

Consolidated Financial Statements

Haemacure Corporation

October 31, 2006 and 2005

AUDITORS' REPORT

To the Shareholders of
Haemacure Corporation

We have audited the consolidated balance sheets of **Haemacure Corporation** as at October 31, 2006 and 2005 and the consolidated statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at October 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Montréal, Canada
January 12, 2007
(except for note 17 which is as of
January 17, 2007)

Chartered Accountants

Haemacure CorporationIncorporated under the *Canada Business Corporations Act***CONSOLIDATED BALANCE SHEETS**[See Nature of Business and Going Concern Assumption – *note 1*]

As at October 31

	2006	2005
	\$	\$
ASSETS		
Current assets		
Cash and cash equivalents	78,300	814,664
Temporary investment <i>[note 3]</i>	441,000	1,987,581
Accounts receivable – trade	12,431	24,394
Other receivables <i>[note 4]</i>	80,540	1,264,921
Inventories	34,167	69,755
Prepaid expenses	74,974	115,653
	<u>721,412</u>	<u>4,276,968</u>
Property, plant and equipment <i>[note 5]</i>	1,959,679	1,173,878
Other assets <i>[note 6]</i>	15,107	18,593
	<u>2,696,198</u>	<u>5,469,439</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	447,539	317,783
Current portion of obligation under capital leases <i>[note 7]</i>	10,933	10,337
	<u>458,472</u>	<u>328,120</u>
Obligation under capital leases <i>[note 7]</i>	36,730	47,663
Lease obligation	29,851	—
Long-term debt <i>[note 8]</i>	1,189,764	1,141,257
	<u>1,714,817</u>	<u>1,517,040</u>
Shareholders' equity	981,381	3,952,399
	<u>2,696,198</u>	<u>5,469,439</u>

Commitments and contingencies *[notes 8 and 12]**See accompanying notes*

On behalf of the Board:

[Signed] Pierre Alary
Director[Signed] Joseph Galli
Chairman of the Board

Haemacure Corporation

CONSOLIDATED STATEMENTS OF OPERATIONS

[See Nature of Business and Going Concern Assumption – *note 1*]

Years ended October 31

	2006	2005
	\$	\$
Sales	147,134	258,153
Cost of sales	60,771	78,947
Gross margin	86,363	179,206
EXPENSES (INCOME)		
Selling and marketing	45,527	55,374
General and administrative	2,232,048	2,174,930
Research and development	717,228	312,622
Loss (gain) on disposal of property, plant and equipment	18,127	(523,289)
Loss on foreign exchange	43,595	74,169
Amortization of property, plant and equipment	58,523	111,246
Amortization of other assets	3,486	3,486
Interest on obligation under capital leases <i>[note 7]</i>	2,995	—
Interest on long-term debt <i>[note 8]</i>	48,507	33,694
Other financial expenses	10	5,892
Investment income	(72,202)	(181,680)
	3,097,844	2,066,444
Net loss	(3,011,481)	(1,887,238)
Loss per common share <i>[note 9]</i>		
Basic and diluted	(0.08)	(0.05)
Weighted average number of outstanding common shares <i>[note 9]</i>		
Basic and diluted	38,800,917	38,800,917

See accompanying notes

Haemacure Corporation

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

[See Nature of Business and Going Concern Assumption – *note 1*]

Years ended October 31

	2006		2005	
	Number of shares	Amount \$	Number of shares	Amount \$
Share capital [note 9]				
Common shares				
Balance at beginning of year	38,800,917	92,266,948	38,800,917	92,266,948
Balance at end of year	38,800,917	92,266,948	38,800,917	92,266,948
Deficit				
Balance at beginning of year		(90,752,598)		(88,865,360)
Repricing of warrants [note 9]		(62,400)		—
Net loss		(3,011,481)		(1,887,238)
Balance at end of year		(93,826,479)		(90,752,598)
Additional paid-in capital [note 9]		2,540,912		2,438,049
Total shareholders' equity		981,381		3,952,399

See accompanying notes

Haemacure Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS

[See Nature of Business and Going Concern Assumption – *note 1*]

Years ended October 31

	2006 \$	2005 \$
OPERATING ACTIVITIES		
Net loss	(3,011,481)	(1,887,238)
Items not affecting cash:		
Amortization of property, plant and equipment	58,523	111,246
Amortization of other assets	3,486	3,486
Accrued interest on long-term debt	48,507	33,672
Accrued interest on accounts receivable from a supplier	(15,859)	(80,350)
Loss (gain) on disposal of property, plant and equipment	18,127	(523,289)
Stock-based compensation expense	40,463	27,640
Rent expense	29,851	—
Foreign exchange loss	12,276	21,537
Unrealized foreign exchange loss	15,824	57,392
	(2,800,283)	(2,235,904)
Net change in non-cash working capital balances related to operations [<i>note 14</i>]	1,363,484	1,119,841
Cash flows relating to operating activities	(1,436,799)	(1,116,063)
FINANCING ACTIVITIES		
Repayment of obligation under capital leases	(10,337)	—
Repayment of long-term debt	—	(891)
Cash flows relating to financing activities	(10,337)	(891)
INVESTING ACTIVITIES		
Proceeds on disposition of temporary investments	1,547,088	—
Acquisition of property, plant and equipment	(862,451)	(950,557)
Proceeds from disposal of property, plant and equipment	—	689,715
Accounts payable related to property, plant and equipment	38,411	—
Cash flows relating to investing activities	723,048	(260,842)
Effect of exchange rate changes on cash and cash equivalents	(12,276)	(21,537)
Net decrease in cash and cash equivalents	(736,364)	(1,399,333)
Cash and cash equivalents at beginning of year	814,664	2,213,997
Cash and cash equivalents at end of year [<i>note 14</i>]	78,300	814,664
Supplemental information		
Interest paid	3,005	5,913

See accompanying notes

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

1. NATURE OF BUSINESS AND GOING CONCERN ASSUMPTION

Nature of business

Haemacure Corporation's [the "Corporation"] activities since incorporation have been to perform research and development, establish offices and its sales network, build research facilities, sell its products, and raise capital. The Corporation specializes in developing innovative biological adhesives, biomaterials and surgical devices for acute surgical wound care. Since 1997, the Corporation had planned to pursue the marketing of Hemaseel APR which represented substantially all sales revenue of the Corporation. As of October 31, 2003, the Corporation ceased the commercialization of Hemaseel APR and is focusing on the completion of the development of Hemaseel HMN ["HMN"] and Hemaseel Thrombin. As a consequence, the Corporation's status is considered to have returned to that of a corporation in the development stage as of November 1, 2003 and will remain so until significant revenues are generated from Hemaseel HMN and Hemaseel Thrombin. The Corporation considers that it is primarily pursuing only one project, which is the development of Hemaseel HMN and Hemaseel Thrombin, from which no revenues have been derived to date, and for which the Corporation incurred expenses, namely research and development expenses and significant purchases of property, plant and equipments. The Corporation's activities are subject to the risks inherent in any corporation that operates in the field of biotechnology.

Going concern assumption

These consolidated financial statements have been prepared on a going concern basis, which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future.

The Corporation has not realized profit from operations since its inception and has exited its Hemaseel APR product line. As of November 1, 2003, the Corporation is in the development stage and will not generate significant revenues or profitable operations in the near future and there can be no assurance that it will achieve profitability in the future. As a result, there is significant uncertainty regarding the Corporation's ability to continue as a going concern. The Corporation will also require additional financing to fund its operations and development as well as to completing its HMN facility, conducting clinical trials and obtaining regulatory approvals.

The Corporation's ability to continue as a going concern is dependent on its raising additional financing, developing and bringing its technology to market, obtaining the necessary regulatory approvals and achieving and maintaining profitable operations. The outcome of these matters cannot be predicted at this time. It will be necessary for the Corporation to raise additional funds for the continuing development and marketing of its technologies. These consolidated financial statements do not include any adjustments and classifications of assets and liabilities, which might be necessary should the Corporation be unable to continue its operations.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at year-end and the reported amounts of revenues and expenses during the period. Actual results may differ from the estimates and assumptions used. Because the Corporation has not yet started to market its Hemaseel HMN technology, the carrying value of the Corporation's property, plant and equipment is subject to uncertainty. Future events could result in material changes to the carrying values of property, plant and equipment recognized in the consolidated financial statements.

Revenue recognition

Revenue from sale of products is recognized upon shipment of the product.

Cash equivalents

Cash equivalents consist of investments that are readily convertible into a known amount of cash, that are subject to minimal risk of changes in value and which have an original maturity of three months or less from the date of purchase.

Temporary investment

The temporary investment, representing a fixed income security, is valued at the lower of amortized cost and fair market value.

Inventories

Inventories, which consist of products held for resale, are valued at the lower of cost, using the first-in, first-out method, and net realizable value, less allowance for obsolescence which takes into consideration factors such as expiration dates.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of related government assistance and investment tax credits. Assets acquired under capital leases are carried at cost, being the present value of the minimum lease payments. Depreciation of property, plant and equipment and assets acquired under capital leases is calculated over their estimated useful life using the following methods and rates:

Laboratory equipment	Straight line	5 years
Office equipment	Declining balance	20%
Computer equipment	Declining balance	30%
Leasehold improvements	Straight line	Lease term

No amortization is recorded on construction-in-progress. Amortization will be recorded when the production process begins.

Government assistance and investment tax credits

Government assistance and investment tax credits are recorded as a reduction of the related expenditures or property, plant and equipment when there is reasonable assurance of their ultimate realization.

Income taxes

The Corporation follows the liability method of accounting for income taxes under which future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates that are expected to be in effect in the periods in which assets or liabilities will be realized or settled. A valuation allowance is provided to the extent that it is not more likely than not that future income tax assets will be realized.

Other assets

Other assets are comprised of manufacturing rights. Manufacturing rights are recorded at cost and amortized using the straight-line method over a period of 12 to 15 years.

Research and development

Research costs are charged against income in the year they are incurred. Development costs are charged against income in the year of expenditure unless a development project meets the criteria under Canadian generally accepted accounting principles for deferral and amortization. The Corporation has not deferred any development costs to date.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Translation of foreign currencies

Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets and liabilities as well as revenues and expenses denominated in a foreign currency are translated at the exchange rate prevailing at the transaction date. Foreign currency translation gains and losses are included in the consolidated statement of operations of the reporting period. The accounts of the foreign subsidiary are translated using the temporal method.

Basic and diluted loss

Basic loss per share is calculated using the weighted average number of voting shares outstanding during the year. Diluted loss per share is calculated using the treasury stock method.

Stock-based compensation and other stock-based payments

The Corporation has a stock option incentive plan which is described in note 10. The Corporation accounts for stock-based compensation using the fair value method of accounting for stock-based compensation plans.

Impairment of long-lived assets

Long-lived assets and certain identifiable intangibles are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use together with its residual value [net recoverable value]. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Any impairment results in a write-down of the long-lived assets and a charge to operations in the year [*see note 1 – going concern assumption*].

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

3. TEMPORARY INVESTMENT

The following table summarizes information relating to the temporary investment as at October 31, 2006:

	Amortized cost \$	Market value \$	Original maturity
Crown corporation bond	441,882	441,000	Nov. 1, 2006

At October 31, 2005 the temporary investment had an amortized cost of \$1,988,970 and a market value of \$1,987,581 with a maturity date of November 1, 2006. During the year a portion of the investment was sold. This temporary investment bears interest at floating quarterly rates. The interest rate amounted to 4.421% as at October 31, 2006 [2.772% as at October 31, 2005].

4. OTHER RECEIVABLES

	2006 \$	2005 \$
Account receivable from a company controlled by a director <i>[note 15]</i>	26,254	16,454
Account receivable from a supplier	—	1,160,372
Commodity taxes and other	54,286	88,095
	80,540	1,264,921

5. PROPERTY, PLANT AND EQUIPMENT

	2006		2005	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Laboratory equipment	58,000	11,600	71,790	13,330
Office equipment	41,364	25,823	69,915	39,964
Computer equipment	203,434	118,704	236,728	101,818
Construction-in-progress	1,813,008	—	950,557	—
	2,115,806	156,127	1,328,990	155,112
Less: accumulated amortization	156,127		155,112	
Net carrying amount	1,959,679		1,173,878	

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

5. PROPERTY, PLANT AND EQUIPMENT [Cont'd]

Property, plant and equipment include the following assets under capital leases:

	2006	2005
	\$	\$
Laboratory equipment, at cost	58,000	58,000
Less: accumulated amortization	11,600	—
Net carrying amount	46,400	58,000

6. OTHER ASSETS

	2006	2005
	\$	\$
Manufacturing rights, at cost	49,346	49,346
Less: accumulated amortization	34,239	30,753
	15,107	18,593

7. OBLIGATION UNDER CAPITAL LEASES

	2006	2005
	\$	\$
Lease for laboratory equipment, repayable in monthly instalments of \$1,111 including interest of 5.62%, maturing in October 2010	47,663	58,000
Less: current portion	10,933	10,337
	36,730	47,663

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. OBLIGATION UNDER CAPITAL LEASES [Cont'd]

Minimum lease payments under capital leases for the next years are as follows:

	\$
2007	13,333
2008	13,333
2009	13,333
2010	13,333
	53,332
Less: imputed interest	5,669
	<u>47,663</u>

8. LONG-TERM DEBT

	2006	2005
	\$	\$
Loan from Investissement Québec	1,189,764	1,141,257
Less: current portion	—	—
	<u>1,189,764</u>	<u>1,141,257</u>

Under the terms of the agreement with Investissement Québec ["IQ"], this loan bears interest at a rate equal to the rate prescribed by the Ministère du Revenu du Québec less 4% [5% as at October 31, 2006 and 3% as at October 31, 2005]. Interest for the year ended October 31, 2006 amounting to \$48,507 [\$33,672 in 2005] has been capitalized to the loan in accordance with the provisions of the loan agreement. The loan and interest thereon will be repayable in instalments equal to 10% of gross sales of products stemming from the sale of internally developed fibrin sealants [Hemaseel HMN]. As of October 31, 2006, no such products had been sold. After repayment of the loan and the interest thereon, the Corporation will pay a royalty equal to 2% of gross sales from the date of final repayment until the end of a period of ten years starting with the commencement of the commercialization of these products. The Corporation will have to reimburse the loan immediately if the Hemaseel HMN project is interrupted or aborted.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

9. SHARE CAPITAL

Authorized

Unlimited number of common shares, without par value, voting and participating.

Unlimited number of preferred shares, without par value, non-voting, issuable in series, with such rights and conditions as may be determined by the Board of Directors. As of October 31, 2006 and 2005, Nil preferred shares were issued.

Options

In March 1996, the Board of Directors of the Corporation established the 1996 stock option plan, which provides for the granting of options to acquire common shares to employees, officers and directors, and service providers to the Corporation. A maximum of 2,423,295 common shares may be issued under the 1996 stock option plan.

The exercise price of an option granted under the 1996 stock option plan is set at the time of the grant of the option, but cannot in any event be less than the closing sale price of the common shares on The Toronto Stock Exchange on the last business day prior to the day the option is granted. The vesting period is generally between one and three years as determined by the Board of Directors. The exercise period of options granted under the 1996 stock option plan may not exceed ten years from the date of grant.

A summary of the status of the Corporation's fixed-price stock option plan as at October 31, 2006 and 2005 and the changes during the years then ended is shown below:

	2006		2005	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding options, at beginning of year	1,549,356	2.28	1,886,623	2.38
Granted	160,000	0.30	98,000	0.30
Expired	—	—	(435,267)	2.27
Outstanding options, at end of year	1,709,356	2.09	1,549,356	2.28
Exercisable options, at end of year	1,709,356	2.09	1,529,356	2.30

An amount of \$40,463 for the year ended October 31, 2006 was recorded as an expense and was credited to additional paid-in capital for the fair value of stock options granted to employees, officers and directors, determined using the Black-Scholes option pricing model, with a volatility of approximately 69%, a risk-free interest rate of 5.25%, a dividend yield of nil and an expected life of the options of 10 years. The weighted average grant date fair value of stock options granted during the year ended October 31, 2006 was \$0.24.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

9. SHARE CAPITAL [Cont'd]

An amount of \$27,640 for the year ended October 31, 2005 was recorded as an expense and was credited to additional paid-in capital for the fair value of stock options granted to employees, officers and directors, determined using the Black-Scholes option pricing model, with a volatility of approximately 69%, a risk-free interest rate of 4.25%, a dividend yield of nil and an expected life of the options of 10 years. The weighted average grant date fair value of stock options granted during the year ended October 31, 2005 was \$0.21.

The following table contains information regarding outstanding fixed-price stock options as at October 31, 2006:

Price range for the year \$	Number of outstanding options #	Weighted average remaining contractual life Years	Weighted average exercise price \$	Number of outstanding exercisable options #	Weighted average exercise price \$
0.29 to 1.00	744,006	6.82	0.58	744,006	0.58
1.21 to 1.35	147,100	4.21	1.26	147,100	1.26
2.15 to 2.60	444,000	3.99	2.19	444,000	2.19
3.10 to 4.00	143,250	2.45	3.78	143,250	3.78
4.10 to 5.00	35,000	0.05	4.10	35,000	4.10
5.60 to 6.00	46,000	1.93	5.60	46,000	5.60
7.00 to 7.00	150,000	—	7.00	150,000	7.00
0.29 to 7.00	1,709,356	4.63	2.09	1,709,356	2.09

Warrants

A summary of the status of the Corporation's warrants as at October 31, 2006 and 2005 and the changes during the years then ended is shown below:

	2006		2005	
	Warrants	Weighted average exercise price	Warrants	Weighted average exercise price
Outstanding warrants, at beginning of year	6,399,741	0.76	6,578,312	0.76
Expired	(1,117,241)	1.44	(178,571)	0.87
Outstanding warrants, at end of year	5,282,500	0.76	6,399,741	0.76

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

9. SHARE CAPITAL [Cont'd]

On July 22, 2005, the Board of Directors of the Corporation approved a modification to the terms of the 5,200,000 warrants and the options to purchase 1,040,000 shares granted to the agent under the private placement completed on March 19, 2004, subject to receiving the approvals from the Toronto Stock Exchange, the Autorité des marchés financiers and the shareholders. Under the new terms, the warrant's exercise period has been extended by one year, entitling the holder to acquire one common share of the Corporation at an exercise price of \$0.60 per share until March 18, 2006 and at an exercise price of \$0.75 per share until March 18, 2007. Under the new terms, the agent's options are now exercisable at \$0.50 per share on or before March 18, 2007.

The shareholders approved the extension of the warrants' life at the Annual General Meeting held on March 19, 2006. This repricing added \$52,000 to the accounting value of the warrants and \$10,400 to the agent's options which was recorded in additional paid-in-capital. The value was determined using the Black-Scholes option pricing model, assuming an expected life of 12 months, volatility of 70%, a risk-free interest rate of 5.25% and no dividend yield.

During the year ended October 31, 2004, the Corporation issued a common share purchase warrant to Bio Products Laboratory ["BPL"], giving BPL the right to purchase up to 300,000 common shares of the Corporation at a price of \$3.00 per share over a period of two years. This warrant is estimated to have a nominal value. During the year ended October 31, 2006, the 300,000 warrants expired unexercised.

During the year ended October 31, 2002, in connection with a term loan of US\$2,250,000, the Corporation granted 817,241 warrants to its lender and 178,571 warrants to the agent in the transaction. These warrants entitle the holder to purchase one common share at a price of \$0.87 on or before October 24, 2006 for 817,241 warrants and on or before October 24, 2005 for 178,571 warrants. The Corporation calculated the fair value of these warrants, using the Black-Scholes option pricing model, and recognized \$465,000 as debt issue costs and recorded a corresponding amount as additional paid-in capital in the year ended October 31, 2002. During the year ended October 31, 2005, the 178,571 warrants expired unexercised. During the year ended October 31, 2006, the balance of the 817,241 warrants expired unexercised.

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

9. SHARE CAPITAL [Cont'd]

Loss per share

The following is a reconciliation of the numerator and denominator of the basic and diluted loss per share computations for the years ended October 31, 2006 and 2005.

	2006	2005
	\$	\$
Numerator		
Net loss – numerator for basic and diluted loss per share	(3,011,481)	(1,887,238)
Denominator		
Denominator for basic loss per share		
Weighted-average number of outstanding common shares	38,800,917	38,800,917
Effect of dilutive securities		
Stock options and warrants	—	—
Denominator for diluted loss per share		
Adjusted weighted-average number of outstanding common shares and assumed conversions	38,800,917	38,800,917

For 2006 and 2005, the Corporation's diluted loss per share is equivalent to its basic loss per share, since all of the Corporation's potentially issuable securities, including stock options and warrants, would have an anti-dilutive effect.

10. INCOME TAXES

The income tax recovery reported differs from the amount of income tax recovery computed by applying Canadian federal and provincial rates to the loss before income taxes. The nature of the differences and the related tax effects are as follows:

	2006	2005
	%	%
Statutory federal and provincial recovery	31.8	31.0
Increase (decrease) in taxes recoverable resulting from:		
Non-deductible expenses	(0.6)	(0.8)
Unrecognized tax benefits of operating losses and other available deductions	(36.4)	(35.5)
Foreign tax rate differential	3.8	3.7
Other	1.4	1.6

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

10. INCOME TAXES [Cont'd]

The tax effects of temporary differences and net operating losses that give rise to future income tax assets and liabilities are as follows:

	2006	2005
	\$	\$
Future income tax assets		
Tax basis of Canadian property, plant and equipment and other assets in excess of carrying value	7,935,000	7,993,000
Tax basis of U.S. property, plant and equipment in excess of carrying value	64,000	15,000
Canadian non-capital losses carried forward	1,663,000	2,117,000
Canadian capital losses carried forward	43,000	21,000
U.S. net operating losses carried forward	16,073,000	16,205,000
Research and development expenditures	1,368,000	1,348,000
Financing fees	84,000	142,000
Charitable donations	7,000	38,000
Total future income tax assets	27,237,000	27,879,000
Valuation allowance	(27,237,000)	(27,879,000)
Net future income tax assets	—	—
Net future income tax	—	—

Haemacure Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

October 31, 2006 and 2005

10. INCOME TAXES [Cont'd]

The Corporation has accumulated non-capital losses which are available to reduce future Canadian federal and provincial taxable income and net operating losses which are available to reduce future U.S. federal taxable income. The related income tax benefits have not been reflected in the consolidated financial statements. These losses, if not utilized, will expire as follows:

	Canadian Federal losses	Canadian Provincial losses	U.S. Federal losses
	\$	\$	\$
2007	1,000	—	—
2011	2,272,000	2,271,000	10,000
2012	—	—	807,000
2015	1,577,000	1,577,000	—
2018	—	—	4,820,000
2019	—	—	6,447,000
2020	—	—	9,299,000
2021	—	—	5,174,000
2022	—	—	6,828,000
2023	—	—	5,460,000
2024	—	—	1,433,000
2025	—	—	948,000
2026	1,531,000	1,531,000	1,486,000
	<u>5,381,000</u>	<u>5,379,000</u>	<u>42,712,000</u>

U.S. loss carryforwards may be restricted pursuant to Internal Revenue Code Section 382, if it is determined that a change in control occurred in the current year or prior years for U.S. federal income tax purposes. The Corporation also has capital loss carryforwards of \$ 277,000 which are available to reduce future capital gains for an indefinite period.

In addition, the Corporation has accumulated Canadian scientific research and experimental development expenditures of \$4,642,000 which have not been deducted for federal income tax purposes and \$4,084,000 for provincial income tax purposes. These expenditures are available to reduce future taxable income and have an unlimited carry-forward period. Scientific research and experimental development tax credits and expenses are subject to verification by the tax authorities, and accordingly, these amounts may vary.

The Corporation also has accumulated share issue expenses that have not been deducted for income tax purposes amounting to approximately \$270,000. The benefits of these expenses have not been recorded in the financial statements.

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11. GOVERNMENT ASSISTANCE

The Corporation has available non-refundable investment tax credits of \$145,000 [2005 – \$145,000] related to research and development expenditures which may be utilized to reduce federal income taxes payable in the future years end expire as follows:

	\$
2007	71,000
2008	55,000
2009	19,000
	<u>145,000</u>

Non refundable investment tax credits are subject to verification by the tax authorities, and accordingly, these amounts may vary. The benefits of these non-refundable investment tax credits have not been recognized in the consolidated financial statements.

12. COMMITMENTS AND CONTINGENCIES

[i] The Company occupies certain facilities under lease arrangements and leases certain equipment. Estimated future minimum annual payments, the majority denominated in U.S. funds, required for the next five years are as follows:

	\$
2007	735,000
2008	655,000
2009	601,000
2010	572,000
2011	590,000
Thereafter	2,764,000
	<u>5,917,000</u>

[ii] As at October 31, 2006, the Corporation has commitments outstanding under an agreement to purchase certain production equipment for its manufacturing facility for a total of approximately \$2,856,000. The amount will be repaid over a six-year period upon successful commissioning of the equipment.

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13. FINANCIAL INSTRUMENTS

Concentration of credit risk

In addition to concentrations disclosed elsewhere, cash and cash equivalents are held by Canadian and American financial institutions. Prior to the year ended October 31, 2005, the Corporation's concentration of credit risk with respect to trade accounts receivable was limited because of the Corporation's large number of customers. As at October 31, 2006, two customers represented more than 24% of trade accounts receivable [2005 – one customer represented more than 21% of trade accounts receivable].

Fair value of financial instruments

[i] Short-term financial assets and liabilities

The carrying amounts of these assets and liabilities are a reasonable estimate of the fair values because of the short maturity of these instruments. Short-term financial assets comprise cash and cash equivalents, temporary investment, accounts receivable – trade and other receivables. Short-term financial liabilities comprise accounts payable.

[ii] Long-term financial liabilities

The fair value of the long-term debt is not readily determinable given its specific nature. The carrying amount of the obligation under capital leases approximates its fair value given that the imputed interest rate reflects the current rate.

Interest rate risk

The Corporation has long-term debt which exposes it to interest rate risk through fluctuations in the rate prescribed by the Ministère du Revenu du Québec.

Foreign currency risk

In addition to risks disclosed elsewhere, the Corporation is exposed to foreign currency translation risk due to cash and cash equivalents, accounts receivable-trade, other receivables, accounts receivable from a supplier, accounts payable and accrued liabilities, denominated in U.S. dollars. As at October 31, 2006, financial assets, consisting principally of accounts receivable, denominated in US dollars totaled US\$62,993 [US\$1,466,072 as at October 31, 2005] and financial liabilities denominated in US dollars totaled US\$226,646 [US\$174,697 as at October 31, 2005]. The Corporation does not enter into arrangements to hedge its foreign currency risk.

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14. STATEMENTS OF CASH FLOWS

Cash and cash equivalents

Cash and cash equivalents consist of the following:

	2006	2005
	\$	\$
Cash on hand and bank balances	78,300	248,780
Bankers acceptance and US Treasury bill	—	565,884
	78,300	814,664

Net change in non-cash working capital balances related to operations

	2006	2005
	\$	\$
Accounts receivable – trade	11,963	71,316
Other receivables	1,183,909	1,324,568
Inventories	35,588	(24,205)
Prepaid expenses	40,679	(82,524)
Accounts payable and accrued liabilities	91,345	(169,314)
	1,363,484	1,119,841

15. RELATED PARTY TRANSACTION

Amounts were paid on behalf of a company controlled by a director for the storage and packaging of a product personally owned by the company controlled by the director. The account receivable amounted to \$26,254 as at October 31, 2006 [\$16,454 as at October 31, 2005].

During the year, a Director provided consulting services to the Corporation. The total cash consideration paid by the Corporation during the year for such services totaled \$159,320 [2005 - \$123,695] at the exchange amount, being the amount agreed upon by the parties, and was charged to general and administrative expenses.

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16. SEGMENT DISCLOSURES

The Corporation considers that it is operating in a single segment, being the market of acute surgical wound care. The Corporation allocates sales to individual countries according to the location of its customers.

Geographic information

	Sales		Property, plant and equipment	
	2006 \$	2005 \$	2006 \$	2005 \$
Canada	—	—	130,226	183,266
United States	147,134	258,153	1,829,453	990,612
	147,134	258,153	1,959,679	1,173,878

17. SUBSEQUENT EVENTS

In January 2007, the Corporation issued 125,000,000 units under a private placement at a price of \$0.10 per unit for gross proceeds of \$12.5 million. Each unit consists of one common share, one-half of a Series A common share purchase warrant and one-half of a Series B common share purchase warrant. Each full Series A warrant will entitle its holder to acquire one additional common share for a period of five years from the closing date of the placement, at a price of \$0.30. Each full Series B warrant will entitle its holder to acquire one additional common share for a period of five years from the closing date of the placement, at a price of \$0.20. Haemacure will have the right to force the exercise of the Series B warrants if the closing price of its common shares on the Toronto Stock Exchange is \$0.40 or greater for 20 consecutive trading days. The 125,000,000 warrants have been valued at \$3,250,000 using the Black-Scholes option pricing model, which assumed an expected life of five years, volatility of 62%, risk-free interest rate of 6% and no dividend yield. This amount less its proportionate share of issue costs will be allocated to additional paid-in capital and the balance of \$9,250,000 less issuance costs will be allocated to common shares.

At the closing, Haemacure paid 8% cash commissions to securities dealers and others with respect to units sold by them. Haemacure also issued an aggregate of 11,409,000 broker warrants to such persons, representing 10% of the number of units sold by them at the closing. Each broker warrants entitles the holder to purchase one additional unit from Haemacure for two years at a price of \$0.10 per unit. The additional units are identical to those issued to investors. The Corporation calculated the fair value of these broker warrants, using the Black-Scholes option pricing model, and will recognize \$1,255,000 as share issue costs charged to deficit and will record a corresponding amount as additional paid-in capital.

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17. SUBSEQUENT EVENTS [Cont'd]

In January 2007, the Board of Directors approved the grant of 4,748,481 options to directors, officers, employees and consultants of the Corporation at prices ranging from \$0.155 to \$0.21 per share. The grant of options is subject to shareholder's approval of the modification of the 1996 stock option plan to increase the maximum number of common shares that may be issued under the plan.

18. COMPARATIVE FIGURES

Certain of the 2005 figures have been reclassified in order to conform with the presentation adopted in 2006.