial marketing, could lead to the need for product recall, or regulator-initiated action such as the suspension of manufacturing or seizure of the product, which could delay further marketing until the products are brought into compliance. The regulator may also request a voluntary recall of a product. The regulator may also require post-marketing testing and surveillance to monitor the record of the product and continued compliance with regulatory requirements.

### *Europe*

The CE ("Conformité Européene") mark is a mandatory European mark for medical devices and in vitro diagnostic devices ("IVD") that indicates conformity of the product with the essential health and safety requirements of the applicable European directive(s).

Before placing a medical device or IVD on the European Union ("E.U.") market, the manufacturer must subject the product to the conformity assessment procedure that is provided in the applicable directive, with the intention of affixing a CE-mark to the product. Certain products, such as the Corporation's consumer version of the skin cholesterol test, currently in development, will require a third-party conformity assessment to be carried out by a "Notified Body", which is a public or private company designated by member states of the E.U. to assess a product's conformity with the essential requirements of the medical device and IVD directives. Other products, such as PREVU\* POC, fall under the "Other" category of IVDs. Products in this category can be self-CE-marked by the manufacturer without the involvement of a "Notified Body". As well, all manufacturers outside of the E.U. are required to designate an "Authorized Representative" in the E.U. who can respond to queries from member states and customers with regard to a CE-marked product on behalf of the manufacturer.

Once a product is CE-marked, it may be placed on the E.U. market and freely circulated throughout Member States.

The Corporation received HPB clearance for PREVU\* POC in 2001 and 510(K) clearance from the FDA for PREVU\* POC as part of risk assessment for coronary heart disease in persons with a history of myocardial infarction and/or persons suspected of having significant multivessel CAD (>50% stenosis in >1 vessel as defined by coronary angiography) where further diagnostic evaluation is being considered. PREVU\* POC was CE-marked on September 5, 2002 for European marketing. PREVU\* LT received regulatory clearance for sale in Canada and was CE-marked in Europe in 2006. The Corporation's clinical program is ongoing. The Corporation expects to submit regulatory applications for lab-processed and consumer formats of the skin cholesterol technology upon completion of certain clinical trials. Additionally, the Corporation expects to undertake new clinical studies to support new regulatory claims for PREVU\* POC Skin Cholesterol Test's use.

McNeil commenced an education and awareness program and actively promoted PREVU\* Point of Care Skin Sterol Test at major international medical conferences throughout 2004. McNeil made the product available for sale to the professional medical community in North America in early 2005, with additional world markets to follow. The other technologies of the Corporation are in various stages of clinical trials in the U.S. and Canada, and

thus the timing for receipt of HPB and FDA clearance is uncertain. Generally, research and clinical data used to receive regulatory approval in one jurisdiction may be used for regulatory submissions in other jurisdictions.

While the Corporation has had success in receiving HPB and FDA clearance for PREVU\* POC, the product testing and approval/clearance process for the Corporation's other technologies could take a number of years and involve the expenditure of significant resources. There can be no assurance that clearance will be granted on a timely basis, or at all.

### ***Economic Dependence***

Revenues earned by the Corporation in fiscal years 2004 to 2006 were from one customer. These revenues were pursuant to a license agreement that was terminated on December 28, 2006. All amounts due to the Corporation from this customer had been collected prior to the year end. As at December 31, 2005, substantially all the accounts receivable were due from this customer.

### ***Employees***

The Corporation currently employs 16 full-time people, 10 of whom are located at its head office in Toronto, Ontario and six at its research laboratory in Hamilton, Ontario. In addition, the Corporation has contractual arrangements with a number of research scientists and organizations that provide staff and related services. These contracts provide flexible and directed research staff to the Corporation on an as-needed basis.

### ***C. Organizational Structure***

The Corporation's operations are based in Canada. As at December 31, 2006 the Corporation had two wholly-owned subsidiaries: PreMD International Inc., a corporation incorporated under the laws of Switzerland; and 621178 Canada Inc., incorporated under the laws of Canada, to hold key man insurance coverage. PreMD International Inc. owns the non-North American rights to PREVU\* Skin Cholesterol Test and will manage sales of product in these territories.

### ***D. Property, Plant and Equipment***

The Corporation currently rents approximately 3,500 square feet of office space at 4211 Yonge Street, Suite 615, Toronto, Ontario, M2P 2A9, Canada, its principal place of business. The Corporation also occupies approximately 1,100 square feet of laboratory facilities at McMaster University in the new Biosciences Incubation Centre, part of the Michael G. DeGroot Centre for Learning and Discovery, in Hamilton, Ontario, Canada under an agreement that expires on November 30, 2008. The terms of the foregoing lease agreement with McMaster University is qualified in its entirety by reference to the document attached hereto.

All assets are held in the name of the Corporation. The following table details the Corporation's fixed assets as of December 31, 2006:

|                          | <b>Cost (\$)</b> | <b>Accumulated<br/>Depreciation (\$)</b> | <b>Net Book<br/>Value (\$)</b> |
|--------------------------|------------------|--|--------------------------------|
| Manufacturing equipment  | 20,585           | 10,056                                   | 10,529                         |
| Computer equipment       | 299,947          | 218,529                                  | 81,418                         |
| Furniture and equipment  | 65,609           | 48,373                                   | 17,236                         |
| Research instrumentation | 666,460          | 515,576                                  | 150,884                        |
| Laboratory equipment     | 61,437           | 24,023                                   | 37,414                         |
| Leasehold improvements   | 39,983           | 25,054                                   | 14,929                         |
| <b>TOTAL</b>             | <b>1,154,021</b> | <b>841,611</b>                           | <b>312,410</b>                 |

**ITEM 4A. *Unresolved Staff Comments***

Not Applicable.

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**ITEM 5. *Operating and Financial Review and Prospects.***

*The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and notes thereto for the years ended December 31, 2006, 2005 and 2004, which have been prepared in accordance with Canadian generally accepted accounting principles. Some of the statements contained in this section constitute forward-looking statements. These statements relate to future events or to the Corporation's future financial performance and involve known and unknown risks, uncertainties and other factors that may cause the Corporation's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements.*

**A. *Operating Results***

***Year Ended December 31, 2006 Compared With Year ended December 31, 2005***

*Net Loss*

The consolidated net loss for the year ended December 31, 2006 was \$5,948,000 or \$(0.27) per share compared with a net loss of \$4,990,000 or \$(0.23) per share for the year ended December 31, 2005, an increase of \$958,000. Sales and license revenue increased by \$1,756,000 but was offset by an increase in interest and imputed interest on convertible debentures of \$1,013,000, an increase in research and development expenses of \$1,653,000 and a litigation settlement of \$175,000.

*Revenue*

Product sales of PREVU\* Skin Cholesterol tests to our licensee McNeil amounted to \$7,000 in 2006 compared with \$426,000 in 2005. Throughout 2006, numerous pilot programs were conducted by the Corporation's licensee, particularly in the retail pharmacy setting, utilizing inventory that had been purchased from the Corporation in 2005.

License revenue was \$3,329,000 in 2006 compared to \$1,153,000 in 2005, an increase of \$2,176,000. Milestone revenues earned and received from our licensee were recorded as license revenue and amounted to \$500,000 in 2006 compared with \$638,000 in 2005. In addition, minimum sales levels in the agreements provided additional license revenue of \$220,000 and \$194,000 in 2006 and 2005, respectively. The up-front cash payments from both the worldwide agreement and the original Canadian agreement of \$3,000,000 and \$100,000, respectively, had previously been deferred and were being recognized into income on a straight-line basis over the relative terms of the agreements (10 and 15 years, respectively). Upon termination of the agreements on December 28, 2006, the balance of the deferred revenues, representing the unamortized portion of the up-front payments received from the licensee, was recognized as license revenue. Thus, the amount of the up-front payments recognized in 2006 amounted to \$2,609,000 compared with the amortized amount of \$307,000 in 2005.

*Cost of Product Sales and Gross Profit*

Cost of product sales exceeded sales for 2006 by \$30,000, compared to \$3,000 in 2005. The loss resulted from inventory obsolescence and development costs for label and software changes to inventory.

*Research and Development*

Research and development expenses for the year increased by \$1,653,000 to \$4,774,000 from \$3,120,000 in 2005.

The variance for the year reflects:

• An increase of \$1,673,000 in spending on clinical trials for skin cholesterol and cancer to \$2,571,000 from \$898,000 in 2005. This increase is related to acceleration and completion of several large trials for skin cholesterol to lead to additional regulatory submissions and advancement of the lung cancer trial (the "I-ELCAP" study). The Corporation currently has five clinical trials ongoing, compared with 15 in 2005;

- An increase of \$77,000 in product liability insurance due to the significant increase in patients tested;
- A decrease of \$173,000 in subcontract research as the development of a second-generation color reader for the skin cholesterol test was completed;

- A decrease in compensation of \$41,000, reflecting lower incentive payments for the year for performance milestones and a personnel vacancy; and
- Minor changes in other development costs during the period.

In August 2004, the Corporation learned that two of its U.S. patents had been listed as abandoned by U.S. PTO for failure to pay maintenance fees. The failure to pay these maintenance fees occurred when the files were transferred between U.S. and Canadian patent agents. The Corporation filed a petition with the U.S. PTO for reinstatement of the patents. After several appeals, the U.S. PTO denied the Corporation's request for reinstatement. The U.S. PTO found that the patents lapsed as a result of the law firm's failure to use its established docketing procedures regarding payment of the maintenance fees. The Corporation has authorized legal action against the law firm that was responsible for managing its patent portfolio at the time when the maintenance fees for the two patents in question should have been paid. The claim for damages was outstanding at December 31, 2006.

#### *General and Administration Expenses*

General and administration expenses amounted to \$3,025,000 compared with \$2,691,000 in 2005, an increase of \$334,000.

The increase for the year reflects:

- An increase of \$435,000 in professional expenses which included approximately \$330,000 in legal fees relating to litigation regarding the ColorectAlert™ License Agreements. The litigation was settled on January 5, 2007;
- A payment of \$175,000 upon completion of an amendment to the ColorectAlert License Agreements on January 5, 2007 (see note 8[b][i] to the consolidated financial statements);
- An increase in market research expenses of \$46,000 and in travel of \$58,000 relating to business development opportunities;
- A reduction of \$44,000 in expenses (from \$44,000 to nil) relating to a prior year's unsolicited offer to acquire the shares of another company;
- A reduction in compensation of \$105,000 reflecting lower incentive payments for 2006 for performance milestones and a personnel vacancy;
  - A reduction in investor relations expenses and annual report costs of \$99,000 and \$40,000, respectively; and
- A reduction of \$38,000 in stock-based compensation for options for administrative personnel and consultants resulting in a non-cash expense of \$384,000 compared with \$422,000 in 2005.

#### *Interest on Convertible Debentures*

Interest on convertible debentures (issued on August 30, 2005) amounted to \$678,000 in 2006 compared to \$228,000 in 2005. The debentures bear interest at an annual rate of 7%, payable quarterly in either cash or stock. In 2006, \$281,000 of the interest expense was paid in stock, rather than cash, compared with nil in 2005. Imputed interest of \$820,000 (compared with \$256,000 in 2005) represents the expense related to the accretion of the liability component at an effective interest rate of 12.75%.

#### *Amortization*

Amortization expenses for equipment and acquired technology for 2006 amounted to \$180,000 compared with \$210,000 in 2005. Leasehold improvements in the research facilities and purchases of equipment to support administration, clinical trials and manufacturing amounted to \$25,000 in 2006 and \$130,000 in 2005. In addition, the PREVU\* trademark was purchased from the former licensee of the skin cholesterol technology for \$150,000. Amortization of deferred financing fees amounted to \$139,000 for 2006 compared to \$43,000 in 2005. The financing fees are amortized over the four-year life of the convertible debentures.



*Foreign Exchange*

Loss or foreign exchange due to fluctuations in the CDN/U.S. exchange rates amounted to \$97,000 in 2006 compared with a gain of \$36,000 in 2005. The exchange rate applies to the Convertible debenture which is repayable in U.S. dollars and to some U.S. funds that are invested in short-term investments.

*Investment Tax Credits*

Recoveries of provincial ITCs amounted to \$200,000 for 2006 compared with \$199,000 in 2005.

*Interest Income*

Interest income amounted to \$265,000 for 2006, compared with \$173,000 for 2005. The increase resulted from the investment of the proceeds on the convertible debentures in August 2005.

*U.S. GAAP*

For purposes of U.S. GAAP, the consolidated loss for 2006 was \$5,887,000 compared with \$4,904,000 (as restated) in 2005.

*Other*

Accounts receivable as at December 31, 2006 amounted to \$11,000 compared to \$882,000 as at December 31, 2005. The 2005 amount includes license revenues billed to the licensee, whereas there were no amounts outstanding from the licensee as at December 31, 2006.

The increase in prepaid expenses and other receivables of \$254,000 includes a deposit of \$370,000 made to a contract manufacturer against future production of a new color reader for the skin cholesterol test.

The financing fees related to the convertible debenture are pro-rated between the debt and the fair value of the equity and warrant features. The debt portion is deferred and amortized over the term of the debenture. Additional costs of \$51,000 related to the 2005 issue of convertible debentures were incurred in 2006. Upon conversion of a portion of the convertible debentures in 2006, the unamortized portion transferred to capital stock amounted to \$22,000. The unamortized balance at December 31, 2006 amounted to \$348,000 compared with \$478,000 for the prior year.

Accounts payable at December 31, 2006 amounted to \$964,000, compared with \$291,000 at December 31, 2005. The 2006 amount includes \$316,000 for clinical trial expenses and \$344,000 for legal fees. The increase of \$277,000 in accrued liabilities for 2006 includes \$175,000 related to the settlement of litigation on a cancer license agreement which was concluded on January 5, 2007.

In August 2005, the Corporation issued \$9,828,000 (US\$8,210,000) of unsecured convertible debentures. During 2006, \$475,000 (US\$430,000) was converted into 150,877 common shares of the Corporation, which resulted in a reclassification of \$357,000 of the liability, \$140,000 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital. Additional financing expenses of \$51,000 were incurred in 2006, of which \$14,000 was allocated to the equity component of the convertible debentures and \$7,000 was allocated to warrants based on their relative fair values.

***Year Ended December 31, 2005 Compared With the Year Ended December 31, 2004***

*Net Loss*

The consolidated net loss for the year ended December 31, 2005 was \$4,990,000 or \$(0.23) per share compared with a net loss of \$5,569,000 or \$(0.26) per share for the year ended December 31, 2004, a decrease of \$579,000. The improvement resulted from an increase in sales and license revenue of \$1,094,000, which was partially offset by an increase in interest and imputed interest of \$484,000 on convertible debentures, issued on August 30, 2005.

*Revenue*

Product sales of PREVU\* Skin Cholesterol Tests to the Corporation's licensee, McNeil Consumer Healthcare, amounted to \$426,000 in 2005 compared with \$183,000 in 2004.

In 2004, the Corporation completed a worldwide licensing agreement with McNeil to sell its cardiovascular products under the brand name PREVU\* Skin Cholesterol Test. The upfront cash payments from both the worldwide agreement and the original Canadian agreement of \$3,000,000 and \$100,000, respectively, were deferred and recognized into income on a straight-line basis over the relative terms of the agreements (10 and 15 years, respectively). Thus, the amounts being recognized into income for 2005 and 2004 were \$307,000 and \$182,000, respectively. Furthermore, minimum sales levels in the agreement provided additional revenue of \$194,000 and

\$120,000 in 2005 and 2004, respectively. Revenues received upon achievement of milestones amounted to a further \$638,000 in license revenue for 2005 compared with nil in 2004. Total license revenue amounted to \$1,153,000 for 2005 compared with \$302,000 in 2004.

#### *Cost of Product Sales and Gross Profit*

Cost of product sales exceeded sales for 2005 by \$3,000, compared to \$7,000 in 2004. The loss resulted from development costs for label and software changes to inventory.

#### *Research and Development*

Research and development expenditures for the year increased by \$507,000 to \$3,120,000 from \$2,613,000 in 2004. The variance for the year reflects:

- A \$410,000 increase in spending on clinical trials for skin cholesterol and cancer to \$898,000 from \$488,000 in 2004. This increase was related to additional trials for skin cholesterol to lead to additional regulatory approvals, a new trial for breast cancer and continuation of the lung cancer trial (the "I-ELCAP" study);
- Increased legal fees on intellectual property, which amounted to \$331,000 compared with \$292,000 in fiscal 2004. These costs included \$189,000 in 2005 (\$96,000 in 2004) related to the petition for reinstatement of two U.S. patents for skin cholesterol that had been deemed abandoned;
- An increase of \$135,000 in subcontract research to \$451,000 in support of the development of a second-generation color reader for the skin cholesterol test. This was partially offset by a decrease in product development expenditures for supplies of \$55,000;
- An increase in stock-based compensation expense of \$23,000 resulting in non-cash expenses for research personnel of \$147,000 in 2005 compared with \$124,000 for 2004. This reflects the amortization of the 2003 and 2004 grants as well as the 2005 grants; and
- A decrease in compensation of \$53,000, reflecting lower incentive payments for the year for performance milestones; and
- Minor changes in other development costs during the period.

#### *General and Administration Expenses*

General and administration expenses amounted to \$2,691,000 compared with \$3,347,000 in 2004, a decrease of \$656,000. The decrease for 2005 reflects:

- A reduction of \$434,000 in professional expenses resulting from the non-recurring expenditure of \$478,000 in 2004 for the unsolicited offer to acquire the shares of IBEX Technologies Inc. ("IBEX");
- A reduction of \$54,000 in stock-based compensation for options for administrative personnel and consultants which resulted in a non-cash expense of \$422,000 compared with \$476,000 in 2004. The 2004 amount included \$95,000 as the fair value of the cashless exercise of options by an officer of the Corporation;
- A reduction in investor relations expenses by \$61,000 following the completion of some consulting contracts during 2005;
- A reduction in compensation of \$38,000, reflecting lower incentive payments for 2005 for performance milestones; and
- A reduction of \$45,000 in travel expenses as a result of fewer international business development meetings.

#### *Interest on Convertible Debentures*

Interest on convertible debentures (issued on August 30, 2005) amounted to \$228,000 in 2005 compared to nil in 2004. The debentures bear interest at an annual rate of 7%, payable quarterly in either cash or stock. Imputed interest of \$256,000 (compared to nil in 2004) represents the accretion of the liability component at an effective interest rate of 12.75%.

*Amortization*

Amortization expenses for equipment and acquired technology for 2005 amounted to \$210,000 compared with \$224,000 in 2004. The amortization of production molds amounted to \$3,000 in 2005 (2004 - \$7,000), and was recorded as a cost of inventory. Purchases of equipment to support administration, clinical trials and manufacturing

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amounted to \$130,000 in 2005 and \$165,000 in 2004. Amortization of deferred financing fees amounted to \$43,000 for 2005 compared to nil in 2004. The financing fees are amortized over the life of the convertible debentures.

*Foreign Exchange*

Gain on foreign exchange amounted to \$36,000 in 2005 compared to a loss of \$9,000 in 2004.

*Investment Tax Credits*

Recoveries of provincial ITCs amounted to \$199,000 for 2005 compared with \$205,000 in 2004.

*Interest Income*

Interest income amounted to \$173,000 for 2005, compared with \$124,000 for 2004. The increase resulted from the investment of the proceeds of the convertible debentures in August 2005.

*U.S. GAAP*

For purposes of U.S. GAAP, the consolidated loss for 2005 was \$4,904,000 (as restated) compared with \$5,478,000 in 2004.

*Other*

The increase in accounts receivable as at December 31, 2005 reflects the milestone revenues receivable from the Corporation's licensee, referred to above under "Revenue".

The financing fees related to the convertible debenture are pro-rated between the debt and the fair value of the equity and warrant features. The debt portion is deferred and amortized over the term of the debenture. The unamortized portion amounted to \$478,000 at December 31, 2005.

There was a significant decrease of \$730,000 in accounts payable in 2005 compared with 2004. The 2004 amount included an amount for the purchase of inventory of approximately \$340,000 and most of the expenses related to the IBEX offer.

In August, 2005, the Corporation issued \$9,828,000 (US\$8,210,000) unsecured convertible debentures. As explained in note 5 to the consolidated financial statements, \$5,893,000 was recorded as a liability, \$1,178,000 as warrants and \$2,393,000 as an equity instrument.

***B. Liquidity and Capital Resources***

As at December 31, 2006, the Corporation had cash, cash equivalents and short-term investments totaling \$3,276,000 (\$8,679,000 as at December 31, 2005). The Corporation invests its funds in short-term financial instruments and marketable securities. Cash used in operating activities during the year amounted to \$5,079,000 compared with \$5,308,000 in 2005.

On August 30, 2005, the Corporation issued \$9,828,000 (US\$8,210,000) unsecured convertible debentures, maturing on August 30, 2009, for net proceeds of \$8,966,000 after deducting issue fees and expenses of \$862,000. Additional expenses of \$51,000 were incurred in 2006. The issue costs attributable to the liability component were deferred and will be amortized over the life of the debt. The issue costs attributable to the equity component of the convertible

debentures and the warrants were deducted from the respective balances.

Effective December 28, 2006, the agreements with McNeil to market and distribute the PREVU\* Skin Cholesterol tests were terminated. The Corporation is pursuing several opportunities to continue the commercialization of these tests, including direct sales in certain markets, licensing the marketing rights to other multinational healthcare companies and negotiating distribution agreements in specific territories.

As discussed above in *Item 4, Information on the Corporation: Key Relationships*, on March 28, 2007, the Corporation issued, by way of private placement, 2,917,268 common shares and 1,458,634 common share purchase

warrants for gross proceeds of approximately \$3.9 million. Each common share purchase warrant expires in March 2010 and entitles the holder to acquire one common share at a price of \$1.66 per share.

To date, we have financed our activities through product sales, license revenues, the issuance of shares and convertible debentures and the recovery of provincial ITCs. Management believes that, based on historical cash expenditures and the current expectation of future revenues from product sales, royalties and license revenues, our existing cash resources, together with the proceeds of the private placement subsequent to the year end (see note 12 to the consolidated financial statements) and the ITC receivable of \$200,000, will be sufficient to meet our current operating and capital requirements through at least 2008.

However, our future capital requirements will depend on many factors, including our ability to negotiate new licensing and/or sales distribution agreements to market our PREVU\* Skin Cholesterol tests, continued progress in our product development and clinical programs, time and expense associated with regulatory filings, prosecution and enforcement of our patent claims, and costs associated with obtaining regulatory approvals. In the immediate term, until we obtain additional regulatory approvals for PREVU\* and conclude new relationships for sales and marketing of PREVU\*, revenue growth is expected to be slow.

### *C. Research and Development and Patents and Licenses*

In fiscal 2006, the Corporation spent \$4,774,000 on Corporation-sponsored research and development activities compared with \$3,120,000 and \$2,613,000 in 2005 and 2004, respectively.

Below is a summary of the Corporation's products and the related stages of development for each product in clinical development. The summary contains forward-looking statements regarding timing of completion of product development phases. The actual timing of completion of those phases could differ materially from the estimates produced in the table.

| <b>Product</b>   | <b>Description / Indication</b>   | <b>Phase of Development</b>  | <b>Approx. % Completed</b> | <b>Collaborator</b>                | <b>Estimate of Completion of Phase</b> |
|--|---|--|----------------------------|------------------------------------|--|
|  | <u>Coronary Artery Disease (CAD) Risk Assessment Technology:</u>  |  |                            |                                    |  |
| PREVU*<br>POC Skin<br>Cholesterol<br>Test<br>(previously<br>Cholesterol<br>1,2,3™) | Point of care skin<br>cholesterol test that<br>provides<br>information about<br>an individual's risk<br>of coronary artery<br>disease | Regulatory<br>clearance in<br>Canada, U.S.<br>and Europe;<br>start of<br>commercial<br>sales | 100%                       | McNeil (until<br>December<br>2006) | 2006                                   |
|  |   |  | 80%                        | Clinical trial<br>data being       | 2007                                   |



|  |  |   |     |                     |      |
|--|--|---|-----|---------------------|------|
|  |  | Expand regulatory claims  |     | analyzed            |      |
| PREVU*<br>LT Skin<br>Cholesterol<br>Test | Lab-processed skin cholesterol test      | Regulatory clearance in Canada, CE-marked in Europe; 510(k) filed in US for screening life insurance applicants | 85% | Insurance companies | 2007 |
|  |  | Commercial launch in select markets   | nil | N/A                 | 2007 |
| PREVU*<br>PT Skin<br>Cholesterol<br>Test | Semi-quantitative consumer-oriented test | Prototype development   | 50% | N/A                 | 2008 |

| <b>Product</b>              | <b>Description / Indication</b>                      | <b>Phase of Development</b>                              | <b>Approx. % Completed</b> | <b>Collaborator</b>            | <b>Estimate of Completion of Phase</b> |
|-----------------------------|--|--|----------------------------|--------------------------------|--|
| <u>Cancer Technologies:</u> |  |  |                            |                                |  |
| ColorectAlert™ & Colopath™  | Mucus tests for early detection of colorectal cancer | 2,500 patients tested in clinical trials                 | 100%                       | St. Michael's Hospital         | 2004                                   |
|                             |  | Additional clinical studies to support commercialization | 10%                        | EDRN                           | 2007/08                                |
| LungAlert™                  | Sputum test for early detection of lung cancer       | Automation of procedures                                 | 80%                        | St. Joseph's Hospital; I-ELCAP | 2007                                   |
|                             |  | 2,500 patients tested in clinical trials                 | 80%                        |                                | 2007                                   |
| Breast Cancer Test          | Aspirate test for early detection of breast cancer   | Completed pilot study; pivotal study underway            | 50%                        | University of Louisville       | 2007                                   |
| All Cancer Tests            | Improvement of assay method                          | Alternative format development                           | 80%                        | N/A                            | 2007                                   |

The table below sets out the estimated costs incurred for each of the Corporation's products for the years ended December 31, 2006, 2005, 2004 and 2003. In addition, an historical cumulative total of costs incurred since February 1997, per product, has been provided. Prior to February 1997, the Corporation did not track its costs by project.

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| <b>Product</b>                   | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2006</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2005</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2004</b> | <b>Fiscal<br/>Year<br/>Ended<br/>December<br/>31,<br/>2003</b> | <b>Historical<br/>Cumulative<br/>total since<br/>February 1,<br/>1997</b> |
|----------------------------------|--|--|--|--|---|
| CAD Risk Assessment Technologies | \$ 3,103,000   | \$ 2,025,000   | \$ 1,476,000   | \$ 860,000   | \$ 11,670,000   |
| ColorectAlert™ and ColoPath™     | \$ 275,000   | \$ 309,000   | \$ 304,000   | \$ 327,000   | \$ 3,265,000  |
| LungAlert™                       | \$ 659,000   | \$ 309,000   | \$ 255,000   | \$ 228,000   | \$ 1,797,000  |
| Breast Cancer Test               | \$ 79,000  | \$ 66,000  | \$ 42,000  | \$ 45,000  | \$ 232,000  |

The Corporation started to generate revenues from sales of PREVU\* in the calendar year 2005. The Corporation anticipates that costs to complete the development of new formats and clinical trials of the coronary artery disease technologies will not exceed \$1million.

With respect to the Corporation's cancer-related products, the Corporation estimates that the costs to complete clinical trials and commercialize the colorectal cancer technology will not exceed \$2 million. However, given the nature and uncertainty of ultimately receiving regulatory clearance for these cancer-related products, the Corporation is unable to reasonably estimate the timing of these projects' commercialization.

#### ***D. Trend Information***

See "Information on the Corporation - Business Overview."

#### ***E. Off-Balance Sheet Arrangements***

The Corporation has no material off balance sheet arrangements.

#### ***F. Contractual Commitments***

As at March 31, 2007, the Corporation had certain contractual obligations and commitments related to ongoing clinical trials and research agreements as follows:

|                 | <b>Total</b>      | <b>Less than<br/>1 Year</b> | <b>1 - 2 Years</b> | <b>2-5<br/>Years</b> |
|-----------------|-------------------|-----------------------------|--------------------|----------------------|
| Clinical Trials | \$ 305,000        | \$ 305,000                  | nil                | nil                  |
| Other           | 261,000           | 140,000                     | 121,000            | nil                  |
| <b>Total</b>    | <b>\$ 566,000</b> | <b>\$ 121,000</b>           | <b>\$ 121,000</b>  | <b>nil</b>           |

As at December 31, 2006, the total contractual obligations and commitments amounted to \$685,000.

Certain other obligations, totaling up to \$225,000, are only payable upon the achievement of specific events.

As at December 31, 2006, the balance outstanding of \$9,067,000 (US\$7,780,000) for the convertible debentures that were issued on August 30, 2005 is payable in U.S. dollars and is due in August 2009.



**ITEM 6. *Directors, Senior Management and Employees.***

**A. *Directors and Senior Management.***

**SENIOR MANAGEMENT**

*H.B. Brent Norton, MD, MBA, 46, President and CEO, Director*

Dr. Norton founded the Corporation in 1992 and has since served as President and Chief Executive Officer and as a director of the Corporation. Active in medical practice, management and research for over 15 years, Dr. Norton has represented and led multiple medical groups and scientific initiatives. As a physician-entrepreneur, his cross-functional knowledge and skills enable him to guide the Corporation and its products from the scientific stage through to successful commercialization.

Dr. Norton serves as a director on the boards of public and private medical companies in Canada and the U.S. and is an Advisory Council Member of the Richard Ivey School of Business MBA Biotech Program. He is also an active volunteer, previously serving as Chairman, Friends Project, for the Canadian Institute for Advanced Research, and as a committee member of a Canadian Intergovernmental Economic Commission, Advanced Technology Group.

Dr. Norton completed his medical training at McGill University in Montreal, Quebec in 1984. He subsequently completed a Master of Business Administration degree at the Richard Ivey School of Business, University of Western Ontario, in London, Ontario, Canada, in 1989.

*Tim Currie, BA, 43, Vice President, Corporate Development*

Mr. Currie joined the Corporation on January 4, 2000 as Director, Business Development. On June 16, 2004, Mr. Currie was promoted to his current position. His career includes more than 15 years of experience in the pharmaceutical and health information fields in various senior sales and marketing positions for large multinational companies.

He is responsible for developing and implementing corporate business plans and for building alliances with other companies and organizations that complement the Corporation and drive its products towards commercialization. He leads efforts to acquire new technologies that fit with the Corporation's vision, and manages the Corporation's licensing initiatives for the marketing and distribution of products.

Mr. Currie has a degree in economics from the University of Western Ontario, and is active in a number of community organizations.

*Michael Evelegh, Ph.D., 54, Executive Vice President, Clinical and Regulatory Affairs*

Dr. Evelegh joined the Corporation on April 1, 1997 in the position he currently holds as the Corporation's Executive Vice President, Clinical and Regulatory Affairs.

Dr. Evelegh has 20 years of experience researching and developing human diagnostics, including product development, clinical trials, regulatory submissions and manufacturing. Dr. Evelegh leads the Corporation's scientific team at the Corporation's laboratory located at McMaster University in Hamilton, Ontario. He is also chiefly responsible for evaluating the scientific potential of new technologies for the Corporation's pipeline of products.

Prior to joining the Corporation, Dr. Evelegh was the Director of Research and Development for Biomira Diagnostics Inc., a medical technology company. He also directed research teams at other Canadian biotechnology companies and has been an independent scientific and regulatory consultant. He earned his Ph.D. in Immunology at McMaster University, where he is an Associate Professor in the university's medical school.

*Ron Hosking, 62, Vice President, Finance and Chief Financial Officer*

Mr. Hosking joined the Corporation on September 25, 1997 in the position he currently holds as the Corporation's Vice President, Finance and Chief Financial Officer.

Mr. Hosking's career includes more than 20 years in the health care industry managing the finances of multinational and early-stage companies. Prior to joining the Corporation, Mr. Hosking was Vice President and Chief Financial Officer of LifeTECH Corporation, a biotechnology corporation, from 1996 to 1997. Prior to that time, Mr. Hosking had been Vice President and Chief Financial Officer of Biomira Diagnostics Inc and of Ortho Diagnostics Inc. (a Johnson & Johnson company). He is a Chartered Accountant and completed his B.Comm at the University of Toronto in Toronto, Ontario, Canada.

Mr. Hosking has been actively involved in industry and professional associations, including tenures as Chairman of the Board of Medical Devices Canada (MEDEC) and President of Financial Executives International (FEI) Toronto. He is currently a member of FEI and the Toronto Biotechnology Initiative (TBI).

## **DIRECTORS**

*Stephen A. Wilgar, BA, MBA, 69, Chairman of the Board*

Mr. Wilgar has served as one of the Corporation's directors since March 17, 1993. From May 2001 to June 2002, Mr. Wilgar was also a Director of Dimethaid Research Inc. and from June 1991 to April 2002, he was a Director of Verity International. In addition, he has served as Chairman of AIM Powergen Corp. and Team IMS from January 2002 to the present and as Director of Electrohome Ltd. from January 2004 to the present. Prior to that, Mr. Wilgar was a Director of MedExtra Corp. from December 2001 to March 2002 and was the President of SunBlush Technologies Corporation from 1996 to 1999. From 1974 to 1988 he also served as President of Warner-Lambert Canada, Asia, Australia and Latin America. He is also a former President of the Canadian Automobile Association, Central Ontario.

*H.B. Brent Norton, MD, MBA, 47, Director*

See description above under "Directors, Senior Management and Employees - Directors and Senior Management - Senior Management."

*Anthony F. Griffiths, BA, MBA, 77, Director*

Mr. Griffiths has served as one of the Corporation's directors since July 13, 1995. From 1997 to the present, Mr. Griffiths has served as Director and Chairman of Russel Metals Inc. Since 2002 to the present, he has served as Director and Chairman of Novadaq Technologies, Inc., which completed its initial public offering in June 2005. In addition, Mr. Griffiths is a Director of numerous companies, including Fairfax Financial Holdings Limited from 2002, Vitran Corporation Inc from 1987, Alliance Atlantis Communications Inc. from 1996, Hub International Limited from 1998, Northbridge Financial Corporation from 2003, Odyssey Re Holdings Corp. from 2001 and Jaguar Mining from 2004 to the present.

From 1987 to 1993, Mr. Griffiths was Chairman of Mitel Corporation, also serving as President and Chief Executive Officer from 1991 to 1993. From 2004 to November 2005, Mr. Griffiths served as Director and Chairman of Leitch Technology Corporation (Director since 1994). From 1994 and 2000, respectively, to 2004, Mr. Griffiths served as Director and Chairman of Slater Steel Inc. and Brazilian Resources Inc. He was also a Director of ShawCor from 1980 to 2004, Teklogix International Inc. from December 1998 to September 2000, Calian Technology Ltd. from



1993 to 2004, Canadian Tire Corporation from 1988 to 1998, QLT Inc. from 1988 to 2002 and Consumers Packaging Inc. from 2000 to 2002.

*Ronald D. Henriksen, MBA, 68, Director*

Mr. Henriksen has served as one of the Corporation's directors since June 16, 2004. Mr. Henriksen has 35 years of experience in healthcare, working in the pharmaceutical, biotechnology, consulting, technology transfer and venture capital industries. Since March 2002, Mr. Henriksen has served as the Chief Investment Officer of Twilight Ventures, LLC, an Indianapolis-based venture capital firm investing exclusively in life science companies. Since January 1, 2005 and February 1, 2005, respectively, he has served as Chairman and Chief Executive Officer of Semafore Pharmaceuticals, Inc. and as President and Chief Executive Officer of EndGenitor Technologies Inc.

Previously, Mr. Henriksen was the President of ARTI (Indiana University's Advanced Research & Technology Institute) from November 1998 until March 2002.

Mr. Henriksen has served on the board of directors of ANGEL Learning, QLT, Inc., Cytori Therapeutics and BioStorage Technologies since 2000, 1997, 2002 and 2003, respectively. He received his Bachelor of Science in Industrial Administration at Iowa State University and a Masters of Business Administration "with distinction" from the Harvard Business School.

*David Rosenkrantz, P. Eng., 49, Director*

Mr. Rosenkrantz has served as one of the Corporation's directors since June 11, 1998. Mr. Rosenkrantz has been President and Director of Patuca Securities Limited since 1993 and is the founding partner of Patuca Corporation, a merchant banking corporation. In addition, Mr. Rosenkrantz has served as Director of Stellar Pharmaceuticals Inc. since 2002 (Chairman from 2002 to 2004), Versent Corporation since 1993 (Chairman since 2004), Neuromolecular Inc. since 2001, Carfinco Income Fund since 2002, Medisystem Technologies Inc. (Lead Director) since 2004 and RAS Completions Inc. since 2000. He was also a Director of LymphoSign Inc. from 2000 to 2003, Northern Mountain Helicopter Group Inc. from 1996 to 2000 and Beta Brands Inc. from 1993 to 1995.

## **SCIENTIFIC ADVISORY BOARD**

The role of the Scientific Advisory Board (the "SAB") is to provide the Corporation with guidance for new research directions as well as advice on product development plans. The SAB also assists in identifying and defining attractive market niches and in providing industry-related information.

The members of the SAB include:

*Dr. John Bienenstock, FRCP, FRCPC, FRSC*

Dr. Bienenstock was appointed to the SAB in May 1998. He is a Professor, Departments of Medicine and Pathology, Faculty of Health Sciences, McMaster University, Hamilton, Ontario, Canada. Dr. Bienenstock is an internationally renowned physician and scientist and was awarded the Order of Canada in 2002 in recognition of his contribution to medicine.

*Dr. Herbert A. Fritsche, Jr., Ph.D.*

Dr. Fritsche was appointed to the SAB in January 2000. He is the Chief of Clinical Chemistry and Professor of Biochemistry, Department of Pathology and Laboratory Medicine, University of Texas M.D. Anderson Cancer Center, Houston, Texas. He has been with M.D. Anderson Cancer Center for over 30 years and has been the recipient of many awards, including the Distinguished Scientist Award for 1999 by the Clinical Ligand Assay Society.

*Dr. Norman Marcon, M.D., FRCP*

Dr. Marcon was appointed to the SAB in April 2000. He is a Gastroenterologist and Past-Chief, Division of Gastroenterology of St. Michael's Hospital, Toronto, Ontario, Canada. He has been with St. Michael's Hospital since 1972. Dr. Marcon is a Fellow, Royal College of Physicians and Surgeons of Canada and is a recipient of The Ontario Association of Gastroenterology Lifetime Achievement Award. He is also Associate Professor of Medicine, University of Toronto, Toronto, Ontario, Canada.

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*Dr. Dennis L. Sprecher, MD*

Dr. Sprecher was appointed to the SAB in April 1999. He is Director, Dyslipidemia Discovery Medicine at GlaxoSmithKline, Pennsylvania, USA. He was formerly the Section Head, Preventive Cardiology & Rehabilitation, The Cleveland Clinic Foundation, where he continues to serve as Cardiologist, Adjunct Staff. He is also an Adjunct Professor, University of Pennsylvania Department of Cardiology, University of Pennsylvania Medical Center Presbyterian. Prior to joining the Cleveland Clinic in 1995, Dr. Sprecher was the Section Head of Preventative Cardiology at the University of Cincinnati, Cincinnati, Ohio.

## **B. Compensation**

### **1. Summary Compensation Table**

The following table is a summary of the compensation paid by the Corporation to its: (i) President and Chief Executive Officer; (ii) Executive Vice President, Clinical and Regulatory Affairs; (iii) Vice President, Finance and Chief Financial Officer; and (iv) Vice President, Corporate Development (collectively, the “Named Executive Officers”) for the years ended December 31, 2006, 2005 and 2004.

| Name and Position  | Financial Year Ended | Annual Compensation |            | Long-term Compensation                        |                                     |                             |
|--|----------------------|---------------------|------------|---|-------------------------------------|-----------------------------|
|  |                      | Salary (\$)         | Bonus (\$) | Other Annual Compensation <sup>(1)</sup> (\$) | Securities Under Option Granted (#) | All other Compensation (\$) |
| Dr. Brent Norton<br>President and<br>Chief Executive<br>Officer                              | Dec. 31, 2006        | 325,000             | 32,500     | -   | 230,000                             | 7,713                       |
|  | Dec. 31, 2005        | 331,250             | 28,500     | -   | 100,000                             | 22,101                      |
|  | Dec. 31, 2004        | 285,000             | 142,500    | -   | -                                   | -                           |
| Ronald Hosking<br>Vice President,<br>Finance and Chief<br>Financial Officer                  | Dec. 31, 2006        | 185,400             | -          | -   | 78,000                              | -                           |
|  | Dec. 31, 2005        | 191,461             | 30,000     | -   | 52,000                              | 13,691                      |
|  | Dec. 31, 2004        | 167,500             | 30,000     | -   | -                                   | -                           |
| Michael Evelegh<br>Ph.D., Executive<br>Vice President,<br>Clinical and<br>Regulatory Affairs | Dec. 31, 2006        | 231,750             | 23,175     | -   | 150,000                             | -                           |
|  | Dec. 31, 2005        | 244,125             | 22,500     | -   | 65,000                              | -                           |
|  | Dec. 31, 2004        | 225,000             | 56,250     | -   | -                                   | -                           |
| Tim Currie<br>Vice President,<br>Corporate<br>Development                                    | Dec. 31, 2006        | 185,400             | 18,450     | -   | 150,000                             | 21,320                      |
|  | Dec. 31, 2005        | 200,400             | 29,100     | -   | 52,000                              | 6,230                       |
|  | Dec. 31, 2004        | 150,000             | 45,000     | -   | 35,000                              | -                           |

**Note:**

(1) Unless otherwise disclosed, the aggregate amount of perquisites and other personal benefits do not exceed the lesser of \$50,000 and 10% of the salary and the bonus of each Named Executive Officer for the years ended December 31, 2006, 2005 and 2004.

**2. Long-term Incentive Plan Awards during the Year Ended December 31, 2006**

No Long-term Incentive Plan Awards were made to the Named Executive Officers during the year ended December 31, 2006.

**3. Option Grants during the Year Ended December 31, 2006**

During the year ended December 31, 2006, the following incentive stock options were granted to the Named Executive Officers:

| <b>Name and Position</b>  | <b>Securities Under Options Granted (#) <sup>(1)</sup></b> | <b>% of Total Options Granted to Employees in Financial Year</b> | <b>Exercise or Base Price (\$/Security)</b> | <b>Market Value of Securities Underlying Options on the Date of Grant (\$/Security)</b> | <b>Expiration Date</b>                |
|---|--|--|---|---|---------------------------------------|
| Dr. Brent Norton<br>President and Chief Executive Officer                           | 200,000 <sup>(1)</sup><br>30,000 <sup>(3)</sup>            | 20.2%<br>3.0%  | \$1.25<br>\$2.35                            | \$1.25<br>\$2.35  | February 16, 2011<br>October 28, 2011 |
| Ronald Hosking<br>Vice President, Finance and Chief Financial Officer               | 48,000 <sup>(2)</sup><br>30,000 <sup>(3)</sup>             | 4.8%<br>3.0%   | \$1.40<br>\$2.35                            | \$1.40<br>\$2.35  | February 28, 2011<br>October 28, 2011 |
| Michael Evelegh<br>Ph.D., Executive Vice President, Clinical and Regulatory Affairs | 120,000 <sup>(1)</sup><br>30,000 <sup>(3)</sup>            | 12.1%<br>3.0%  | \$1.25<br>\$2.35                            | \$1.25<br>\$2.35  | February 16, 2011<br>October 28, 2011 |
| Tim Currie<br>Vice President, Corporate Development                                 | 120,000 <sup>(1)</sup><br>30,000 <sup>(3)</sup>            | 12.1%<br>3.0%  | \$1.25<br>\$2.35                            | \$1.25<br>\$2.35  | February 16, 2011<br>October 28, 2011 |

**Note:**

- (1) These options will vest annually over a period of five years.
- (2) These options will vest annually over a period of two years.
- (3) These options will vest upon completion of specific measurable milestones.

**4. Aggregated Option Exercises during the Year Ended December 31, 2005 and Financial Year-end Option Values**

The following table sets out (i) the number of Common Shares issued to the Named Executive Officers upon the exercise of options during the year ended December 31, 2006 and the aggregate value realized upon such exercises; and (ii) the number and value of unexercised options held by the Named Executive Officers as at December 31, 2006:

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| <b>Name and Position</b>  | <b>Securities Acquired on Exercise (#)</b> | <b>Aggregate Value Realized (\$)</b> | <b>Unexercised Options at FY-End (#) Exercisable/Unexercisable</b> | <b>Value of Unexercised in-the-money Options at FY-End (\$) Exercisable/Unexercisable <sup>(3)</sup></b> |
|---|--|--------------------------------------|--|--|
| Dr. Brent Norton,<br>President and<br>Chief Executive<br>Officer                              | -  | -                                    | 760,000 <sup>(1)</sup><br>450,000/310,000 <sup>(2)</sup>           | nil/250,000  |
| Ronald Hosking,<br>Vice President,<br>Finance and Chief<br>Financial Officer                  | -  | -                                    | 251,000 <sup>(1)</sup><br>93,800/157,200 <sup>(2)</sup>            | nil/67,200   |
| Michael Evelegh,<br>Ph.D., Executive<br>Vice President,<br>Clinical and<br>Regulatory Affairs | -  | -                                    | 375,000 <sup>(1)</sup><br>173,500/202,000 <sup>(2)</sup>           | nil/150,000  |
| Tim Currie<br>Vice President,<br>Corporate<br>Development                                     | -  | -                                    | 323,000 <sup>(1)</sup><br>76,000/247,000 <sup>(2)</sup>            | nil/150,000  |

**Notes:**

- (1) These options will vest (i) annually over a pre-determined number of years; and/or (ii) upon the occurrence of certain performance-related milestones of the Corporation relating to the Corporation's core technologies (e.g., FDA clearance of initial claims, strategic relationships, new technologies)
- (2) These options were not yet exercisable as the milestones or time periods referred to in note (1) above had not yet been attained.
- (3) Based upon a closing price of \$1.95 for the Common Shares on the Toronto Stock Exchange on December 31, 2006.

*Employee Share Purchase Plan*

The Corporation implemented a share purchase plan (the "Purchase Plan") in March 1999 whereby the Corporation will match the value of the Common Shares purchased by its employees, officers and directors in the market by issuing from treasury an equal number of Common Shares, up to a maximum value of the lesser of (i) 50% of the maximum allowable annual contribution for registered retirement savings plans as established by the Canada Revenue Agency; and (ii) 9% of the participant's annual salary.

The maximum number of Common Shares which may be issued by the Corporation pursuant to the Purchase Plan is 350,000. As at April 30, 2007, the Corporation has issued an aggregate of 152,429 Common Shares under the Purchase Plan to its employees, officers and directors.

***C. Board Practices***

The Corporation's Board of Directors and senior management consider good corporate governance to be central to the effective and efficient operations of the Corporation. The following table lists the directors of the Corporation, the positions they hold with the Corporation and the dates the directors were first elected or appointed:

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| <b>Name</b>           | <b>Position</b>                                 | <b>Term</b>  |
|-----------------------|---|--|
| Dr. H.B. Brent Norton | President, Chief Executive Officer and Director | President, CEO: 1992-present<br>Director: March 17, 1993-present |
| Stephen A. Wilgar     | Director and Chairman                           | March 17, 1993-present   |
| Anthony F. Griffiths  | Director  | July 13, 1995-present  |
| Ronald D. Henriksen   | Director  | June 16, 2004-present  |
| David A. Rosenkrantz  | Director  | June 11, 1998-present  |

The Board of Directors was elected at the annual meeting of shareholders on May 24, 2006, and each director will serve until the next annual meeting of shareholders or until their resignation. During the year ended December 31, 2006, a total of \$74,856 was paid to the directors of the Corporation in their capacity as directors. The directors of the Corporation are eligible to receive options to purchase Common Shares pursuant to the terms of the Corporation's incentive stock option plan. During the financial year ended December 31, 2006, options to purchase an aggregate of 75,000 Common Shares were granted to the non-executive directors. (see "Directors, Senior Management and Employees - Share Ownership - Stock Option Plan"). None of the directors or executive officers of the Corporation have directors' service contracts with the Corporation or its subsidiary providing for benefits upon termination of employment.

The Corporation has entered into employment agreements with each of the Named Executive Officers. Each of these employment agreements sets out the obligations of the Named Executive Officers to the Corporation and the compensation to be paid to them. These Named Executive Officers' compensation includes a combination of base salary, cash bonus, stock options and other benefits.

Unless terminated earlier pursuant to the terms of their respective agreements, the employment with the Corporation of Dr. Norton and Dr. Evelegh shall continue indefinitely. If the employment of such Named Executive Officers is terminated by the Corporation without cause or, at their option, terminated in the event of a "change of control" (as such term is defined in their respective employment agreements) of the Corporation, he is entitled to cash payments equal to a percentage of his then current annual base salary. Also, in the event of termination without cause or termination by Dr. Norton or Dr. Evelegh in the event of a change of control, all of his options shall immediately vest and shall be exercisable or convertible for a period of 60 days after such termination. Each of Dr. Norton and Dr. Evelegh has agreed not to compete with the Corporation (for two years for Dr. Norton and for one year for Dr. Evelegh) in the event that he is terminated with or without cause or if he voluntarily resigns from the Corporation.

Unless terminated earlier pursuant to the terms of their respective agreements, the employment with the Corporation of Mr. Hosking and Mr. Currie shall continue indefinitely. If the employment of Mr. Hosking or Mr. Currie is terminated without cause, he is entitled to an amount equal to 12 months or 18 months, respectively, of his then current (i) annual salary; (ii) benefits under the agreement; and (iii) bonuses or other forms of long-term compensation as may have been granted by the Board of Directors. Such payments to each of Mr. Hosking or Mr. Currie are subject to certain reductions in the event that he finds alternative employment. In the event of termination by either of Mr.

Hosking or Mr. Currie within a certain period after a “Change of Control” (as such term is defined in the employment agreement) of the Corporation, he is entitled to an amount equal to 12 months of his then current annual salary, payable immediately. Further, in the event of termination without cause or in the event of a Change of Control, all of his options shall immediately vest and shall be exercisable for a period of 30 days after such termination. Each of Mr. Hosking and Mr. Currie has also agreed not to compete with the Corporation for one year in the event that he is terminated with or without cause or if he voluntarily resigns from the Corporation.

During the year ended December 31, 2006, the compensation and corporate governance committee was composed of Anthony F. Griffiths, Ron Henriksen and David A. Rosenkrantz. The compensation and corporate governance committee meets on compensation matters as and when required with respect to executive compensation. The primary goal of the compensation and corporate governance committee is to ensure that the compensation provided to the Named Executive Officers and the Corporation’s other senior officers is determined with regard to the Corporation’s business strategies and objectives, such that the financial interest of the senior officers is matched

with the financial interest of shareholders. They also ensure that the Named Executive Officers and the Corporation's senior officers are paid fairly and commensurably with their contributions to furthering the Corporation's strategic direction and objectives. The Corporation also grants stock options to its officers, directors and employees from time to time in accordance with the Corporation's stock option plan.

During the year ended December 31, 2006, the audit committee of the Corporation, composed entirely of outside directors, was made up of Stephen A. Wilgar, Anthony F. Griffiths and David A. Rosenkrantz, each of whom meets the independence requirements of the listing standards of the American Stock Exchange. Mr. Rosenkrantz is the Chair of the audit committee. The audit committee has primary responsibility for ensuring the integrity of the Corporation's financial reporting, risk management and internal controls. The audit committee has unrestricted access to the Corporation's personnel and documents and has direct communication channels with the Corporation's external auditors in order to discuss audit and related matters whenever appropriate. The audit committee receives and reviews the annual and financial statements of the Corporation and makes recommendations thereon to the Board of Directors prior to their approval by the Board of Directors. The audit committee also reviews the scope and planning of the external audit, the form of audit report, and any correspondence from or comments by the external auditors regarding financial reporting and internal controls. Moreover, the audit committee is responsible for correcting weaknesses identified by the external auditors with respect to the internal control systems and for ensuring that the recommended corrections have been implemented.

On February 2, 2006, the Corporation established a nominating committee, composed entirely of outside directors, made up of Ron Henriksen, Anthony F. Griffiths and Stephen A. Wilgar. The role of the Nominating Committee is to coordinate and manage the process of recruiting, interviewing, and recommending candidates to the Board of Directors. This committee has a formal written charter which outlines the committee's responsibilities, requisite qualifications for new directors, the appointment and removal of directors and the reporting obligations to the Board of Directors. In addition, the Nominating Committee is given the authority to engage and compensate any outside advisor that it determines to be necessary to carry out its duties.

#### ***D. Employees***

The Corporation currently employs 16 full-time employees, 10 of whom are located at its head office in Toronto, Ontario, Canada, and 6 at its research laboratory in Hamilton, Ontario, Canada. In addition, the Corporation has contractual arrangements with a number of research scientists and organizations that provide staff and related services. These contracts provide flexible and directed research staff to the Corporation on an as-needed basis.

#### ***E. Share Ownership***

The following table shows the number of Common Shares and options to purchase Common Shares beneficially owned by each director and the Named Executive Officers as of May 31, 2007:

| <b>Name</b>           | <b>Common Shares held directly and beneficially</b> | <b>% of Outstanding Common Shares as of May 31, 2007</b> | <b>Options outstanding</b> | <b>Exercise price</b> | <b>Expiration date</b> |
|-----------------------|---|--|----------------------------|-----------------------|------------------------|
| Dr. H.B. Brent Norton | 2,360,948   | 9.4 %  | 240,000                    | \$ 2.86               | Nov. 16, 2007          |
|                       |   |  | 70,000                     | \$ 4.00               |                        |

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|                          |         |       |  |         |    |                 |                  |
|--------------------------|---------|-------|--|---------|----|-----------------|------------------|
|                          |         |       |  |         |    | Dec. 5,<br>2008 |                  |
|                          |         |       |  | 100,000 | \$ | 2.95            | Feb. 6,<br>2010  |
|                          |         |       |  | 200,000 | \$ | 1.25            | Feb. 16,<br>2011 |
|                          |         |       |  | 30,000  | \$ | 2.35            | Oct. 28,<br>2011 |
|                          |         |       |  | 200,000 | \$ | 1.70            | Mar. 19,<br>2012 |
| Michael<br>Evelegh, Ph.D | 379,261 | 1.5 % |  | 50,000  | \$ | 2.86            | Nov. 16,<br>2007 |
|                          |         |       |  | 50,000  | \$ | 4.00            | Dec. 5,<br>2008  |
|                          |         |       |  | 65,000  | \$ | 2.95            | Feb. 6,<br>2010  |
|                          |         |       |  | 120,000 | \$ | 1.25            | Feb. 11,<br>2011 |
|                          |         |       |  | 30,000  | \$ | 2.35            | Oct. 28,<br>2011 |
|                          |         |       |  | 140,000 | \$ | 1.70            | Mar. 19,<br>2012 |

| <b>Name</b>       | <b>Common Shares held directly and beneficially</b> | <b>% of Outstanding Common Shares as of April 15, 2007</b> | <b>Options outstanding</b> | <b>Exercise price</b> | <b>Expiration date</b> |
|-------------------|---|--|----------------------------|-----------------------|------------------------|
| Ronald G. Hosking | 293,778   | 1.2 %  | 50,000                     | \$ 2.85               | Jun 27, 2008           |
|                   |   |  | 35,000                     | \$ 4.00               | Dec. 5, 2008           |
|                   |   |  | 52,000                     | \$ 2.95               | Feb. 6, 2010           |
|                   |   |  | 48,000                     | \$ 1.40               | Feb. 28, 2011          |
|                   |   |  | 30,000                     | \$ 2.35               | Oct. 28, 2011          |
|                   |   |  | 120,000                    | \$ 1.70               | Mar. 19, 2012          |
| Tim Currie        | 27,560  | 0.1 %  | 50,000                     | \$ 2.85               | Mar. 3, 2008           |
|                   |   |  | 35,000                     | \$ 4.00               | Feb. 23, 2009          |
|                   |   |  | 52,000                     | \$ 2.95               | Feb. 6, 2010           |
|                   |   |  | 120,000                    | \$ 1.25               | Feb. 16, 2011          |
|                   |   |  | 30,000                     | \$ 2.35               | Oct. 28, 2011          |

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|                      |         |       |         |         |               |
|----------------------|---------|-------|---------|---------|---------------|
|                      |         |       | 120,000 | \$ 1.70 | Mar. 19, 2012 |
| Stephen A. Wilgar    | 290,827 | 1.2 % | 10,000  | \$ 2.86 | Nov. 16, 2007 |
|                      |         |       | 30,000  | \$ 4.00 | Dec. 5, 2008  |
|                      |         |       | 30,000  | \$ 4.09 | Aug. 7, 2009  |
|                      |         |       | 30,000  | \$ 3.41 | June 25, 2010 |
|                      |         |       | 30,000  | \$ 2.95 | June 24, 2011 |
|                      |         |       | 30,000  | \$ 1.10 | June 24, 2012 |
| Anthony F. Griffiths | 510,500 | 2.0 % | 5,000   | \$ 2.86 | Nov. 16, 2007 |
|                      |         |       | 15,000  | \$ 4.00 | Dec. 5, 2008  |
|                      |         |       | 15,000  | \$ 4.09 | Aug. 7, 2009  |
|                      |         |       | 15,000  | \$ 3.41 | June 25, 2010 |
|                      |         |       | 15,000  | \$ 2.95 | June 24, 2011 |
|                      |         |       | 15,000  | \$ 1.10 | June 24, 2012 |

|                         |         |       |        |         |                     |
|-------------------------|---------|-------|--------|---------|---------------------|
| David A.<br>Rosenkrantz | 278,033 | 1.1 % | 5,000  | \$ 2.86 | Nov.<br>16,<br>2007 |
|                         |         |       | 15,000 | \$ 4.00 | Dec.<br>5,<br>2008  |
|                         |         |       | 15,000 | \$ 4.09 | Aug.<br>7,<br>2009  |
|                         |         |       | 15,000 | \$ 3.41 | June<br>25,<br>2010 |
|                         |         |       | 15,000 | \$ 2.95 | June<br>24,<br>2011 |
|                         |         |       | 15,000 | \$ 1.10 | June<br>24,<br>2012 |
| Ronald<br>Henriksen     | 45,000  | 0.2 % | 15,000 | \$ 3.50 | Apr.<br>12,<br>2009 |
|                         |         |       | 15,000 | \$ 3.41 | June<br>25,<br>2010 |
|                         |         |       | 15,000 | \$ 2.95 | June<br>24,<br>2011 |
|                         |         |       | 15,000 | \$ 1.10 | June<br>24,<br>2012 |

*Employee Share Purchase Plan*

See description above under “Directors, Senior Management and Employees - Compensation - Employee Share Purchase Plan.”

### *Stock Option Plan*

The Corporation has established a stock option plan (the “Option Plan”) in order to encourage directors, senior officers, employees and consultants of the Corporation to acquire a proprietary interest in the Corporation and to provide an incentive to such persons related to the performance of the Corporation.

Under the Option Plan, which is administered by the Board of Directors of the Corporation, options to acquire Common Shares may be granted to persons, firms or companies who are employees, senior officers, directors or consultants of the Corporation or any subsidiary of the Corporation.

The directors of the Corporation may from time to time grant options to eligible optionees. At the time options are granted, the directors shall determine the number of options, the date when the options are to become effective and, subject to the other provisions of the Option Plan and subject to applicable laws and regulations, all other terms and conditions of the options. No one optionee can receive options entitling the optionee to purchase more than 5% of the issued and outstanding Common Shares, calculated on an undiluted basis, less the aggregate number of Common Shares reserved for issuance to such person under any other option to purchase Common Shares from treasury granted as a compensation or incentive mechanism. In addition, the maximum number of Common Shares, together with any other Common Shares which may be issuable under any other Share Compensation Arrangements (as such term is defined in the Option Plan), (i) which may be reserved for issuance under the Option Plan to Insiders (as such term is defined in the Option Plan as an “insider” or “associate” of an insider, as such terms are defined in the *Securities Act* (Ontario)) as a group shall be 10% of the issued and outstanding number of Common Shares; (ii) which may be issued to Insiders as a group within a one-year period shall be 10% of the issued and outstanding number of Common Shares; and (iii) which may be issued to any one Insider shall be 5% of the issued and outstanding number of Common Shares.

The exercise price of each option shall be determined at the discretion of the directors of the Corporation at the time of the granting of the option, provided that any exercise price may not be less than the “market price” of the Common Shares (being the closing price of the Common Shares as reported by the Toronto Stock Exchange on the trading day immediately prior to the date of grant).

All options shall be for a term and exercisable from time to time as determined in the discretion of the directors of the Corporation at the time of the granting of the options. The maximum exercise period for options granted under the Option Plan is 10 years although options are typically granted with a five year term. Options are typically subject to vesting conditions based upon time or performance related milestones as determined by the Board of Directors from time to time.

Unless otherwise determined by the Board of Directors, options terminate (i) immediately upon an optionee’s employment with the Corporation being terminated for cause; (ii) 30 days from the date of termination in the case of termination unless as a result of permanent disability, early retirement or death; (iii) 90 days from the date of termination if such termination is a result of permanent disability or early retirement; and (iv) 90 days from the date of termination if such termination is a result of death. Each of the preceding time periods are subject to earlier expiry in the normal course based upon the original exercise period.

Options are not assignable by the optionees except for a limited right of assignment to allow the exercise of options by an optionee’s legal representative in the event of death or incapacity.

The Option Plan provides that the Corporation may arrange for the Corporation or any subsidiary thereof to make loans or provide guarantees for loans by financial institutions to assist eligible optionees to purchase Common Shares upon the exercise of options. Any such loans granted by the Corporation or any subsidiary thereof shall be full



recourse to the optionee and shall be secured by the Common Shares so purchased.

On May 24, 2007, the Shareholders passed a resolution approving certain amendments to the Option Plan to increase the maximum number of Common Shares which may be issued upon the exercise of options granted pursuant to the Option Plan to all participants from 3,500,000 to 4,500,000. As at May 31, 2007, 3,212,804 Common Shares, being approximately 12.9% of the currently issued Common Shares, were issuable pursuant to unexercised

options granted to such date under the Option Plan and options to purchase a further 1,014,983 Common Shares, being approximately 4.06% of the currently issued Common Shares, remained available for grant under the Option Plan as at such date.

**ITEM 7. *Major Shareholders And Related-Party Transactions.***

**A. *Major shareholders***

To the knowledge of the directors and senior officers of the Corporation, as at the date of this Annual Report, the only person who beneficially owns, directly or indirectly, or exercises control or direction over voting securities of the Corporation carrying more than 5% of the voting rights of the total issued and outstanding shares of the Corporation is as follows:

| <b>Name</b>              | <b>Number of Voting Securities Owned</b> |                            |
|--------------------------|--|----------------------------|
|                          | <b>Common Shares</b>                     | <b>Percentage of Class</b> |
| Dr. H.B. Brent Norton    | 2,360,948                                | 9.4%                       |
| Midsummer Investment Ltd | 1,945,865                                | 7.8%                       |

Dr. Norton does not have different voting rights from any other stockholder of the Corporation.

Based on information available from Equity Transfer Services, the Corporation's registrar and transfer agent, as of May 27, 2007, there were 38 registered holders of record of the Corporation's common shares in the United States representing 3,861,795 Common Shares, or 15.45% of the total Common Shares issued and outstanding. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where these beneficial holders are residents since many of these ordinary shares were held of record by brokers or other nominees.

**B. *Related-Party Transactions***

Aside from the employment agreements, option grants and other compensation with management and the directors, as the case may be, all of which were made in the ordinary course of business and discussed above, there were no related party transactions during the period covered by this report, none have occurred to date, nor are any outstanding.

There were no shareholder loans outstanding as at December 31, 2006 or April 15, 2007.

**C. *Interests of Experts and Counsel***

Not Applicable.

**ITEM 8. *Financial Information.***

**A. *Consolidated Statements and Other Financial Information (Audited)***

Refer to Item 18, which incorporates the following financial statements:

- Consolidated Balance Sheets
- Consolidated Statements of Loss and Deficit
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements

To date the Corporation has not declared any dividends on its shares. The Board of Directors of the Corporation does not currently anticipate paying any dividends on its Common Shares in the foreseeable future but intends to retain earnings to finance the growth and development of the business of the Corporation. Any future determination to pay dividends will be at the discretion of the Board of Directors of the Corporation and will depend upon the Corporation's financial condition, results of operations, capital requirements and such other factors as the Board of Directors of the Corporation deems relevant.

**B. *Significant Changes***

None.

**ITEM 9. *The Offer And Listing.***

**A. *Offer and Listing Details***

1. Indicate the expected price at which the securities will be offered or the method of determining the price, and the amount of any expenses specifically charged to the subscriber or purchaser.

Not Applicable.

2. If there is not an established market for the securities, the document shall contain information regarding the manner of determination of the offering price as well as of the exercise price of warrants and the conversion price of convertible securities, including who established the price or who is formally responsible for the determination of the price, the various factors considered in such determination and the parameters or elements used as a basis for establishing the price.

Not Applicable.

3. If the corporation's shareholders have pre-emptive purchase rights and where the exercise of the right of pre-emption of shareholders is restricted or withdrawn, the corporation shall indicate the basis for the issue price if the issue is for cash, together with the reasons for such restriction or withdrawal and the beneficiaries of such restriction or withdrawal if intended to benefit specific persons.

Not Applicable.

4. The following table sets forth information regarding the price history of the Common Shares on the Toronto Stock Exchange and the American Stock Exchange for the periods indicated.

- (a) for the five most recent full financial years: the annual high and low market prices:

|        | TSX          |             | Amex           |               |
|--------|--------------|-------------|----------------|---------------|
|        | High<br>(\$) | Low<br>(\$) | High<br>(\$US) | Low<br>(\$US) |
| Dec-06 | 3.36         | 1.19        | 3.00           | 1.02          |
| Dec-05 | 4.14         | 1.32        | 3.50           | 1.05          |
| Dec-04 | 4.70         | 2.60        | 3.40           | 1.88          |
| Dec-03 | 4.89         | 2.41        | 3.65           | 2.84          |
| Dec-02 | 7.15         | 2.20        | -              | ----          |

- (b) for the most recent full financial years and any subsequent period: the high and low market prices for each full financial quarter:

|           | TSX          |             | Amex           |               |
|-----------|--------------|-------------|----------------|---------------|
|           | High<br>(\$) | Low<br>(\$) | High<br>(\$US) | Low<br>(\$US) |
| Q1/07     | 2.10         | 1.06        | 1.79           | 1.22          |
| Jan - Mar |              |             |                |               |
| Q4/06     | 2.62         | 1.34        | 2.39           | 1.25          |
| Oct-Dec   |              |             |                |               |
| Q3/06     | 3.36         | 1.68        | 3.00           | 1.50          |
| July-Sept |              |             |                |               |
| Q2/06     | 3.02         | 1.85        | 1.92           | 1.61          |
| Apr-Jun   |              |             |                |               |
| Q1/06     | 2.47         | 1.16        | 2.15           | 1.02          |
| Jan-Mar   |              |             |                |               |
| Q4/05     | 2.50         | 1.32        | 2.09           | 1.05          |
| Oct-Dec   |              |             |                |               |
| Q3/05     | 3.45         | 2.06        | 2.80           | 1.72          |
| July-Sept |              |             |                |               |
| Q2/05     | 3.94         | 2.12        | 3.27           | 1.74          |
| Apr-Jun   |              |             |                |               |
| Q1/05     | 4.14         | 2.91        | 3.50           | 2.35          |
| Jan-Mar   |              |             |                |               |



(c) for the most recent six months: the high and low market prices for each month:

|        | TSX          |             | AMEX           |               |
|--------|--------------|-------------|----------------|---------------|
|        | High<br>(\$) | Low<br>(\$) | High<br>(\$US) | Low<br>(\$US) |
| May 07 | 1.42         | 0.89        | 1.30           | 0.94          |
| Apr 07 | 1.40         | 1.08        | 1.23           | 1.00          |
| Mar 07 | 1.55         | 1.06        | 1.36           | 0.95          |
| Feb-07 | 1.85         | 1.51        | 1.70           | 1.30          |
| Jan-07 | 2.10         | 1.57        | 1.79           | 1.40          |
| Dec-06 | 1.99         | 1.34        | 1.74           | 1.25          |

(d) for pre-emptive issues, the market prices for the first trading day in the most recent six months, for the last trading day before the announcement of the offering and (if different) for the latest practicable date prior to publication of the document.

Not Applicable.

5. State the type and class of securities being offered or listed and furnish the following information:

(a) Indicate whether the shares are registered shares or bearer shares and provide the number of shares to be issued and to be made available to the market for each kind of share. The nominal par or equivalent value should be given on a per share basis and, where applicable, a statement of the minimum offer price. Describe the coupons attached, if applicable.

Not Applicable.

(b) Describe arrangements for transfer and any restrictions on the free transferability of the shares.

Not Applicable.

6. If the rights evidenced by the securities being offered or listed are or may be materially limited or qualified by the rights evidenced by any other class of securities or by the provisions of any contract or other documents, include information regarding such limitation or qualification and its effect on the rights evidenced by the securities to be listed or offered.

Not Applicable.

7.

With respect to securities other than common or ordinary shares to be listed or offered, outline briefly the rights evidenced thereby.

Not Applicable.

***B. Plan of Distribution***

Not Applicable.



**C. Markets**

The Corporation's Common Shares are traded on the Toronto Stock Exchange under the symbol "PMD" and on the American Stock Exchange under the symbol "PME".

**D. Selling Shareholders**

Not Applicable.

**E. Dilution**

Not Applicable.

**F. Expenses of the Issue**

Not Applicable.

**ITEM 10. Additional Information.**

**A.**

**Share Capital**

Not Applicable.

**B. Memorandum and Articles of Association**

The Corporation previously provided the disclosure to its memorandum and articles of association in response to Item 10.B. of its Registration Statement on Form 20-F (File No. 001-31360) filed on June 18, 2000, as amended, and the Corporation hereby incorporates that disclosure into this Annual Report by reference and amends it with the attached/incorporated articles of amendment to reflect the Corporation's name change.

**C. Material Contracts**

The Corporation is not a party to any material contracts outside of the ordinary course of business.

**D. Exchange Controls**

There are currently no limitations imposed by Canadian federal or provincial laws on the rights of non-resident or foreign owners of Canadian securities to hold or vote the securities held by such persons in the Corporation. There are also no such limitations imposed by the Corporation's Articles and By-laws with respect to the Common Shares.

**Investment Canada Act**

Under the Investment Canada Act, the acquisition of control by a "non-Canadian" of a Canadian business which carries on most types of business activities (including the business activity carried on by the Corporation) is subject to review in certain circumstances by the Investment Review Division of Industry Canada ("Industry Canada"), a Canadian federal government department, and will not be allowed unless the investment is found by the Minister responsible for Industry Canada likely to be of "net benefit" to Canada. On the other hand, the acquisition of control by a non-Canadian of a Canadian business which carries on a specific type of business activity, as prescribed, that is related to Canada's

cultural heritage or national identity is subject to review in certain circumstances by the Department of Canadian Heritage.

Subject to the provisions relating to so-called WTO transactions as described below, an acquisition of control will be reviewable by Industry Canada if the “value of the assets” (essentially, book value) of the Canadian business of which control is being acquired is (1) \$5 million or more in the case of a “direct” acquisition; (2) \$50 million or more in the case of an “indirect” acquisition, which is a transaction involving the acquisition of the shares of a corporation incorporated outside Canada which owns one or more subsidiaries in Canada; or (3) \$5 million or more but less than \$50 million where the value of the Canadian assets acquired constitutes more than 50% of the value of the assets of all entities acquired, if the acquisition is effected through the acquisition of control of a foreign corporation.

These thresholds have been increased respecting the acquisition of control of a Canadian business (1) by investors which are ultimately controlled by nationals of countries which are members of the World Trade Organization (“WTO”), including Americans; or (2) which is a WTO member-controlled (other than Canadian-controlled) Canadian business (either, a “WTO transaction”). A direct acquisition in a WTO transaction is reviewable only if the transaction involves the direct acquisition of a Canadian business where the value of the assets is \$265 million or more for transactions closing in 2006 (this figure is adjusted annually to reflect the increase in the Canadian nominal gross domestic product at market prices). Indirect acquisitions in WTO transactions are not reviewable.

The increased thresholds applicable in WTO transactions do not apply to the acquisition of control of a Canadian business that is engaged in certain sensitive areas such as uranium production, financial services, transportation services or cultural businesses.

Even if such acquisition of control is not so reviewable, a non-Canadian must still give notice to Industry Canada of the acquisition of control of a Canadian business either before or within 30 days after its completion.

#### *Competition Act (Canada)*

Under the Competition Act, certain transactions are subject to the notification requirements of the Competition Act whereby notice of the transaction and specific information in connection therewith must be provided to the Commissioner of Competition by the parties to the transaction. A transaction may not be completed until the applicable statutory waiting periods have expired, namely 14 days for a short-form filing or 42 days for a long-form filing. Where the parties elect to file a short-form notice, the Commissioner may require a long-form notice, thereby restarting the clock once the parties submit their filing.

A proposed transaction is subject to notification if two thresholds are exceeded. First, the parties and their “affiliates” must have assets in Canada or annual gross revenues from sales in, from or into Canada that exceed \$400 million in aggregate value. Having met this first threshold, the parties to a transaction involving a corporation which carries on an “operating business” in Canada must then give notice if any one of the following additional thresholds is met: (1) for an acquisition of assets in Canada, where the aggregate value of the assets in Canada or the annual gross revenues from sales in or from Canada generated from those assets exceed \$50 million (the “\$50 million threshold”); (2) in the case of an acquisition of shares of a corporation in Canada or which controls a corporation in Canada where as a result of the proposed acquisition, the person acquiring the shares, together with its affiliates, would own more than 20% (or, if the person or persons making the acquisition already own 20% or more of the voting shares of the target, then 50%) of the voting shares of a corporation that are publicly traded or, in the case of a corporation of which the shares are not publicly traded, the threshold is 35% of the voting shares (and 50%, if the person or persons making the acquisition own 35% or more of the voting shares of the subject corporation prior to making the acquisition) and the \$50 million threshold is exceeded; or (3) in the case of a proposed amalgamation of two or more corporations where one or more of the amalgamating corporations carries on an operating business (either directly or indirectly), where the aggregate value of the assets in Canada that would be owned by the continuing corporation resulting from the amalgamation would exceed \$70 million or the annual gross revenues from sales in or from Canada generated from the assets of the amalgamated entity would exceed \$70 million.

Finally, all merger transactions, regardless of whether they are subject to notice as aforesaid, are subject to the substantive provisions of the Competition Act, namely whether the proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially in a relevant market in Canada.

#### ***E. Taxation***

This section summarizes the material U.S. federal and Canadian federal income tax consequences of the ownership and disposition of the Common Shares. Nothing contained herein shall be construed as tax advice; you must rely only on the advice of your own tax advisor. The Corporation makes no assurances as to the applicability of any tax laws with respect to any individual investment. This summary relating to the Common Shares applies to the beneficial owners who are individuals, corporations, trusts and estates which:

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- for purposes of the U.S. Internal Revenue Code of 1986, as amended, through the date hereof (the “Code”), are U.S. persons and, for purposes of the Income Tax Act (Canada) (the “Income Tax Act”) and the Canada-United States Income Tax Convention (1980), are non-residents of Canada and residents of the U.S. respectively, at all relevant times;
- hold Common Shares as capital assets for purposes of the Code and capital property for the purposes of the Income Tax Act;
- deal at arm’s length with, and are not affiliated with, the Corporation for purposes of the Income Tax Act; and
- do not and will not use or hold the Common Shares in carrying on a business in Canada.

Persons who satisfy the above conditions are referred to as “Unconnected U.S. Shareholders.”

The tax consequences of an investment in Common Shares by persons who are not Unconnected U.S. Shareholders may differ materially from the tax consequences discussed in this section. The Income Tax Act contains rules relating to securities held by financial institutions. This Annual Report does not discuss these rules, and holders that are financial institutions for the purposes of the Income Tax Act should consult their own tax advisors.

This discussion is based upon the following, all as currently in effect:

- the Income Tax Act and regulations under the Income Tax Act;
- the Code and Treasury regulations under the Code;
- the Canada-United States Income Tax Convention (1980);
- the administrative policies and practices published by the Canada Revenue Agency;
- all specific proposals to amend the Income Tax Act and the regulations under the Income Tax Act that have been publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date of this report;
- the administrative policies published by the U.S. Internal Revenue Service; and
- judicial decisions.

All of the foregoing are subject to change either prospectively or retroactively. This summary does not take into account the tax laws of the various provinces or territories of Canada or the tax laws of the various state and local jurisdictions of the U.S. or foreign jurisdictions.

This discussion summarizes the material U.S. federal and Canadian federal income tax considerations of the ownership and disposition of Common Shares. This discussion does not address all possible tax consequences relating to an investment in Common Shares. No account has been taken of your particular circumstances and this summary does not address consequences peculiar to you if you are subject to special provisions of U.S. or Canadian income tax law (including, without limitation, dealers in securities or foreign currency, tax-exempt entities, banks, insurance

companies or other financial institutions, persons that hold Common Shares as part of a “straddle,” “hedge” or “conversion transaction,” Unconnected U.S. Shareholders that have a “functional currency” other than the U.S. dollar or that own Common Shares through a partnership or other pass through entity, expatriates, persons subject to the U.S. alternative minimum tax, regulated invested companies, or real estate investment trusts). Therefore, you should consult your own tax advisor regarding the tax consequences of purchasing Common Shares.

*Material U.S. Federal Income Tax Considerations*

Subject to the discussion below regarding Passive Foreign Investment Company Rules and Controlled Foreign Corporation Rules, this section summarizes certain U.S. federal income tax consequences of ownership and disposition of the Common Shares.

As an Unconnected U.S. Shareholder, you generally will be required to include in income dividend distributions, if any, paid by the Corporation to the extent of the Corporation's current or accumulated earnings and profits attributable to the distribution as computed based on U.S. income tax principles. The amount of any cash distribution paid in Canadian dollars will be equal to the U.S. dollar value of the Canadian dollars on the date of distribution based on the exchange rate on such date, regardless of whether the payment is in fact converted to U.S. dollars and without reduction for Canadian withholding tax. (For a discussion of Canadian withholding taxes applicable to dividends paid by the Corporation, see "Material Canadian Federal Income Tax Considerations"). You will generally be entitled to a foreign tax credit or deduction in an amount equal to the Canadian tax withheld. To the extent distributions paid by the Corporation on the Common Shares exceed the Corporation's current or accumulated earnings and profits, they will be treated first as a return of capital up to your adjusted tax basis in the shares and then as capital gain from the sale or exchange of the shares. The Corporation expects to be a "qualified foreign corporation" for purposes of Section 1(h)(11) of the Code. If so, dividends paid by the Corporation to Unconnected U.S. Shareholders who are individuals, estates, or trusts, on Common Shares held by such shareholder for at least 61 days during the 121-day period beginning 60 days before the "ex-dividend date," may be eligible to be taxed at the long-term capital gains rate. This preference is subject to certain limitations.

Dividends paid by the Corporation generally will constitute foreign source dividend income and "passive income" for purposes of the foreign tax credit, which could reduce the amount of foreign tax credits available to you. The Code applies various limitations on the amount of foreign tax credits that may be available to a U.S. taxpayer. Because of the complexity of those limitations, you should consult your own tax advisor with respect to the availability of foreign tax credits.

With effect from January 1, 2003, for individuals and other taxpayers subject to tax under Section 1 of the Code, the United States reduced the maximum tax rate on certain qualifying dividend distributions to 15% (5% for certain Unconnected U.S. Shareholders). In order for dividends paid by a foreign corporation whose shares are publicly traded (such as the Corporation) to qualify for the reduced rates, (1) the foreign corporation must not be classified as a passive foreign investment company (as defined below) for United States federal income tax purposes either in the taxable year of the distribution or the preceding taxable year, and (2) the Unconnected U.S. Shareholder must hold the underlying shares for at least 60 days during the 121-day period beginning 60 days before the ex-dividend date. Dividends paid by the Corporation on the Common Shares generally will not be eligible for the "dividend received" deduction.

If you sell the Common Shares, you generally will recognize gain or loss in an amount equal to the difference between the amount realized on the sale and your adjusted tax basis in the shares. Any such gain or loss will be long-term or short-term capital gain or loss, depending on whether the shares have been held by you for more than one year, and will generally be U.S. source gain or loss. Capital losses are subject to significant limitations.

Dividends paid by the Corporation on, and proceeds from the sale or disposition of, the Common Shares generally will be subject to U.S. information reporting and the 28% backup withholding tax, unless you furnish the paying agent or middleman with a duly completed and signed Form W-9 or the Internal Revenue Service notifies the Corporation that you previously failed to properly report items subject to backup withholding. Unconnected U.S. Shareholders who are corporations are generally not subject to these rules, with limited exceptions. You will be allowed a refund or a credit equal to any amount withheld under the U.S. backup withholding tax rules against your U.S. federal income tax liability, provided you furnish the required information to the Internal Revenue Service.

#### *Passive Foreign Investment Company Rules*

The passive foreign investment company ("PFIC") provisions of the Code can have significant tax effects on Unconnected U.S. Shareholders. The Corporation could be classified as a PFIC if, after the application of certain "look

through” rules for any taxable year, either:

- 75% or more of the Corporation’s gross income is “passive income,” which includes interest, dividends and certain rents and royalties; or
- the average quarterly percentage, by fair market value of the Corporation’s assets that produce or are held for the production of “passive income,” is 50% or more of the fair market value of all the Corporation’s assets.



To the extent the Corporation owns at least 25% by value of the stock of another corporation, the Corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of such corporation, and as receiving directly its proportionate share of the income of such corporation.

Distributions which constitute “excess distributions” from a PFIC and dispositions of Common Shares of a PFIC are subject to the following special rules: (1) the excess distributions (generally any distributions received by an Unconnected U.S. Shareholder on the shares in any taxable year that are greater than 125% of the average annual distributions received by such Unconnected U.S. Shareholder in the three preceding taxable years, or the Unconnected U.S. Shareholder’s holding period for the shares, if shorter) or gain would be allocated ratably over an Unconnected U.S. Shareholder’s holding period for the shares, (2) the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which the Corporation is a PFIC would be treated as ordinary income in the current taxable year and (3) the amount to each of the other taxable years would be subject to the highest rate of tax on ordinary income in effect for that year and to an interest charge based on the value of the tax deferred during the period during which the shares were owned.

Subject to specific limitations, Unconnected U.S. Shareholders who actually or constructively own marketable shares in a PFIC may make an election under Section 1296 of the Code to mark those shares to market annually, rather than being subject to the above-described rules. Amounts included in or deducted from income under this mark-to-market election and actual gains and losses realized upon disposition, subject to specific limitations, will be treated as ordinary gains or losses. For this purpose, the Corporation believes that the Corporation’s shares will be treated as “marketable securities” within the meaning of Section 1296(e)(1) of the Code.

The Corporation believes that it will not be a PFIC for the current fiscal year, that it has not been a PFIC for any prior fiscal year, and it does not expect to become a PFIC in future years; however, because the PFIC determination is made annually on the basis of facts and circumstances that may be beyond its control and because the principles and methodology for determining the fair market values of its assets are unclear, there can be no assurance that the Corporation will not be a PFIC for such years or that the Corporation’s determination concerning its PFIC status will not be challenged by the Internal Revenue Service. You should be aware, however, that if the Corporation is or becomes a PFIC, the Corporation may not be able or willing to satisfy record-keeping requirements that would enable you to make a “qualified electing fund” election.

You should consult your tax advisor with respect to how the PFIC rules affect your tax situation.

#### *Controlled Foreign Corporation Rules*

If more than 50% of the voting power or total value of all classes of the Corporation’s shares is owned, directly or indirectly, by U.S. shareholders, each of which owns 10% or more of the total combined voting power of all classes of the Corporation’s shares, the Corporation could be treated as a controlled foreign corporation (“CFC”) under Subpart F of the Code. This classification would require such 10% or greater shareholders to include in income their pro rata shares of the Corporation “Subpart F Income,” as defined in the Code. In addition, under Section 1248 of the Code, gain from the sale or exchange of shares by an Unconnected U.S. Shareholder who is or was a 10% or greater shareholder at any time during the five year period ending with the sale or exchange will be ordinary dividend income to the extent of the Corporation’s earnings and profits attributable to the shares sold or exchanged.

The Corporation believes that it is not a CFC. However, the Corporation cannot assure you that the Corporation will not become a CFC in the future.

#### *Material Canadian Federal Income Tax Considerations*

This section summarizes the material anticipated Canadian federal income tax considerations relevant to the ownership and disposition of the Common Shares.

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Under the Income Tax Act, assuming you are an Unconnected U.S. Shareholder, and provided the Common Shares are listed on a prescribed stock exchange, which includes the Toronto Stock Exchange and the American Stock Exchange, you will generally not be subject to Canadian tax on a capital gain realized on an actual or deemed disposition of the Common Shares unless you alone or together with persons with whom you did not deal at arm's length owned or had rights to acquire 25% or more of the Corporation's issued shares of any class at any time during the 60-month period before the actual or deemed disposition.

Dividends paid, credited or deemed to have been paid or credited on the Common Shares to Unconnected U.S. Shareholders will be subject to a Canadian withholding tax under the Income Tax Act at a rate of 25% of the gross amount of the dividends. Under the Canada-United States Income Tax Convention (1980), the rate of withholding tax on dividends generally applicable to Unconnected U.S. Shareholders who beneficially own the dividends is reduced to 15%. In the case of Unconnected U.S. Shareholders that are corporations that beneficially own at least 10% of the Corporation's voting shares, the rate of withholding tax on dividends generally is reduced to 5%. United States limited liability companies ("LLCs") will not be entitled to these reduced rates. Shareholders that are partnerships will be subject to the 25% rate.

Canada does not currently impose any federal estate taxes or succession duties. However, if you die, there is a deemed disposition of the Common Shares held at that time for proceeds of disposition generally equal to the fair market value of the Common Shares immediately before your death. Capital gains realized on the deemed disposition, if any, will have the income tax consequences described above.

***F. Dividends and Paying Agents***

Not Applicable

***G. Statement by Experts***

Not Applicable

***H. Documents on Display***

The Corporation is subject to the information requirements of the Securities Exchange Act of 1934, as amended, and files reports and other information with the SEC. You may read and copy any of the Corporation's reports and other information at, and obtain copies upon payment of prescribed fees from, the Public Reference Room maintained by the SEC at 100 F Street, NE, Room 1580, Washington, D.C. 20549 and at the SEC's regional offices at Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, IL 60661. In addition, the SEC maintains a website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC at <http://www.sec.gov>. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

The Corporation is required to file reports and other information with the securities commissions in the Canadian provinces of Ontario and Quebec. You are invited to read and copy any reports, statements or other information, other than confidential filings, that the Corporation files with such provincial securities commissions. These filings are also electronically available from the Canadian System for Electronic Document Analysis and Retrieval (SEDAR) (<http://www.sedar.com>), the Canadian equivalent of the SEC's electronic document gathering and retrieval system.

The Corporation "incorporates by reference" information that it files with the SEC, which means that it can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this Annual Report on Form 20-F and more recent information automatically updates and supersedes

more dated information contained by reference in this Annual Report on Form 20-F.

The Corporation will provide without charge to each person, including any beneficial owner, on the written or oral request of such person, a copy of any or all documents referred to above which have been or may be incorporated by reference in this report (not including exhibits to such incorporated information that are not specifically incorporated by reference into such information). Requests for such copies should be directed to the Corporation at the following address: 4211 Yonge Street, Suite 615, Toronto, Ontario, Canada M2P 2A9.

***I. Subsidiary Information***

Not Applicable.

**ITEM 11. *Quantitative and Qualitative Disclosures About Market Risk.***

*Quantitative and Qualitative Information about Market Risk*

The Corporation holds no material financial instruments for trading purposes. Accordingly, the Corporation does not believe that there is any material market risk exposure with respect to derivative or other financial instruments that would require disclosure under this item.

**ITEM 12. *Description Of Securities Other Than Equity Securities.***

Not Applicable.

**PART II**

**ITEM 13. *Defaults, Dividend Arrearages and Delinquencies.***

The Corporation is not currently in a default or delinquent status.

**ITEM 14. *Material Modifications to the Rights of Security Holders and Use of Proceeds.***

The Corporation has not made any material modifications to the rights of security holders.

## **ITEM 15. Controls and Procedures.**

### **A. *Disclosure Controls and Procedures***

At the end of the period covered by this Annual Report, the Corporation performed an evaluation of the effectiveness of its disclosure controls and procedures. These controls and procedures are designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized and reported within specified time periods. The Corporation notes that there are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide a reasonable assurance of achieving their control objectives. Given the foregoing, the Corporation’s evaluation, which was performed under the supervision and with the participation of our management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), the CEO and CFO have concluded that the Corporation’s disclosure controls and procedures (as defined in the Exchange Act Rules 13(a) - 15(e) and 15(d) - 15(e)) as of the end of the period covered by this Annual Report on Form 20-F are adequate and effective.

The CEO and CFO have indicated that there have been no significant changes in the internal controls or other factors that could significantly affect internal controls subsequent to the above-mentioned evaluation, nor were there any significant deficiencies or material weaknesses in the Corporation’s internal controls. Accordingly, no corrective actions were required or undertaken.

## **ITEM 16. [RESERVED]**

### **ITEM 16A. Audit Committee Financial Expert**

The Corporation has identified a financial expert to serve as the Chair of the Audit Committee. Mr. David Rosenkrantz is an independent director of the Corporation. His relevant experience includes, but is not limited to, the following:

1. Over 10 years of experience in investing as a principal in private companies as Chairman of Patuca Corporation, a merchant banking company
2. Over 7 years of experience in investing in and bringing to the public markets junior, high-growth companies
3. Controlling shareholder of several private corporations
4. Chief Compliance Officer of Patuca Securities Limited, a Limited Market Dealer in Ontario, as defined and regulated by the Ontario Securities Commission
5. Former Chief Compliance Officer for Patuca Securities Inc. (now, Kingsdale Capital Markets Inc.), regulated by the Investment Dealers Association and the Ontario Securities Commission, and
6. Over 10 years of serving as a director on various public company boards, including work chairing and participating on several audit committees

### **ITEM 16B. Code of Ethics/Code of Business Conduct**

The Corporation adopted a Code of Business Conduct and has previously provided the disclosure on Form 20-F filed on June 23, 2004 (File No. 001-31360). The full text of the Code is available at the Corporation’s website, [http://www.premdinc.com/investor\\_relations\\_govern.htm](http://www.premdinc.com/investor_relations_govern.htm). The Corporation hereby incorporates that disclosure into this Annual Report by reference.

**ITEM 16C. Principal Accountant Fees and Services***Fees and Services*

The table below summarizes the fees (expressed in Canadian dollars) paid by the Corporation and its consolidated subsidiaries during each of 2005 and 2006.

|                         | 2005       |       | 2006      |       |
|-------------------------|------------|-------|-----------|-------|
|                         | Amount     | %     | Amount    | %     |
| Audit Fees              | \$ 125,000 | 91.9  | \$137,000 | 91.3  |
| Audit-Related Fees      | Nil        |       | 2,000     | 1.3   |
| Tax Fees <sup>(1)</sup> | 11,000     | 8.1   | 11,000    | 7.4   |
| Total                   | \$ 136,000 | 100.0 | \$150,000 | 100.0 |

(1) "Tax fees" are for professional services rendered by our auditors for tax compliance, tax advice on actual or contemplated transactions and tax consulting associated with international transfer prices.

*Audit Committee's pre-approval policies and procedures*

The audit committee of the Corporation's board of directors chooses and engages independent auditors to audit the Corporation's financial statements. In 2003, the audit committee also adopted a policy requiring management to obtain the audit committee's approval before engaging the independent auditors to provide any other audit or permitted non-audit services to the Corporation or its subsidiaries. This policy, which is designed to assure that such engagements do not impair the independence of the Corporation's auditors, requires the audit committee to pre-approve audit and non-audit services that may be performed by the auditors.

On a quarterly basis, the Corporation informs the audit committee of the pre-approved services actually provided by the auditors. Services of a type that are not pre-approved by the audit committee require pre-approval by the audit committee's chairman on a case-by-case basis. The chairman of the audit committee is not permitted to approve any engagement of the Corporation's auditors if the services to be performed either fall into a category of services that are not permitted by applicable law or the services would be inconsistent with maintaining the auditors' independence.

**ITEM 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

**ITEM 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchases**

Not applicable.

**PART III**

**ITEM 17. *Financial Statements.***

**See item 18.**

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**ITEM 18. *Financial Statements.***

The Corporation has previously filed its fiscal 2006 consolidated financial statements and notes to the consolidated financial statements under Form 6-K on May 8, 2007 (File No. 001-31360) and The financial statements included herein are unaltered from those supplied on the Form 6-K.

See pages F-1 through F-24 included herein.

The following financial statements, together with the report of Ernst & Young LLP thereon, are filed as part of this Annual Report on Form 20-F:

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**ITEM 19. Exhibits.**

- 1.1 Articles of Amalgamation of the Corporation. Previously filed as Exhibit 1.1 to the Corporation's Registration Statement on Form 20-F filed on June 18, 2002 (File No. 001-31360).
- 1.2 By-laws of the Corporation. Previously filed as Exhibit 1.2 to the Corporation's Registration Statement on Form 20-F filed on June 18, 2002 (File No. 001-31360).
- 1.3 Articles of Amendment of the Corporation to change the name of the Corporation from IMI International Medical Innovations Inc. to PreMD Inc. dated September 26, 2005. Previously filed as Exhibit 1.3 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 1.4 Certificate of Amendment of the Corporation to change the name of the Corporation from IMI International Medical Innovations Inc. to PreMD Inc. dated September 26, 2005. Previously filed as Exhibit 1.4 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 2.1 Certificate of 7% Convertible Debenture due August 30, 2009 and issued August 30, 2005. Previously filed as Exhibit 2.1 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 2.2 Certificate of Common Stock Purchase Warrant dated August 30, 2005. Previously filed as Exhibit 2.2 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 2.3 Securities Purchase Agreement by and between the Registrant and each purchaser identified on the signature pages thereto dated March 20, 2007. Previously filed as Exhibit 99.2 to the Form 6-K on March 22, 2007 (File No. 001-31360).
- 2.4 Common Stock Purchase Warrant. Previously filed as Exhibit 99.3 to the Form 6-K on March 22, 2007 (File No. 001-31360).
- 2.5 Registration Rights Agreement by and between the Registrant and each of the several purchasers signatory thereto dated March 20, 2007. Previously filed as Exhibit 99.4 to the Form 6-K on March 22, 2007 (File No. 001-31360).
- 4.1\* Supply Agreement by and between the Registrant and Diagnostic Chemicals Limited dated June 19, 2001. Previously filed as Exhibit 4.1 to the Corporation's Registration Statement on Form 20-F filed on June 18, 2002 (File No. 001-31360).
- 4.2\* Cholesterol 1,2,3 - Skin Cholesterol Measurement System - Product Development, Manufacturing and Marketing and Sales Agreement by and between the Registrant and X-Rite, Inc. dated May 14, 1999. Previously filed as Exhibit 4.2 to the Corporation's Registration Statement on Amendment No. 1 to the Form 20-F filed on October 28, 2002 (File No. 001-31360).
- 4.3 Employment Agreement by and between the Registrant and Ronald Hosking dated February 2, 2006. Previously filed as Exhibit 4.3 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 4.4

Employment Agreement by and between the Registrant and Tim Currie dated January 10, 2006.  
Previously filed as Exhibit 4.4 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006  
(File No. 001-31360).

- 4.5 Employment Agreement by and between the Registrant and Dr. H.B. Brent Norton dated Jan. 1, 2001. Previously filed as Exhibit 4.4 to the Corporation's Registration Statement on Form 20-F filed on June 18, 2002 (File No. 001-31360).
- 4.6 Employment Agreement by and between the Registrant and Michael Evelegh dated Jan 1, 2001. Previously filed as Exhibit 4.5 to the Corporation's Registration Statement on Amendment No.1 to the Form 20-F filed on October 28, 2002 (File No. 001-31360).
- 4.7 Lease Agreement by and between the Registrant, and 448048 Ontario Inc. dated November 19, 2004. Previously filed as Exhibit 4.6 to the Corporation's Annual Report on Form 20-F filed on June 30, 2005 (File No. 001-31360).
- 4.8 McMaster Bioscience Incubation Centre Host Agreement between McMaster University and the Registrant dated November 17, 2005. Previously filed as Exhibit 4.8 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 4.9\* License, Development and Supply Agreement between McNeil PDI Inc. and the Registrant dated May 9, 2002. Previously filed as Exhibit 4.8 to the Corporation's Registration Statement on Amendment No. 4 to the Form 20-F filed on March 7, 2003 (File No. 001-31360).
- 4.10\* Amendment to License, Development and Supply Agreement by and between McNeil PDI Inc. and the Registrant dated December 20, 2002. Previously filed as Exhibit 4.9 to the Corporation's Registration Statement on Amendment No. 4 to the Form 20-F filed on March 7, 2003 (File No. 001-31360).
- 4.11\* License, Development and Supply Agreement by and between McNeil PDI Inc., McNeil Consumer & Specialty Pharmaceuticals Division of McNeil-PPC, Inc., IMI International Medical Innovations Inc. (Switzerland) and the Registrant, dated May 28, 2004. Previously filed as Exhibit 99.1 to the Form 6-K on June 9, 2004 (File No. 001-31360).
- 4.12\* Amendment dated December 9, 2005 to the License, Development and Supply Agreement by and between McNeil PDI Inc. and the Registrant dated May 9, 2002 as amended December 20, 2002. Previously filed as Exhibit 4.12 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360).
- 4.13\* Amendment dated December 9, 2005 to the License, Development and Supply Agreement by and between McNeil PDI Inc., McNeil Consumer & Specialty Pharmaceuticals Division of McNeil-PPC, Inc., IMI International Medical Innovations Inc. (Switzerland) and the Registrant, dated May 28, 2004. Previously filed as Exhibit 4.13 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360)
- 4.14 Code of Ethics/Code of Business Conduct previously filed as Exhibit 4.11 to the Corporation's Annual Report on Form 20-F filed on June 23, 2004 (File No. 001-31360)
- 4.15 Underwriting Agreement between Orion Securities Inc., Loewen, Ondaatje, McCutcheon Limited and the Registrant dated August 30, 2005. Previously filed as Exhibit 4.16 to the Corporation's Annual Report on Form 20-F filed on May 12, 2006 (File No. 001-31360)
- 4.16 Manufacturing services agreement with Jabil Circuit, Inc., dated March 30, 2007, filed herewith.
- 12.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act.

- 12.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act.
- 13.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act.

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- \* Certain confidential information contained in this exhibit, marked by brackets with asterisks, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

**SIGNATURE**

PreMD Inc. hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

PreMD Inc.

**By:**  
**Its:**

/s/ RONALD  
HOSKING  
**Ronald Hosking**  
**Vice President, Finance**  
**and Chief Financial**  
**Officer**

**Date: June 20, 2007**

**PreMD Inc.**

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**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

The following financial statements, together with the report of Ernst & Young LLP thereon, are filed as part of this Annual Report on Form 20-F:

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## Report of Independent Auditors

To the Shareholders of **PreMD Inc.**

We have audited the consolidated balance sheets of **PreMD Inc.** as at December 31, 2006 and 2005 and the consolidated statements of loss and deficit and cash flows for each of the years in the three-year period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PreMD Inc. as at December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006 in conformity with Canadian generally accepted accounting principles, which differ in certain respects from accounting principles generally accepted in the United States of America (see note 10 (as restated) to the consolidated financial statements).

Chartered Accountants  
Toronto, Canada  
March 28, 2007



**PreMD Inc.**

Incorporated under the laws of Canada

**Consolidated Balance Sheets**

[In Canadian dollars]

| As at December 31  | 2006<br>\$         | 2005<br>\$        |
|--|--------------------|-------------------|
| <b>ASSETS</b>  |                    |                   |
| <b>Current</b>   |                    |                   |
| Cash and cash equivalents  | 112,577            | 773,199           |
| Short-term investments   | 3,163,482          | 7,905,883         |
| Accounts receivable <i>[note 3]</i>  | 11,221             | 881,891           |
| Inventory  | 179,219            | 36,306            |
| Prepaid expenses and other receivables   | 570,773            | 317,264           |
| Investment tax credits receivable  | 200,000            | 200,000           |
| <b>Total current assets</b>  | <b>4,237,272</b>   | <b>10,114,543</b> |
| Deferred financing fees, net of accumulated amortization of \$174,863 [2005 - \$43,059] <i>[note 5]</i>        | 347,589            | 477,725           |
| Capital assets, net <i>[note 4[a]]</i>   | 312,410            | 410,636           |
| Intangible assets, net of accumulated amortization of \$915,027 [2005 - \$856,970] <i>[note 4[b] and 8[a]]</i> | 382,229            | 290,286           |
|  | <b>5,279,500</b>   | <b>11,293,190</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)</b>   |                    |                   |
| <b>Current</b>   |                    |                   |
| Accounts payable   | 963,990            | 291,125           |
| Accrued liabilities  | 932,372            | 655,113           |
| Current portion of deferred revenue <i>[note 8[a]]</i>   | -                  | 311,915           |
| <b>Total current liabilities</b>   | <b>1,896,362</b>   | <b>1,258,153</b>  |
| Convertible debentures <i>[note 6]</i>   | 6,350,680          | 5,893,340         |
| Deferred revenue <i>[note 8[a]]</i>  | -                  | 2,297,400         |
| <b>Total liabilities</b>   | <b>8,247,042</b>   | <b>9,448,893</b>  |
| Commitments <i>[note 8]</i>  |                    |                   |
| <b>Shareholders' equity (deficiency)</b>   |                    |                   |
| Capital stock <i>[note 6]</i>  | 25,263,480         | 24,449,826        |
| Contributed surplus <i>[note 6]</i>  | 2,521,915          | 1,840,979         |
| Equity component of convertible debentures <i>[note 5]</i>   | 2,239,385          | 2,393,145         |
| Warrants <i>[notes 5, 6[c] and 8[b][ii]]</i>   | 1,170,020          | 1,373,718         |
| Deficit  | (34,162,342)       | (28,213,371)      |
| <b>Total shareholders' equity (deficiency)</b>   | <b>(2,967,542)</b> | <b>1,844,297</b>  |
|  | <b>5,279,500</b>   | <b>11,293,190</b> |

See accompanying notes



**Consolidated Statements of Loss and Deficit**

[In Canadian dollars]

| Years ended December 31  | 2006<br>\$          | 2005<br>\$          | 2004<br>\$          |
|--|---------------------|---------------------|---------------------|
| <b>REVENUE</b>   |                     |                     |                     |
| Product sales <i>[note 3]</i>  | 6,513               | 425,730             | 183,258             |
| License revenue <i>[note 3]</i>  | 3,328,827           | 1,153,308           | 302,080             |
|  | 3,335,340           | 1,579,038           | 485,338             |
| Cost of product sales, including amortization of nil<br>[2005 - \$3,456; 2004 - \$6,600] | 36,824              | 428,650             | 190,214             |
| <b>Gross profit</b>  | <b>3,298,516</b>    | <b>1,150,388</b>    | <b>295,124</b>      |
| <b>EXPENSES</b>  |                     |                     |                     |
| Research and development   | 4,773,762           | 3,120,276           | 2,612,770           |
| General and administration   | 3,024,811           | 2,690,790           | 3,346,720           |
| Interest on convertible debentures <i>[notes 5 and 6]</i>                                | 677,723             | 228,481             | -                   |
| Imputed interest on convertible debentures <i>[note 5]</i>                               | 819,609             | 255,529             | -                   |
| Amortization <i>[notes 4[a], [b] and 5]</i>  | 319,205             | 252,804             | 224,428             |
| Loss (gain) on foreign exchange  | 97,746              | (35,734)            | 8,731               |
|  | 9,712,856           | 6,512,146           | 6,192,649           |
| <b>RECOVERIES AND OTHER INCOME</b>   |                     |                     |                     |
| Investment tax credits   | 200,000             | 198,923             | 205,000             |
| Interest   | 265,369             | 173,130             | 123,626             |
|  | 465,369             | 372,053             | 328,626             |
| <b>Net loss for the year</b>   | <b>(5,948,971)</b>  | <b>(4,989,705)</b>  | <b>(5,568,899)</b>  |
| Deficit, beginning of year   | (28,213,371)        | (23,223,666)        | (17,654,767)        |
| <b>Deficit, end of year</b>  | <b>(34,162,342)</b> | <b>(28,213,371)</b> | <b>(23,223,666)</b> |
| <b>Basic and diluted loss per share</b>  | <b>\$ (0.27)</b>    | <b>\$ (0.23)</b>    | <b>\$ (0.26)</b>    |
| <b>Weighted average number of common shares outstanding</b>                              | <b>21,663,698</b>   | <b>21,487,008</b>   | <b>21,276,497</b>   |

See accompanying notes



**Consolidated Statements of Cash Flows**

[In Canadian dollars]

| Years ended December 31   | 2006<br>\$         | 2005<br>\$         | 2004<br>\$         |
|---|--------------------|--------------------|--------------------|
| <b>OPERATING ACTIVITIES</b>   |                    |                    |                    |
| Net loss for the year   | (5,948,971)        | (4,989,705)        | (5,568,899)        |
| Add (deduct) items not involving cash   |                    |                    |                    |
| Amortization  | 319,205            | 256,260            | 231,028            |
| Stock-based compensation costs included in  |                    |                    |                    |
| Research and development expense  | 156,920            | 147,085            | 123,925            |
| General and administration expense  | 383,767            | 421,812            | 476,164            |
| Loss (gain) on sale of capital asset  | (1,743)            | -                  | 6,098              |
| Imputed interest on convertible debenture   | 819,609            | 255,529            | -                  |
| Interest on convertible debenture paid in common shares                               | 281,462            | -                  | -                  |
| Loss (gain) on foreign exchange   | 97,748             | (35,734)           | 8,731              |
| Net change in non-cash working capital balances related to operations <i>[note 9]</i> | 1,422,730          | (1,061,397)        | 535,284            |
| Increase (decrease) in deferred revenue   | (2,609,315)        | (301,885)          | 2,818,100          |
| <b>Cash used in operating activities</b>  | <b>(5,078,588)</b> | <b>(5,308,035)</b> | <b>(1,369,569)</b> |
| <b>INVESTING ACTIVITIES</b>   |                    |                    |                    |
| Short-term investments  | 4,589,356          | (3,065,568)        | 1,678,190          |
| Purchase of trademark   | (150,000)          | -                  | -                  |
| Purchase of capital assets  | (24,965)           | (130,310)          | (164,789)          |
| Sale of capital assets  | 3,000              | -                  | 628                |
| <b>Cash provided by (used in) investing activities</b>                                | <b>4,417,391</b>   | <b>(3,195,878)</b> | <b>1,514,029</b>   |
| <b>FINANCING ACTIVITIES</b>   |                    |                    |                    |
| Issuance of convertible debentures <i>[note 5]</i>                                    | -                  | 9,827,616          | -                  |
| Financing fees <i>[note 5]</i>  | (51,399)           | (861,328)          | -                  |
| Issuance of capital stock, net of issue costs   | -                  | 198,400            | 33,373             |
| <b>Cash provided by (used in) financing activities</b>                                | <b>(51,399)</b>    | <b>9,164,688</b>   | <b>33,373</b>      |
| <b>Effect of exchange rate changes on cash and cash equivalents</b>                   | <b>51,974</b>      | <b>(127,034)</b>   | <b>-</b>           |
| <b>Net increase (decrease) in cash and cash equivalents during the year</b>           | <b>(660,622)</b>   | <b>533,741</b>     | <b>177,833</b>     |
| Cash and cash equivalents, beginning of year  | 773,199            | 239,458            | 61,625             |
| <b>Cash and cash equivalents, end of year</b>   | <b>112,577</b>     | <b>773,199</b>     | <b>239,458</b>     |

**Represented by**

|                  |                |         |         |
|------------------|----------------|---------|---------|
| Cash             | <b>112,577</b> | 773,199 | 173,302 |
| Cash equivalents | -              | -       | 66,156  |
|                  | <b>112,577</b> | 773,199 | 239,458 |

**Supplemental cash flow information**

|  |                |         |   |
|--|----------------|---------|---|
| Cash paid during the year for interest | <b>396,261</b> | 228,481 | - |
|--|----------------|---------|---|

*See accompanying notes*



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**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

**1. NATURE OF THE COMPANY**

PreMD Inc. [the “Company”] operates in a single business segment and is a predictive medicine company dedicated to improving health outcomes with non-invasive or minimally-invasive tools for the early detection of life-threatening diseases, particularly cardiovascular disease and cancer. The Company develops easy-to-use, accurate and cost-effective tests designed for use in a point-of-care setting, in a laboratory, in the life insurance industry, and, eventually, at home, and licenses the global marketing rights to third parties.

The Company currently owns patents for a test used to measure skin cholesterol and has in-licensed the technologies for tests to detect the presence of a cancer-specific marker for use in colorectal, lung and breast cancer. In addition, the Company has patents and patents pending for color measurement in biological reactions and has a right of first refusal on certain genomics-related technologies in the predictive medicine field.

**2. SIGNIFICANT ACCOUNTING POLICIES****New pronouncements**

The Canadian Institute of Chartered Accountants [“CICA”] released five new standards related to financial instruments and hedging. The Company is currently evaluating the impact on its consolidated financial statements of adopting these standards on January 1, 2007. These standards are effective for years beginning on or after October 1, 2006 and include the following sections:

[a] Section 3855 of the CICA Handbook, “Financial Instruments - Recognition and Measurement”, describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This section requires that:

- All financial assets be measured at fair value, with some exceptions, such as loans and receivables and investments that are classified as held-to-maturity;
- All financial liabilities be measured at fair value if they are derivatives or classified as held-for-trading purposes. Other financial liabilities are measured at their carrying value; and
- All derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

[b] Section 3865 of the CICA Handbook, “Hedges”, describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between:

- Changes in the fair value of a hedged item and a hedging item; and
- Changes resulting from risk exposure relating to a hedged item and a hedging item.

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period.

[c] Section 1530 of the CICA Handbook, “Comprehensive Income”, describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a company’s net assets that results

from transactions, events and circumstances from sources other than the company's shareholders. It includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments. Adopting this section will require the Company to start reporting the following items in the consolidated financial statements: comprehensive income and its components, and accumulated other comprehensive income and its components.

**[d]** Section 3250 of the CICA Handbook, "Surplus", was changed and reissued as Section 3251, "Equity". The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of Section 1530, "Comprehensive Income".

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**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

[e] Section 3861 of the CICA Handbook, “Financial Instruments - Disclosure and Presentation”, establishes standards for presentation of financial instruments as non-financial derivatives and identifies disclosure requirements. Adopting this section would impact the classification of a financial instrument, or its component parts, as a liability or as an equity instrument in accordance with the substance of the contractual arrangement on initial recognition.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles [“Canadian GAAP”] consistently applied within the framework of the significant accounting policies summarized below. The significant differences between Canadian GAAP and United States generally accepted accounting principles [“U.S. GAAP”] are described and reconciled in note 10.

**Basis of consolidation**

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, PreMD International Inc., Berne, incorporated under the laws of Switzerland, and 6211178 Canada Inc., incorporated under the laws of Canada. All significant intercompany transactions and balances have been eliminated upon consolidation.

**Foreign currency translation**

The Company’s functional currency is the Canadian dollar. Foreign operations are considered integrated and are translated into Canadian dollars using the temporal method. Monetary items are translated using the exchange rate in effect at the year end and non-monetary items are translated at historical exchange rates. Revenue and expenses are translated at the average rate for the year, except for amortization of capital assets which is translated at the same exchange rates as the assets to which they relate. Exchange gains or losses are included in the determination of net loss for the year.

**Use of estimates**

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ materially from those estimates.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand and highly liquid investments that are readily convertible into cash with maturities of less than 90 days when purchased. There were no cash equivalents as at December 31, 2006 and 2005, but as at December 31, 2004, cash equivalents were comprised of funds with an average interest rate of 2.9%.

**Short-term investments**

Short-term investments are carried at the lower of cost and market value. Market value approximates cost. Short-term investments as at December 31, 2006 were comprised of money market funds and fixed income securities with interest rates of approximately 4.5% [2005 - 3.6%]. Short-term investments are comprised of highly liquid investments with maturity periods greater than 90 days but less than one year when purchased.

**Financial instruments**

The carrying values of cash and cash equivalents, short-term investments, accounts receivable, other receivables, accounts payable and accrued liabilities are considered to approximate their respective fair values due to their short-term nature.

The fair values of the equity and warrant components of the convertible debentures are recorded as “equity component of convertible debentures” and “warrants”, respectively, net of the allocated financing costs. The carrying value of the convertible debentures is recorded as a liability and is being accreted to its maturity value through charges to income for the imputed interest *[note 5]*.

## Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

### Inventory

Inventory of raw materials is valued at the lower of cost and replacement cost. Inventories of finished goods are valued at the lower of cost and net realizable value, determined on a first-in, first-out basis.

### Deferred financing fees

Financing costs relating to the issue of convertible debentures are pro-rated between the liability and the equity and warrant components of the debentures [note 5]. The expenses related to the liability component are deferred and are amortized on a straight-line basis over the term of the debentures. Should the debentures be converted prior to maturity, the unamortized balance of financing costs will be transferred to capital stock. The “equity component of convertible debentures” and the “warrants” are recorded net of the respective allocated financing costs.

### Capital assets

Capital assets are recorded at acquisition cost less accumulated amortization.

Purchases of molds required for the manufacture of products are capitalized and amortized over the useful life of the assets on the basis of units produced. The amortization expense for molds is recorded as a cost of product sales.

The Company provides for amortization on the declining balance basis, unless otherwise indicated, at rates which are expected to charge operations with the cost of the assets over their estimated useful lives as follows:

|                          |  |
|--------------------------|--|
| Manufacturing equipment  | useful life on basis of units produced   |
| Computer equipment       | 30%                                      |
| Furniture and equipment  | 20%                                      |
| Research instrumentation | 30%                                      |
| Laboratory equipment     | 20%                                      |
| Leasehold improvements   | straight-line over the term of the lease |

### Intangible assets

Patents, patent rights and trademarks acquired by the Company are recorded at acquisition cost and are amortized on a declining balance basis at 20% per year. The Company evaluates the carrying value of intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized when the carrying amount of an intangible asset exceeds the sum of the undiscounted cash flows expected to result from its use.

### Indemnifications

Many of the Company's agreements, specifically those related to financing, clinical trials, research and development and supply arrangements, include indemnification provisions where the Company agrees to indemnify and hold harmless the counterparty against possible claims by third parties. Potential payments under these provisions relate to personal injury resulting from clinical trials and from breach of fundamental representation and warranty terms in the agreements with respect to matters such as corporate status, title of assets, consents to transfer, employment matters, litigation and other potential material liabilities. None of the indemnification provisions absorb the credit risk of the counterparties' assets or liabilities. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is not reasonably quantifiable as certain indemnifications are not subject to a monetary limitation. The Company also maintains product liability insurance to cover claims related to its clinical trials and sales of products. At December 31, 2006, management believes there is only a remote possibility that the indemnification provisions would require any material cash payment.

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**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

**Revenue recognition**

The Company earned 100% of its revenue from one customer under the terms of two contracts [note 8[a]]. These contracts outlined the terms for all products and services provided to the customer, and were considered multiple revenue arrangements. Under the terms of Emerging Issues Committee No. 142 - "Revenue Arrangements with Multiple Deliverables", products and services under these contracts are separated into units of accounting for revenue recognition purposes.

Non-refundable, up-front payments received from licensees are deferred and recognized in income on a straight-line basis over the respective terms of the agreements. Milestone payments received from licensees are recorded as income in the period when the respective measurable milestones are achieved and collectability is assured. Royalty revenues are based on sales by licensees and are recorded as income in the period earned and reported by the licensees.

Revenue from sales of products to licensees is recognized when the title passes to the licensee and when the products are shipped.

Interest income is recognized as earned.

**Research and development and related investment tax credits**

Research and development expenditures include related salaries, subcontractor fees, product development expenses including patent costs, clinical trials costs and an allocation of administrative expenses and corporate costs specifically attributable to research and development. Research and development excludes any costs associated with the acquisition of capital assets and acquired technology. Research and development expenditures are charged to expenses as incurred unless management believes a development cost meets the generally accepted criteria for deferral. All development costs incurred to date have been expensed. Reimbursements for specific expenditures received through collaborative funding have been applied against research and development expenses.

Investment tax credits earned as a result of incurring qualified scientific research and experimental development expenses are recorded when the amounts are readily determinable. The amounts are recorded as follows:

- For capital assets - as a reduction of the cost of the related asset; and
- For operating expenses - as a recovery within the consolidated statements of loss and deficit.

**Stock-based compensation**

The Company has two stock-based compensation plans for employees, directors and consultants, which are described in note 6[d]. Certain of the stock options granted vest over a fixed term and others vest based on performance upon the achievement of certain milestones.

Canadian GAAP requires that options issued be accounted for using the fair value method of accounting. Non-cash compensation expense for fixed-term options is recorded over the term of the vesting period, whereas compensation expense for performance options is recorded when it is determined that achievement of the milestone is likely. Prior to 2003, no compensation expense was recognized for stock options granted to employees. For stock options awarded to employees prior to January 1, 2003 but subsequent to January 1, 2002, pro forma disclosure of net loss and loss per share is provided as if these awards were accounted for using the fair value method. Consideration paid on the exercise of stock options and warrants is credited to capital stock.



**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

Shares issued to employees under the share purchase plan are accounted for as direct awards of stock and are recognized as a non-cash compensation expense in the consolidated statements of loss and deficit [note 6[e]].

**Income taxes**

The Company applies the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are provided if it is more likely than not that some or all of the future tax assets will not be realized.

**Loss per share**

Loss per share has been calculated on the basis of net loss for the year divided by the weighted average number of common shares outstanding during the year. Diluted loss per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method. The inclusion of the Company's stock options, the conversion feature of the convertible debentures and the warrants in the computation of diluted loss per share would have an anti-dilutive effect on loss per share. Therefore, stock options and warrants have been excluded from the calculation of diluted loss per share. Consequently, there is no difference between basic loss per share and diluted loss per share.

**3. ECONOMIC DEPENDENCE AND CONCENTRATION OF CREDIT RISK**

Revenues earned by the Company in fiscal years 2004 to 2006 were from one customer. These revenues were pursuant to a license agreement that was terminated on December 28, 2006 [note 8[a]]. All amounts due to the Company from this customer had been collected prior to the year end. As at December 31, 2005, substantially all the accounts receivable were due from this customer.

**4. CAPITAL AND INTANGIBLE ASSETS**

[a] Capital assets consist of the following:

|                          | Cost<br>\$ | Accumulated<br>amortization<br>\$ | 2006<br>Net book<br>value<br>\$ |
|--------------------------|------------|-----------------------------------|---------------------------------|
| Manufacturing equipment  | 20,585     | 10,056                            | 10,529                          |
| Computer equipment       | 299,947    | 218,529                           | 81,418                          |
| Furniture and equipment  | 65,609     | 48,373                            | 17,236                          |
| Research instrumentation | 666,460    | 515,576                           | 150,884                         |
| Laboratory equipment     | 61,437     | 24,023                            | 37,414                          |
| Leasehold improvements   | 39,983     | 25,054                            | 14,929                          |

|                  |                |                |
|------------------|----------------|----------------|
| <b>1,154,021</b> | <b>841,611</b> | <b>312,410</b> |
|------------------|----------------|----------------|

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

|                          | Cost<br>\$       | Accumulated<br>amortization<br>\$ | 2005<br>Net book<br>value<br>\$ |
|--------------------------|------------------|-----------------------------------|---------------------------------|
| Manufacturing equipment  | 20,585           | 10,056                            | 10,529                          |
| Computer equipment       | 293,388          | 185,361                           | 108,027                         |
| Furniture and equipment  | 65,609           | 44,064                            | 21,545                          |
| Research instrumentation | 669,183          | 452,701                           | 216,482                         |
| Laboratory equipment     | 60,496           | 14,787                            | 45,709                          |
| Leasehold improvements   | 23,159           | 14,815                            | 8,344                           |
|                          | <b>1,132,420</b> | <b>721,784</b>                    | <b>410,636</b>                  |

Amortization expense on capital assets amounted to \$121,934 in 2006 [2005 - \$140,629; 2004 - \$140,313].

**[b]** Intangible assets consist of the following:

|                           | Cost<br>\$       | Accumulated<br>amortization<br>\$ | 2006<br>Net book<br>value<br>\$ |
|---------------------------|------------------|-----------------------------------|---------------------------------|
| Patents and patent rights | <b>1,147,256</b> | <b>915,027</b>                    | <b>232,229</b>                  |
| Trademarks                | <b>150,000</b>   | -                                 | <b>150,000</b>                  |
|                           | <b>1,297,256</b> | <b>915,027</b>                    | <b>382,229</b>                  |

|                           | Cost<br>\$       | Accumulated<br>amortization<br>\$ | 2005<br>Net book<br>value<br>\$ |
|---------------------------|------------------|-----------------------------------|---------------------------------|
| Patents and patent rights | 1,147,256        | 856,970                           | 290,286                         |
|                           | <b>1,147,256</b> | <b>856,970</b>                    | <b>290,286</b>                  |

Amortization expense on intangible assets amounted to \$58,057 in 2006 [2005 - \$72,572; 2004 - \$90,715].

**5. CONVERTIBLE DEBENTURES**

On August 30, 2005, the Company completed a financing, by way of a private placement of convertible debentures maturing on August 30, 2009, for gross proceeds of \$9,827,616 [US\$8,210,000] less issue fees and expenses of \$913,000 (resulting in net proceeds of \$8,915,000). The unsecured debentures bear interest at an annual rate of 7% [effective rate of 12.75% on the liability component], payable quarterly in cash or common shares at the Company's option. The number of common shares issuable in satisfaction of interest payments is dependent on the trading price of the shares at the time of the applicable interest payment date. The debentures are convertible into common shares at any time during the term, at the option of the holder, at \$3.47 per share (subject to adjustment). If all the debentures were converted into common shares, it would result in the issuance of an additional 2,882,195 common shares.

Purchasers of the convertible debentures also received warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per share (subject to adjustment). At any time after one year from the date of issuance of the warrants, the warrants may also be exercised by means of a cashless exercise by the holder. On August 25, 2006, \$475,441 [US\$430,000] of the debentures were converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,304 of the liability, \$140,137 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital.

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

Of the total amount of the financing, \$5,917,209 was recorded as a liability using the residual method. The fair value of the equity component of the convertible debentures at the date of grant is estimated at \$2,393,145 [net of expenses of \$228,292], using the Black-Scholes option pricing model. The fair value of the warrants is estimated at \$1,176,718 [net of expenses of \$112,252], determined using the Black-Scholes option pricing model. Additional financing expenses of \$51,399 were incurred in 2006, of which \$13,623 was allocated to the equity component of the convertible debenture and \$6,698 was allocated to warrants based on their relative fair values. The assumptions used to calculate the fair value of the equity component and the warrants are as follows:

|                         | Equity<br>component | Warrants |
|-------------------------|---------------------|----------|
| Expected volatility     | 42.7%               | 41.7%    |
| Risk-free interest rate | 3.35%               | 3.35%    |
| Expected option life    | 4 years             | 5 years  |
| Dividend yield          | nil                 | nil      |

The table below presents a summary of the offering:

|   | Proceeds<br>\$   | Deferred<br>financing<br>fees<br>\$ | Net<br>\$        |
|---|------------------|-------------------------------------|------------------|
| Issuance of convertible debenture                   | 9,827,616        | 861,328                             | 8,966,288        |
| Equity component of convertible debentures          | (2,621,437)      | (228,292)                           | (2,393,145)      |
| Warrants  | (1,288,970)      | (112,252)                           | (1,176,718)      |
| <b>Liability component of convertible debenture</b> | <b>5,917,209</b> | <b>520,784</b>                      | <b>5,396,425</b> |

The liability component is being accreted over time by a charge to the consolidated statements of loss and deficit for imputed interest at an effective rate of 12.75% and, at maturity, will be equal to the face value of the debentures. All cash repayments, default payments or redemptions of the principal under the debentures shall be made in U.S. dollars.

The table below presents a reconciliation of the valuation of the liability component from date of issue to December 31, 2006:

|   | \$        |
|---|-----------|
| Issuance of convertible debentures, August 30, 2005 | 5,917,209 |
| Changes in foreign exchange rates                   | (279,398) |
| Imputed interest                                    | 255,529   |
| Balance, December 31, 2005                          | 5,893,340 |

|                                   |                  |
|-----------------------------------|------------------|
| Conversion to common shares       | (357,304)        |
| Changes in foreign exchange rates | (4,965)          |
| Imputed interest                  | 819,609          |
| <b>Balance, December 31, 2006</b> | <b>6,350,680</b> |

The amortization of the deferred financing fees amounted to \$139,214 for 2006 [2005 - 43,059; 2004 - nil].

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

**6. CAPITAL STOCK AND CONTRIBUTED SURPLUS****[a] Authorized**

The authorized capital stock of the Company consists of an unlimited number of common shares, without nominal or par value, and an unlimited number of preferred shares, issuable in series.

**[b] Issued and outstanding shares**

|  | Number<br>\$ | Stated<br>value<br>\$ | Contributed<br>surplus<br>\$ | Total<br>\$ |
|--|--------------|-----------------------|------------------------------|-------------|
| Common shares                                |              |                       |                              |             |
| <b>Balance, December 31, 2003</b>            | 21,260,902   | 24,056,853            | 723,993                      | 24,780,846  |
| Expiry of warrants [notes 6[c] and 8[b][ii]] | -            | -                     | 115,200                      | 115,200     |
| Stock-based compensation expense [note 6[d]] | -            | -                     | 488,994                      | 488,994     |
| Issued under share purchase plan [note 6[e]] | 1,830        | 7,595                 | -                            | 7,595       |
| Issued on exercise of options [note 6[d]]    | 8,150        | 23,368                | -                            | 23,368      |
| Issued on cashless exercise of options       | 27,713       | 94,500                | -                            | 94,500      |
| Repayment of share purchase loans            | 15,000       | 10,005                | -                            | 10,005      |
| <b>Balance, December 31, 2004</b>            | 21,313,595   | 24,192,321            | 1,328,187                    | 25,520,508  |
| Expiry of warrants [note 6[c]]               | -            | -                     | 3,000                        | 3,000       |
| Stock-based compensation expense [note 6[d]] | -            | -                     | 509,792                      | 509,792     |
| Issued under share purchase plan [note 6[e]] | 23,167       | 59,105                | -                            | 59,105      |
| Issued on exercise of options [note 6[d]]    | 31,000       | 78,400                | -                            | 78,400      |
| Repayment of share purchase loans            | 180,000      | 120,000               | -                            | 120,000     |
| <b>Balance, December 31, 2005</b>            | 21,547,762   | 24,449,826            | 1,840,979                    | 26,290,805  |
| Expiry of warrants [note 8[b][i]]            | -            | -                     | 197,000                      | 197,000     |
| Stock-based compensation expense [note 6[d]] | -            | -                     | 483,936                      | 483,936     |
| Issued under share purchase plan [note 6[e]] | 25,910       | 56,751                | -                            | 56,751      |
| Issued as payment for interest [note 5]      | 133,674      | 281,462               | -                            | 281,462     |
|  | 150,877      | 475,441               | -                            | 475,441     |

Issued on conversion of debenture *[note 5]*

|                                   |                   |                   |                  |                   |
|-----------------------------------|-------------------|-------------------|------------------|-------------------|
| <b>Balance, December 31, 2006</b> | <b>21,858,223</b> | <b>25,263,480</b> | <b>2,521,915</b> | <b>27,785,395</b> |
|-----------------------------------|-------------------|-------------------|------------------|-------------------|

On September 13, 2004, an executive of the Company exercised, on a cashless basis, 75,000 options to acquire common shares of the Company at \$2.15 per share. The Company issued 27,713 common shares to the executive with an aggregate value equal to the difference between the exercise price of the options and the fair market value of the Company's common shares [\$94,500] on September 13, 2004. The Toronto Stock Exchange and the Board of Directors of the Company approved this cashless exercise.

#### **[c] Warrants**

Pursuant to the issue of convertible debentures on August 30, 2005, the Company granted warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per share *[note 5]*.



**Notes to Consolidated Financial Statements**

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Pursuant to a research collaboration agreement dated October 31, 2000, the Company granted warrants to purchase up to 50,000 common shares at an exercise price of \$4.50 per share; these warrants were issued in annual increments of 10,000 warrants exercisable immediately and expiring in one year. As of October 31, 2005, all warrants expired unexercised.

The status of warrants as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

|                                       | 2006<br>Weighted<br>average<br>exercise<br>price<br>\$ | Number of<br>warrants<br># | 2005<br>Weighted<br>average<br>exercise<br>price<br>\$ | Number of<br>warrants<br># | 2004<br>Weighted<br>average<br>exercise<br>price<br>\$ |
|---------------------------------------|--|----------------------------|--|----------------------------|--|
| <b>Outstanding, beginning of year</b> | <b>3.60</b>  | <b>1,388,970</b>           | 4.05   | 110,000                    | 4.23   |
| Granted                               | -  | -                          | 3.57   | 1,288,970                  | 4.50   |
| Expired or forfeited                  | (100,000)  | 4.00                       | 4.50   | (10,000)                   | 4.50   |
| <b>Outstanding, end of year</b>       | <b>3.57</b>  | <b>1,288,970</b>           | 3.60   | 110,000                    | 4.05   |

**[d] Options**

Under the 1998 Stock Option Plan, the Company grants options to its employees, directors and consultants. The Company may issue options for up to 3,500,000 common shares. As at December 31, 2006, 3,189,517 options had been issued, of which 2,920,304 remain outstanding under this plan, and the remaining 310,483 are eligible to be issued. The exercise price of each option granted may not be less than the market price of the Company's stock on the date of the grant and no option may have a term exceeding 10 years.

Certain of the options vest over a fixed term and others vest based on performance upon the achievement of certain milestones. A summary of the status of the two types of options is presented below:

**Fixed stock options**

Fixed stock options vest on an annual basis over a period of up to five years. The status of fixed stock options as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

|  | 2006<br>Weighted<br>average<br>exercise<br>price<br>\$ | Number<br>of shares<br># | 2005<br>Weighted<br>average<br>exercise<br>price<br>\$ | Number<br>of shares<br># | 2004<br>Weighted<br>average<br>exercise<br>price<br>\$ |
|--|--|--------------------------|--|--------------------------|--|
|  |  |                          |  |                          |  |

|  |                  |             |           |      |           |      |
|--|------------------|-------------|-----------|------|-----------|------|
| <b>Outstanding, beginning of year</b>  | <b>2,297,785</b> | <b>3.41</b> | 1,954,285 | 3.54 | 1,757,035 | 3.45 |
| Granted                                | <b>896,500</b>   | <b>1.48</b> | 549,500   | 3.02 | 406,000   | 3.79 |
| Exercised                              | -                | -           | (31,000)  | 2.53 | (33,613)  | 2.24 |
| Expired or forfeited                   | <b>(454,981)</b> | <b>3.08</b> | (175,000) | 3.79 | (175,137) | 3.50 |
| <b>Outstanding, end of year</b>        | <b>2,739,304</b> | <b>2.83</b> | 2,297,785 | 3.41 | 1,954,285 | 3.54 |
| <b>Options exercisable end of year</b> | <b>1,461,783</b> | <b>3.47</b> | 1,458,114 | 3.49 | 1,258,957 | 3.52 |

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

The following table presents information about fixed stock options outstanding at December 31, 2006:

| Range of exercise prices<br>\$ | Number<br>outstanding<br># | Weighted<br>average<br>remaining<br>life<br>[in years] | Weighted<br>average<br>exercise<br>price<br>\$ | Number<br>exercisable<br># | Weighted<br>average<br>exercise<br>price<br>\$ |
|--------------------------------|----------------------------|--|--|----------------------------|--|
| 1.25 - 1.40                    | 735,500                    | 4.14   | 1.31   | -                          | -  |
| 2.20 - 2.95                    | 1,056,304                  | 2.20   | 2.88   | 633,783                    | 2.86   |
| 3.20 - 3.97                    | 218,000                    | 2.77   | 3.58   | 168,200                    | 3.48   |
| 4.00 - 4.09                    | 709,500                    | 1.24   | 4.01   | 643,800                    | 4.01   |
| 6.05                           | 20,000                     | 0.43   | 6.05   | 16,000                     | 6.05   |
|                                | 2,739,304                  | 2.51   | 2.83   | 1,461,783                  | 3.47   |

The assumptions used to calculate the fair value of stock-based compensation expense using the Black-Scholes option pricing model are approximately as follows:

|                         | 2006    | 2005    | 2004    |
|-------------------------|---------|---------|---------|
| Expected volatility     | 43.9%   | 42.2%   | 50.1%   |
| Risk-free interest rate | 3.97%   | 3.66%   | 3.79%   |
| Expected life           | 5 years | 5 years | 5 years |

Dividend yield assumption used for all years presented was nil.

The Black-Scholes option pricing model, used by the Company to calculate option values, as well as other accepted option valuation models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values. Accordingly, management believes that these models do not necessarily provide a reliable single measure of the fair value of the Company's stock option awards.

**Performance stock options**

Performance stock options vest immediately upon the achievement of certain milestones as determined by the Board of Directors at the time of issuance. The performance stock option milestones include criteria measured by product-related goals and corporate goals. Product-related goals include product development, completion of clinical trials, regulatory submissions, regulatory approvals, signing of marketing partners and commercial launch of the Company's products. The corporate goals include successful investor and public relations activities related to media publications and investor analyst coverage, as well as financial goals including completion of financings and government grants.



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The status of performance stock options as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

|  | December 31, 2006 |             | December 31, 2005 |          | December 31, 2004 |          |
|--|-------------------|-------------|-------------------|----------|-------------------|----------|
|  | Number            | Weighted    | Number            | Weighted | Number            | Weighted |
|  | of shares         | average     | of shares         | average  | of shares         | average  |
|  | #                 | exercise    | #                 | exercise | #                 | exercise |
|  |                   | price       |                   | price    |                   | price    |
|  |                   | \$          |                   | \$       |                   | \$       |
| <b>Outstanding, beginning of year</b>  | <b>176,000</b>    | <b>3.46</b> | 176,000           | 3.46     | 214,750           | 3.54     |
| Granted                                | 120,000           | 2.35        | -                 | -        | -                 | -        |
| Exercised                              | -                 | -           | -                 | -        | (2,250)           | 3.45     |
| Expired or forfeited                   | (115,000)         | 3.17        | -                 | -        | (36,500)          | 3.93     |
| <b>Outstanding, end of year</b>        | <b>181,000</b>    | <b>2.91</b> | 176,000           | 3.46     | 176,000           | 3.46     |
| <b>Options exercisable end of year</b> | <b>34,700</b>     | <b>4.00</b> | 85,825            | 3.29     | 85,825            | 3.29     |

The following table presents information about performance stock options outstanding at December 31, 2006:

| Range of exercise prices | Number         | Weighted    | Weighted    | Number        | Weighted    |
|--------------------------|----------------|-------------|-------------|---------------|-------------|
| \$                       | outstanding    | average     | average     | exercisable   | average     |
|                          | #              | remaining   | exercise    | #             | exercise    |
|                          |                | life        | price       |               | price       |
|                          |                | [in years]  | \$          |               | \$          |
| <b>2.35</b>              | <b>120,000</b> | <b>4.83</b> | <b>2.35</b> | <b>-</b>      | <b>-</b>    |
| <b>4.00</b>              | <b>61,000</b>  | <b>0.13</b> | <b>4.00</b> | <b>34,700</b> | <b>4.00</b> |
|                          | <b>181,000</b> | <b>3.24</b> | <b>2.91</b> | <b>34,700</b> | <b>4.00</b> |

**Pro forma impact of stock-based compensation**

The table below presents pro forma net loss and basic and diluted loss per common share as if stock options granted to employees between January 1, 2002 and December 31, 2002 had been determined based on the fair value method.

|   | 2006               | 2005               | 2004               |
|---|--------------------|--------------------|--------------------|
|   | \$                 | \$                 | \$                 |
| Net loss as reported                        | (5,948,971)        | (4,989,705)        | (5,568,899)        |
| Estimated stock-based compensation expenses | (50,610)           | (116,286)          | (223,830)          |
| <b>Pro forma net loss</b>                   | <b>(5,999,581)</b> | <b>(5,105,991)</b> | <b>(5,792,729)</b> |

**Pro forma basic and diluted loss per common share**

|    |        |    |        |    |        |
|----|--------|----|--------|----|--------|
| \$ | (0.28) | \$ | (0.24) | \$ | (0.27) |
|----|--------|----|--------|----|--------|

The assumptions used to calculate the fair value of stock-based compensation expense using the Black-Scholes option pricing model are approximately as follows: expected volatility of 54.3%; risk-free interest rate of 4.06%; dividend yield of nil; and expected life of the options of five years.

**[e] Share purchase plan**

The Company implemented a share purchase plan effective March 22, 1999, as amended on May 25, 2005. Pursuant to the terms of the plan, the Company will match the value of the common shares purchased by its employees or directors by issuing from treasury an equal number of common shares, up to a maximum value of the lesser of 50% of the maximum allowable

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

annual contribution for registered retirement savings plans [being \$9,000 as at December 31, 2006 or 9% of the employee's annual salary]. The maximum number of common shares which may be issued by the Company pursuant to the share purchase plan is 350,000. Under the plan, the Company issued 25,910 common shares to employees and directors during the year ended December 31, 2006 and 23,167 and 1,830 common shares during the years ended December 31, 2005 and 2004, respectively.

**7. INCOME TAXES**

[a] Significant components of the Company's future tax assets are as follows:

|  | 2006       | 2005       |
|--|------------|------------|
|  | \$         | \$         |
| <b>Future tax assets</b>                     |            |            |
| Federal tax loss carryforwards               | 3,045,000  | 2,450,000  |
| Ontario tax loss carryforwards               | 2,170,000  | 1,612,000  |
| Investment tax credits                       | 2,061,000  | 1,700,000  |
| Financing and share issue costs              | 194,000    | 263,000    |
| SR&ED expenditures                           | 3,684,000  | 3,380,000  |
| Capital assets                               | 95,000     | 99,000     |
| Deferred revenue                             | -          | 684,000    |
| Future tax assets before valuation allowance | 11,249,000 | 10,188,000 |
| Valuation allowance                          | 11,249,000 | 10,188,000 |
| <b>Net future tax assets</b>                 | -          | -          |

No net future tax assets have been recognized in the consolidated financial statements as the realization of the net future tax assets does not meet the more likely than not recognition criteria.

[b] The Company has accumulated tax losses for federal and provincial purposes in Canada. The Company also has unclaimed federal scientific research investment tax credits. The losses and investment tax credits can be used to offset future years' Canadian taxable income, the benefit of which has not been recorded in the accounts.

The approximate tax losses and investment tax credits expire as follows:

|      | Federal   | Ontario   | Investment<br>tax credits |
|------|-----------|-----------|---------------------------|
|      | \$        | \$        | \$                        |
| 2007 | 1,062,000 | 1,340,000 | -                         |
| 2008 | 1,562,000 | 1,562,000 | -                         |
| 2009 | 2,887,000 | 2,887,000 | 18,000                    |
| 2010 | 2,018,000 | 2,018,000 | 247,000                   |
| 2011 | -         | -         | 337,000                   |

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|      |            |            |           |
|------|------------|------------|-----------|
| 2012 | -          | -          | 297,000   |
| 2013 | -          | -          | 397,000   |
| 2014 | 494,000    | 494,000    | 423,000   |
| 2015 | 2,178,000  | 2,178,000  | 464,000   |
| 2016 | 5,024,000  | 5,024,000  | 458,000   |
|      | 15,225,000 | 15,503,000 | 2,641,000 |

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**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

[c] The Company has available scientific research and experimental development ["SR&ED"] expenditures for income tax purposes which may be carried forward indefinitely to reduce future years' taxable income. The total of such expenditures accumulated to December 31, 2006 was approximately \$11,162,000. The potential income tax benefits associated with these expenditures have not been recorded in the accounts.

[d] The Company is entitled to receive provincial investment tax credits relating to SR&ED expenditures incurred, the benefits of which have been accrued in the accounts.

[e] The following is a reconciliation of the provision for (recovery of) income taxes between those that are expected, based on substantially enacted rates, to those currently reported:

|                                   | 2006        |        | 2005        |        | 2004        |        |
|-----------------------------------|-------------|--------|-------------|--------|-------------|--------|
|                                   | \$          | %      | \$          | %      | \$          | %      |
| Loss before income taxes          | (5,948,971) |        | (4,989,705) |        | (5,568,899) |        |
| Expected recovery of income taxes | (2,148,768) | (36.1) | (1,802,281) | (36.1) | (2,011,486) | (36.1) |
| Permanent differences             | 526,482     | 8.8    | 299,044     | 6.0    | 268,428     | 4.8    |
| Change in valuation allowance     | 1,622,286   | 27.3   | 1,503,237   | 30.1   | 1,743,058   | 31.3   |
|                                   | -           | -      | -           | -      | -           | -      |

**8. COMMITMENTS****[a] Commercialization agreements**

Pursuant to an agreement dated May 10, 2002, as amended on December 20, 2002 and December 9, 2005, the Company licensed to McNeil Consumer Healthcare ["McNeil"] the right to market and distribute the Company's test for coronary artery disease in Canada and for the insurance laboratory field in the United States and Mexico. The term of the agreement was 15 years and required McNeil to purchase the Company's skin cholesterol test and to pay ongoing royalties to the Company based on McNeil's sales, in addition to a series of financial milestone payments of up to \$3,300,000, which were to be based on McNeil's achievement of specified annual sales levels of the licensed products.

On May 28, 2004, as amended on December 9, 2005, the Company signed an additional marketing agreement with McNeil and completed an exclusive worldwide licensing agreement to sell the Company's skin cholesterol tests under the brand name PREVU\* Skin Sterol Test. The agreement had a minimum term of 10 years. Under the financial terms of the agreement, the Company received a non-refundable \$3,000,000 up-front payment.

On December 28, 2006, the agreements with McNeil were terminated and the balance of the deferred revenue, which had been received as an up-front payment, of \$2,297,400 was recorded as license revenue. In addition, the Company received additional license revenue of \$221,000 related to annual minimum sales levels and purchased other assets from McNeil for \$221,000, including the PREVU\* trademark for \$150,000.

**[b] Research and collaboration agreements**

The Company has entered into agreements with various clinical sites to conduct clinical trials on its technologies. The Company is committed, upon the progressive completion of the trials, to make further payments of approximately \$305,000.

**Notes to Consolidated Financial Statements**

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The Company has acquired or is developing in collaboration with others a number of technologies that will require the Company to make payments upon the successful achievement of certain technological milestones. Additionally, in connection with the development of the technologies, the Company has entered into research agreements whereby a minimum fee will be paid for research and development to be carried out by other parties. The Company is committed, upon the successful achievement of future operating performance milestones, to make further payments of approximately \$225,000 to these parties.

[i] Pursuant to agreements [the “ColorectAlert™ License Agreements”] dated March 27, 1998, May 1, 1998, and October 23, 2001 between the Company and Dr. A.K.M. Shamsuddin [the “ColorectAlert™ Inventor”], the Company acquired a license, including the three existing United States and Japanese patents, for a technology that detects a carbohydrate marker associated with cancerous and pre-cancerous conditions [“ColorectAlert™”]. Pursuant to the terms of the agreements, the Company is required to make payments upon achieving certain research and development milestones as well as royalty payments based on revenues from sales of this technology. As at December 31, 2006, the Company had made milestone payments under the ColorectAlert™ License Agreements of approximately \$328,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$120,000. In addition, the Company granted warrants to purchase up to 100,000 common shares at exercise prices ranging from \$3.50 to \$4.50 per share to the ColorectAlert™ Inventor. These warrants expired unexercised on October 19, 2006, and the fair value of \$197,000 was reclassified from warrants to contributed surplus [note 6[b]].

Subsequent to the year end, on January 5, 2007, the Company settled litigation relating to the ColorectAlert™ License Agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11 AG, the Company agreed to pay \$175,000 to Med-11 AG [“Med-11”] and amended the agreements to replace Dr. Shamsuddin with Med-11 as the licensor. This amount was expensed in 2006 as general and administration expense. The amendment also reduced the royalty payable by the Company from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Company may have been required to pay under the initial agreements.

[ii] The Company entered into an agreement [the “Procyon License Agreement”] with Ambrilia Biopharma, Inc. (formerly, Procyon Biopharma Inc.) [“Procyon”] dated March 19, 2001, as amended, whereby the Company has the right to complete the development, clinical trials and regulatory submission for the technology and is entitled to develop, manufacture, market and distribute the ColoPath™ technology exclusively on a global basis. Pursuant to the terms of the Procyon License Agreement, all new patents will be owned by the Company. Procyon is entitled to payments based on the completion of certain research and development milestones as well as a royalty payment based on sales of all mucus-based colorectal cancer tests. As at December 31, 2006, the Company had made milestone payments under the Procyon License Agreement of \$125,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$225,000. The Procyon License Agreement does not have a fixed termination date and it may be terminated upon written agreement of the parties, if the Company has not at that time engaged in any clinical work or product development in connection with the research and development of ColorectAlert™ or ColoPath™ or met minimum levels of sales of these products. In addition, the Company granted Procyon warrants to purchase up to 75,000 common shares at an exercise price of \$4.50 per share in connection with this agreement. These warrants expired unexercised on March 19, 2004, and the fair value of \$108,000 was reclassified from warrants to contributed surplus [note 6[b]].

**[c] Key man life insurance**

A subsidiary of the Company, 6211178 Canada Inc. [the “Subsidiary”], owns life insurance policies for the CEO in the amount of \$8,000,000, with the Subsidiary as the named beneficiary. In the event of the CEO’s death, the Subsidiary shall use 75% of the insurance proceeds to purchase the CEO’s common shares in the Company from his estate.

Pursuant to the terms of the insurance agreement, on January 1 of each year, the Subsidiary shall ensure that the amount of the insurance policy is not less than 100% of the fair market value of the CEO’s common shares at that date. The Company owns an additional life insurance policy for the CEO in the amount of \$3,000,000.

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**[d] Operating leases and other commitments**

The Company has contractual commitments and future minimum annual lease payments under operating leases for its office premises and laboratory facilities as follows:

|                     | \$             |
|---------------------|----------------|
| 2007                | 226,000        |
| 2008                | 135,000        |
| 2009                | 19,000         |
| 2010 and thereafter | -              |
|                     | <b>380,000</b> |

**9. CONSOLIDATED STATEMENTS OF CASH FLOWS**

The net change in non-cash working capital balances related to operations consists of the following:

|  | 2006<br>\$       | 2005<br>\$  | 2004<br>\$ |
|--|------------------|-------------|------------|
| Accounts receivable                      | <b>870,670</b>   | (659,543)   | (211,648)  |
| Inventory                                | <b>(142,913)</b> | 231,194     | (267,500)  |
| Prepaid expenses and other receivables   | <b>(253,509)</b> | (180,249)   | 186,774    |
| Investment tax credits receivable        | -                | 189,000     | (209,000)  |
| Accounts payable and accrued liabilities | <b>948,482</b>   | (641,799)   | 1,036,658) |
|  | <b>1,422,730</b> | (1,061,397) | 535,284    |

Excluded from the consolidated statements of cash flows for the years ended December 31, 2006 was the issuance of common shares paid as consideration for interest on the convertible debentures of \$281,462 and a foreign exchange adjustment of \$1,642. There was no impact on the years ended December 31, 2005 and 2004.

The Company did not pay any amounts for income taxes from 2004 to 2006.



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**10. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

The Company prepares its consolidated financial statements in accordance with Canadian GAAP, which, as applied in these consolidated financial statements, conforms in all material respects to U.S. GAAP, except as follows:

|   | 2006               | 2005        | 2004        |
|---|--------------------|-------------|-------------|
|   | \$                 | \$          | \$          |
|   |                    | [note b]    |             |
| <b>Net loss for the year [Canadian GAAP]</b>                | <b>(5,948,971)</b> | (4,989,705) | (5,568,899) |
| Adjustments   |                    |             |             |
| Amortization of acquired technology [a]                     | 58,057             | 72,572      | 90,715      |
| Mark-to-market adjustment on derivative [b]                 | 54,088             | 28,807      | -           |
| Amortization of deferred financing fees [c]                 | (50,043)           | (15,798)    | -           |
| <b>Net loss and comprehensive loss for the year</b>         |                    |             |             |
| [U.S. GAAP] [e]   | (5,886,869)        | (4,904,124) | (5,478,184) |
| <b>Basic and diluted loss per share</b>                     |                    |             |             |
| [U.S. GAAP]   | \$ (0.27)          | \$ (0.23)   | \$ (0.26)   |
| <b>Weighted average number of common shares outstanding</b> |                    |             |             |
| Basic and diluted   | 21,663,698         | 21,487,008  | 21,276,497  |

Basic loss per common share is determined using the weighted average number of common shares outstanding during the years. As a result of the net losses for the years ended December 31, 2006, 2005 and 2004, the potential dilutive effect of the exercise of stock options and warrants was anti-dilutive, and therefore, it was not included in the calculation of diluted loss per share.

Consolidated balance sheet items, which would differ under U.S. GAAP, are as follows:

|                             | 2006      | 2005       | 2004      |
|-----------------------------|-----------|------------|-----------|
|                             | \$        | \$         | \$        |
| <b>ASSETS</b>               |           |            |           |
| Intangible assets, net [a]  | 150,000   | -          | -         |
| Deferred financing fees [c] | 475,851   | 686,653    | -         |
|                             | 5,167,639 | 11,211,832 | 6,633,221 |

**LIABILITIES AND SHAREHOLDERS' EQUITY**

|                                       |                     |              |              |
|---------------------------------------|---------------------|--------------|--------------|
| Derivative liability <i>[b]</i>       | <b>2,402,244</b>    | 2,592,630    | -            |
|                                       | <b>10,649,286</b>   | 12,041,523   | 4,499,237    |
| <b>Shareholders' equity</b>           |                     |              |              |
| Capital stock                         | <b>29,981,717</b>   | 29,182,269   | 28,924,764   |
| Additional paid-in capital <i>[d]</i> | <b>5,167,851</b>    | 4,735,952    | 3,049,442    |
| Deficit <i>[a] [b] [c]</i>            | <b>(40,631,215)</b> | (34,747,912) | (29,840,222) |
|                                       | <b>(5,481,647)</b>  | (829,691)    | 2,133,984    |
|                                       | <b>5,167,639</b>    | 11,211,832   | 6,633,221    |



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**Notes to Consolidated Financial Statements**

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**[a] Intangible assets**

Under U.S. GAAP, the Company's patents and patent rights, which are primarily comprised of patents and know-how which require regulatory approval to be commercialized and which have no proven alternative future uses, are considered in-process research and development and are immediately expensed upon acquisition in accordance with Statement of Financial Accounting Standards ["SFAS"] No. 2, "Accounting for Research and Development Costs". The Company's patents and patent rights do not have an alternative future use given their specialized nature and limited alternative use. Under Canadian GAAP, the patents and patent rights are considered to be a development asset that is capitalized and amortized over its expected useful life.

**[b] Convertible debentures**

During 2006, the Company determined that the conversion feature of the convertible debentures met the definition of a derivative under FAS 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and should be recorded on the balance sheet as a derivative liability with subsequent changes in value recorded through earnings. Previously, the fair value assigned to the conversion feature of the convertible debenture was recorded as a liability and accreted to its maturity value through charges to income for the imputed interest at an effective rate of 3.52%. As a result, the previously reported difference relating to the imputed interest on the liability component of \$154,900 no longer exists. The elimination of the imputed interest is partially offset by the mark-to-market gain of the derivative liability of \$28,807, as well as a reduction in the amortization of the deferred financing fees (see [c] below). The net impact of these three adjustments increases the net loss for 2005 under U.S. GAAP by \$122,527 from amounts previously reported and also increases basic and diluted loss per share of \$0.22 previously reported to \$0.24. The restated pro forma basic and diluted loss per share increases from \$0.23 previously reported to \$0.24 [see note f].

The impact of these adjustments on the balance sheet under U.S. GAAP is as follows:

- The fair value of the conversion feature of \$2,621,437, as at August 30, 2005, being the same value as the equity component under Canadian GAAP, was reclassified from convertible debentures to derivative liability;
- The derivative liability was revalued to \$2,592,630 as at December 31, 2005 which represents a mark-to-market gain of \$28,807.

In accordance with Accounting Principles Board ["APB"] Opinion No. 14, a value is assigned to the warrants when they are detachable from the convertible debentures. As a result, there is no difference in the value assigned to warrants under Canadian and U.S. GAAP.

On August 25, 2006, \$461,235 [US\$430,000] of the debentures were converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,304 of the liability component of the convertible debentures, \$136,298 of the derivative liability and \$32,367 of the deferred financing fees to share capital. These amounts differ slightly from the amounts reported under Canadian GAAP described in note 5.

**[c] Deferred financing fees**

Under U.S. GAAP, financing fees relating to the issue of convertible debentures are pro-rated between the liability (exclusive of the fair value assigned to the conversion feature) and the warrant components of the debentures. Under Canadian GAAP, the financing fees are allocated between the liability and the equity and the warrant components.

The expenses related to the liability component are deferred and amortized over the term of the debentures whereas the expenses related to the equity and warrant components are netted against their respective fair values. The resulting difference is that the financing fees allocated to the liability component under U.S. GAAP are higher than under Canadian GAAP, and therefore, additional amortization expense is recorded.

As a result of the 2005 restatement discussed in [b] above, the Company determined that the deferred financing fees allocated to the liability and warrant components as at August 30, 2005 were restated to \$706,289 and \$155,039, respectively.

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(previously reported as \$748,493 and \$112,834, respectively). The unamortized portion of deferred financing fees as at December 31, 2005 has been restated to \$647,423, a decrease of \$39,230 from the previously reported amount of \$686,653. Amortization of deferred financing fees under U.S. GAAP for fiscal 2005 has decreased \$3,566 to \$15,798 from the previously reported amount of \$19,364. Furthermore, additional paid-in capital has decreased by \$42,787 to \$4,693,165 to reflect the additional deferred financing fees netted against the warrants when compared to Canadian GAAP.

**[d] Stock options**

Prior to 2003, the Company did not recognize compensation expense relating to stock options under Canadian or U.S. GAAP. Effective January 1, 2003, the Company adopted the provisions of SFAS No. 123 ["SFAS 123"], which aligned with the provisions of CICA Handbook Section 3870. Prior to January 1, 2003, the Company recognized compensation expense for the fixed and performance stock options granted to employees in accordance with APB Opinion No. 25 ["APB 25"]. APB 25 required the Company to recognize compensation expense relating to the intrinsic value of the options when the market price of the underlying stock is greater than the exercise price of the stock options on the grant date. Compensation expense recorded prior to January 1, 2003 was recorded as additional paid-in capital and was reclassified to capital stock upon exercising of the actual options. Under Canadian GAAP, there was no recognition of compensation expense related to employee options prior to January 1, 2003.

**[e] Comprehensive income**

SFAS No. 130, "Reporting Comprehensive Income", establishes standards for the reporting and display of comprehensive income and its components in general purpose financial statements. Comprehensive income is defined as the change in net assets of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, and includes all changes in equity during a period. For the years presented, the Company did not have any material transactions that would otherwise have had an impact on comprehensive income. As such, net loss for the year under U.S. GAAP is equal to comprehensive income.

**[f] SFAS 123 pro forma disclosures**

SFAS 123 requires pro forma disclosures of net loss and loss per share as if the fair value method, as opposed to the intrinsic value-based method, of accounting for employee stock options had been applied for performance stock options granted prior to January 1, 2003.

The following tables present the Company's net loss and loss per share on a pro forma basis using the fair value method as determined by the Black-Scholes option pricing model:

|  | 2006        | 2005        | 2004        |
|--|-------------|-------------|-------------|
|  | \$          | \$          | \$          |
|  |             |             |             |
|  |             | [note b]    |             |
| <b>Net loss for the year</b>                   |             |             |             |
| U.S. GAAP - as reported                        | (5,886,869) | (4,904,124) | (5,478,184) |
| Pro forma stock-based compensation expense [d] | (45,888)    | (225,923)   | (376,879)   |

|   |                    |             |             |
|---|--------------------|-------------|-------------|
| <b>Net loss under U.S. GAAP - pro forma</b>                 | <b>(5,932,757)</b> | (5,130,047) | (5,855,063) |
| <b>Basic and diluted loss per share [U.S. GAAP]</b>         |                    |             |             |
| As reported   | \$ (0.27)          | \$ (0.24)   | \$ (0.26)   |
| Pro forma   | \$ (0.27)          | \$ (0.24)   | \$ (0.28)   |
| <b>Weighted average number of common shares outstanding</b> |                    |             |             |
| Basic and diluted   | <b>21,663,698</b>  | 21,487,008  | 21,276,497  |

**Notes to Consolidated Financial Statements**

December 31, 2006 [In Canadian dollars, unless otherwise noted]

The assumptions used to calculate the fair value of stock-based compensation expense for performance stock options granted in the respective years prior to 2003 using the Black-Scholes option pricing model are as follows:

|                         | High    | Low     |
|-------------------------|---------|---------|
| Expected volatility     | 62.3%   | 55.5%   |
| Risk-free interest rate | 6.19%   | 4.56%   |
| Expected option life    | 5 years | 5 years |
| Dividend yield          | Nil     | Nil     |

**[g] Additional consolidated balance sheet information**

Accounts payable and accrued liabilities consisted primarily of amounts owing to trade creditors of \$1,208,702 [2005 - \$573,818; 2004 - \$1,352,014] and accruals related to clinical trials of \$512,660 [2005 - \$372,420; 2004 - \$236,023] and a litigation settlement of \$175,000 [nil in 2005 and 2004].

In accordance with Canadian GAAP, the Company's cash and cash equivalents and short-term investments are carried at the lower of cost or market based on quoted market prices. Under U.S. GAAP, these investments would have been classified as held-to-maturity and would have been recorded at amortized cost. There is no significant difference between cost under Canadian GAAP and amortized cost under U.S. GAAP.

**[h] Recent accounting developments**

The Company has adopted SFAS No. 123(R), "Share-Based Payment" on a modified prospective basis. SFAS No. 123(R) is a revision of SFAS 123 and supersedes APB 25 and requires all share-based payments to employees to be recognized in the financial statements based on their fair values. The Company has reviewed its policies and determined that there is no material impact on the consolidated financial statements as a result of the Company adopting this pronouncement.

In July 2006, the Financial Accounting Standards Board ["FASB"] issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109". FIN 48 is effective for years beginning after December 15, 2006. The Company is currently reviewing this standard, but has not yet determined its impact on the consolidated financial statements.

**11. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS**

The comparative consolidated financial statements for the years ended December 31, 2005 and 2004 have been reclassified from statements previously presented to conform to the presentation of the 2006 consolidated financial statements.

**12. SUBSEQUENT EVENT**

In March 2007, the Company issued, by way of private placement, approximately 2,917,268 common shares and 1,458,634 common share purchase warrants at \$1.33 per unit for gross proceeds of approximately \$3.9 million. Each common share purchase warrant expires in March 2010 and entitles the holder to acquire one common share at a price

of \$1.66 per share.