



**Victhom** Human Bionics

**Consolidated Financial  
Statements  
December 31, 2007 and 2006**

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## Auditors' Report

To the Shareholders of  
Victhom Human Bionics Inc.

We have audited the consolidated balance sheets of Victhom Human Bionics Inc. as at December 31, 2007 and 2006 and the consolidated statements of operations and comprehensive loss, contributed surplus, deficit and cash flows for the years then ended. 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. 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 Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

/S/ Raymond Chabot Grant Thornton, LLP

Chartered accountants

Quebec

February 21, 2008



## Consolidated Statements of Operations and Comprehensive Loss

Years ended on December 31

	<u>2007</u>	<u>2006</u>
	\$	\$
<b>Revenues</b>	<u>2,271,600</u>	<u>3,199,545</u>
<b>Expenses</b>		
Cost of revenues	-	443,606
Research and development	8,513,547	8,414,372
Tax credits and grants	(1,031,191)	(1,166,947)
General and administrative	2,552,777	3,521,522
Financial	1,998,146	2,133,158
	<u>12,033,279</u>	<u>13,345,711</u>
<b>Net loss and comprehensive loss</b>	<u>9,761,679</u>	<u>10,146,166</u>
Weighted average number of common shares outstanding	<u>82,046,201</u>	<u>50,902,311</u>
Basic and diluted net loss per share	<u>0.119</u>	<u>0.199</u>

The accompanying notes are an integral part of the consolidated financial statements and Note 14 provides additional information on the consolidated statements of operations and comprehensive loss.



## Consolidated Statements of Contributed Surplus and Deficit

Years ended on December 31

	<u>2007</u>	<u>2006</u>
	\$	\$
<b>CONTRIBUTED SURPLUS</b>		
Balance, beginning of year	7,535,941	6,981,595
Warrants issued in public offering (Note 10)	2,024,866	-
Stock-based compensation related to:		
Stock options vested (Note 12)	325,437	566,922
Stock options exercised	<u>(1,747)</u>	<u>(12,576)</u>
Balance, end of year	<u><u>9,884,497</u></u>	<u><u>7,535,941</u></u>
<b>DEFICIT</b>		
Balance, beginning of year	(31,858,337)	(21,712,171)
Restatement related to adoption of Section 3855 "Financial Instruments" (Note 2)	<u>128,294</u>	<u>-</u>
	(31,730,043)	(21,712,171)
Net loss and comprehensive loss	<u>(9,761,679)</u>	<u>(10,146,166)</u>
Balance, end of year	<u><u>(41,491,722)</u></u>	<u><u>(31,858,337)</u></u>

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



## Consolidated Statements of Cash Flows

Years ended on December 31

	2007	2006
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss and comprehensive loss	(9,761,679)	(10,146,166)
Non-cash items:		
Stock-based compensation (Note 12)	325,437	566,922
Interest on convertible debentures	2,482,774	2,098,865
Amortization of property, plant and equipment	694,266	704,900
Amortization of intangible assets	72,600	-
Amortization of deferred financing costs	-	325,752
Changes in working capital items	1,971,453	(940,661)
Cash flows from operating activities	<u>(4,215,149)</u>	<u>(7,390,388)</u>
<b>INVESTING ACTIVITIES</b>		
Property, plant and equipment	(170,846)	(834,448)
Intangible assets	<u>(375,625)</u>	<u>(466,852)</u>
Cash flows from investing activities	<u>(546,471)</u>	<u>(1,301,300)</u>
<b>FINANCING ACTIVITIES</b>		
Demand loan	(820,000)	820,000
Repayment of long-term debt	(30,978)	(35,499)
Issue of shares and warrants net of costs of \$834,517	<u>11,556,121</u>	<u>25,440</u>
Cash flows from financing activities	<u>10,705,143</u>	<u>809,941</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>5,943,523</b>	<b>(7,881,747)</b>
Cash and cash equivalents, beginning of year	<u>6,498,854</u>	<u>14,380,601</u>
Cash and cash equivalents, end of year	<u><u>12,442,377</u></u>	<u><u>6,498,854</u></u>
Interest paid during the year	13,195	56,010
Cash flows from non-monetary financing activities are detailed as follows:		
Issue of shares related to:		
Exercise of stock options	1,747	12,576
Payment of interest due on convertible debentures	1,302,624	1,302,634
Issue of warrants	2,024,866	-
Cash and cash equivalents are detailed as follows:		
Cash in National Bank of Canada	675,802	1,501,202
Banker's acceptance, interest of 4.65% annually, maturing January 3, 2008	2,748,954	4,997,652
Banker's acceptance, interest of 4.54% annually, maturing January 23, 2008	1,096,864	-
Money market security, interest of 3.98% annually, maturing April 1, 2008	7,920,757	-
	<u><u>12,442,377</u></u>	<u><u>6,498,854</u></u>

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



## Consolidated Balance Sheets

as of December 31

	2007	2006
	\$	\$
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	12,442,377	6,498,854
Accounts receivable (Note 4)	1,293,916	2,985,348
Prepaid expenses	174,980	229,768
	<u>13,911,273</u>	<u>9,713,970</u>
Property, plant and equipment (Note 5)	2,401,006	2,924,426
Intangible assets (Note 6)	9,701,105	9,398,080
Deferred financing costs on the convertible debentures (Note 2)	-	1,027,528
	<u>26,013,384</u>	<u>23,064,004</u>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	1,293,831	1,263,629
Deferred revenues	195,030	-
Demand loan (Note 7)	-	820,000
Instalments on long-term debt (Note 8)	11,843	29,799
	<u>1,500,704</u>	<u>2,113,428</u>
Long-term debt (Note 8)	1,488	14,510
Liability component of convertible debentures (Note 9)	14,890,431	14,866,103
	<u>16,392,623</u>	<u>16,994,041</u>
<b>SHAREHOLDERS' EQUITY</b>		
Equity component of convertible debentures (Note 9)	1,551,780	1,551,780
Capital stock (Note 10)	39,676,206	28,840,579
Contributed surplus	9,884,497	7,535,941
Deficit	(41,491,722)	(31,858,337)
	<u>9,620,761</u>	<u>6,069,963</u>
	<u>26,013,384</u>	<u>23,064,004</u>

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

On behalf of the Board,

/s/ Daniel Johnson  
Chairman

/s/ Nitin Kaushal  
Director

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### **1 - GOVERNING STATUTES AND NATURE OF OPERATIONS**

The Company, incorporated under the Canada Business Corporations Act, is a medical device company that specializes in the development and commercialization of bionic devices aimed at improving the quality of life of individuals suffering from certain physical dysfunctions. The Company has two business units. Victhom's Neurobionix business unit develops implantable closed-loop system ("CLS") devices for the measurement (sensing) and the stimulation of peripheral nerves for the restoration of physiological functions, involving neurosensor implants and neurostimulators. Victhom's Biotronix business unit develops biomechatronic product candidates to support or replace peripheral limbs in what is known as the orthotics and prosthetics or "O&P" market.

The Company expects to incur additional expenditures to complete the development and marketing of its products. Its ability to generate future revenues and cash flows from its operating activities depends on several factors, including its ability to secure additional financing and have its products accepted by the regulatory agencies and the market. The Company believes that with its current financial resources it will have sufficient liquidity to support its cash flow requirements for at least the next 12 months. This disclosure is in compliance with the Canadian Institute of Chartered Accountant modified Section 1400, "General Standards of Financial Statement Presentation".

### **2 - ACCOUNTING POLICIES**

#### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary companies. All significant intercompany balances and transactions have been eliminated on consolidation.

#### **Accounting estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results may differ from these estimates.

#### **Accounting changes**

Effective:

On January 1, 2007, in accordance with the applicable transitional provisions, the Company adopted the recommendations of new Section 1506, "Accounting Changes", of the Canadian Institute of Chartered Accountants Handbook. This new section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. Furthermore, the new standard requires the communication of the new primary sources of GAAP that are issued but not yet effective or not yet adopted by the Company. The new standard has no impact on the Company's financial results.

On January 1, 2007, in accordance with the applicable transitional provisions, the Company adopted the recommendations of new Section 3855, "Financial Instruments - Recognition and Measurement", 1530, "Comprehensive Income", 3861, "Financial Instruments - Disclosure and Presentation", and 3251, "Equity", of the Canadian Institute of Chartered Accountants Handbook.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 2 - ACCOUNTING POLICIES (Continued)

Sections 3855 and 3861 deal with the recognition, measurement, presentation and disclosure of financial instruments and non-financial derivatives in the financial statements. The transitional provisions of these sections require that the Company remeasure the financial assets and liabilities, as appropriate, at the beginning of its fiscal year. Any adjustment of the previous carrying amount is recognized as an adjustment of the opening balance of retained earnings in the fiscal year of initial application or as an adjustment of the opening balance of a separate component of accumulated other comprehensive income, as appropriate. Section 1530 establishes standards for reporting and display of comprehensive income. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting fiscal year. Pursuant to the transitional provisions of these sections, the Company's financial statements of prior fiscal years are not restated.

Adoption of these new recommendations resulted in the following impacts on the classification and measurement of the Company's financial instruments, which were previously recognized at cost.

Cash and cash equivalents are classified as held-for-trading financial assets. They are measured at fair value. This change had no impact on the financial statements as at December 31, 2007.

Trade accounts and other receivables are classified as loans and receivable. Trade accounts receivable are measured at amortized cost, which is generally the initially recognized amount less any allowance for doubtful accounts. This change had no impact on the financial statements as at December 31, 2007.

The demand loan and accounts payable and accrued liabilities are classified as other financial liabilities. They are measured at amortized cost using the effective interest method. This change had no impact on the financial statements as at December 31, 2007.

The debenture and the long-term debt are classified as other financial liabilities. They are measured at amortized cost using the effective interest method. Financing costs are now recorded as a reduction of the debenture or the long-term debt. On January 1, 2007, this change led to a reduction in deferred financing costs of \$1,027,528 and in the debenture of \$1,155,822, together with an increase in the opening balance of retained earnings of \$128,294. This change resulted in a reduction in deferred financing costs of \$324,480 and in the long-term debt of \$893,394, and in an increase in the net earnings of \$62,052 as at December 31, 2007 and for the fiscal year then ended.

For the year ended December 31, 2007 the changes relating to the application of Section 3855 led to a decrease in basic and diluted loss per share of \$0.002.

#### Future accounting standards

In June 2007, the Canadian Institute of Chartered Accountants modified Section 1400, "General Standards of Financial Statement Presentation", in order to require that management make an assessment of the Company's ability to continue as a going concern over a period which is at least, but is not limited to, twelve months from the balance sheet date. These new requirements are effective for fiscal years beginning on or after January 1, 2008 and the Company will implement them as of January 1, 2008. The new requirements only address disclosures and will have no impact on the Company's financial results.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 2 - ACCOUNTING POLICIES (Continued)

In December 2006, the Canadian Institute of Chartered Accountants published a new accounting standard, namely Section 1535, "Capital Disclosures". The new section establishes standards for disclosing information about an entity's capital and how it is managed. This new standard is effective for fiscal years beginning on or after October 1, 2007 and the Company will implement it as of January 1, 2008. The new accounting standards only address disclosures and will have no impact on the Company's financial results.

In December 2006, the CICA published new Sections 3862, "Financial Instruments - Disclosure and Presentation" and 3863, "Financial Instruments - Presentation", which deal with the presentation and disclosure of financial instruments and non-financial derivatives. These new standards are effective for fiscal years beginning on or after October 1, 2007 and the Company will implement them as of January 1, 2008. The new accounting standards only address disclosures and will have no impact on the Company's financial results.

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

#### Cash and cash equivalents

The Company's policy is to present short-term investments immediately cashable without penalty or with a term of three months or less from the acquisition date with cash and cash equivalents.

#### Short-term investments

Short-term investments, other than those considered as cash equivalents, are recorded at the lower of cost and market value.

#### Property, plant and equipment

Property, plant and equipment are recorded at cost, and the assets under capital leases are recorded at cost, which is the present value of the required minimum payment under the lease agreement, less the related executory costs.

Property, plant and equipment are amortized over their estimated useful life according to the following methods and annual rates:

	Methods	Rates
Computer equipment	Diminishing balance	30%
Furniture and equipment	Diminishing balance	20%
Leasehold improvements	Straight-line	12.5%
Assets under capital leases		
Computer equipment	Diminishing balance	30%
Furniture and equipment	Diminishing balance	20%

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 2 - ACCOUNTING POLICIES (Continued)

#### Intangible assets

Patents are recorded at cost and are amortized on a straight-line basis over ten years beginning the year in which the developed products are marketed.

Commercial license agreements are recorded at acquisition cost and will be amortized on a straight-line basis over ten years beginning the year in which the developed products are marketed.

The acquired technology is recorded at the acquisition cost. The technology will be amortized on a straight-line basis over ten years beginning the year in which the developed products are marketed.

#### Share issuance costs

The financing costs related to the issuance of common shares are recorded against the proceeds amount of the common shares issued.

#### Revenue recognition

Victhom entered into a global license and development and marketing agreement with a European medical device Company in September 2005 for the development of three to six new products for the O&P market. That Company supports all development costs by providing Victhom with monthly payments.

By virtue of a marketing agreement, the Company must attain development objectives for its products and services based on a pre-determined timetable to the benefit of the third party. Revenues are recognized in the statement of operations when they are earned. The agreement does not contemplate any terms of repayment in the event that the product is not marketed.

The revenues from research and development service contracts and/or products are recognized, based on the agreements signed by the parties, when they are delivered and accepted by the client.

Investment transactions are recorded on the transaction date and resulting revenues are recognized using the accrual basis. Interest income is accrued based on the number of days the investment is held during the period.

#### Foreign currency translation

Monetary assets and liabilities in foreign currency are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at the exchange rates in effect at transaction dates. Revenues and expenses in foreign currency are translated at the average rate in effect during the year, with the exception of amortization which is translated at the historical rate. Gains and losses are included in the results of the year.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 2 - ACCOUNTING POLICIES (Continued)

#### Research and development costs and investment tax credits

Research costs are expensed as they are incurred. Development costs are deferred when they meet the generally accepted criteria to the extent that their recovery can reasonably be regarded as assured.

Research and development tax credits are applied against the related costs in the year during which they are incurred. Investment tax credits for property, plant and equipment are presented as deferred credits and amortized to income on the same basis as the related depreciable property, plant and equipment are depreciated. The costs are incurred, provided that the Company is reasonably certain that the credits will be received. The investment tax credits must be examined and approved by the tax authorities and the amounts granted might differ from the amounts recorded.

#### Stock option plan

The Company provides a stock option plan, which is described in Note 12. A stock-based compensation expense is recognized with respect to this plan for stock options issued on or after January 10, 2003 for employees. Any consideration paid when exercising stock options and any contributed surplus related to these options are credited to capital stock.

#### Earnings per share

Basic earnings per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options and warrants. The "if-converted" method is used to determine the dilutive effect of convertible debentures.

The convertible debentures, the warrants and the stock options were not included in the computations of diluted earnings per share for the years ended on December 31, 2007 and 2006 because the Company reported losses and the inclusion of the securities would be anti-dilutive.

#### Income taxes

The Company uses the tax liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of the assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse. The Company records a valuation allowance for future income tax asset if, based on available information, it is more likely than not that some or all of the future income tax asset will not be realized.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 3 - INCOME TAXES

The Company's effective income tax rate differs from the combined federal and provincial income tax rate in Canada. This difference is due to the following items:

	<u>2007</u>	<u>2006</u>
	\$	\$
Net loss and comprehensive loss	<b>(9,761,679)</b>	(10,146,166)
Income taxes calculated using the combined federal and provincial income tax rate in Canada of 32.02% (32.90% in 2006)	<b>(3,125,000)</b>	(3,249,000)
Increase (decrease) in income taxes resulting from the following:		
Unrecognized future income tax assets	<b>2,699,000</b>	2,854,000
Non-deductible stock-based compensation	<b>104,000</b>	182,000
Interest on convertible debentures	<b>378,000</b>	255,000
Variation due to income tax rate adjustment	<b>263,000</b>	210,000
Research and development tax credit as per financial statements	<b>(102,000)</b>	(116,000)
Amortization of financing expenses	<b>(279,000)</b>	(82,000)
Non deductible expenses and other items	<b>62,000</b>	(54,000)
Income taxes	<u>-</u>	<u>-</u>

The future income tax assets and liabilities result from the differences between the carrying amount and the tax basis of the following:

	<u>2007</u>	<u>2006</u>
	\$	\$
Future income tax assets		
Non-capital losses	<b>5,067,000</b>	4,216,000
Research and development expenses	<b>8,262,000</b>	6,526,000
	<b>13,329,000</b>	10,742,000
Future income tax liabilities		
Property, plant and equipment	<b>446,000</b>	478,000
Other assets	<b>333,000</b>	413,000
	<b>779,000</b>	891,000
	<b>12,550,000</b>	9,851,000
Valuation allowance	<b>(12,550,000)</b>	(9,851,000)
Net future income taxes	<u>-</u>	<u>-</u>

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 3 - INCOME TAXES (Continued)

The future income tax asset resulting from loss carry-forwards is not recorded in the financial statements. These losses and deductible temporary differences, which are available to reduce income taxes in future years, are as follows:

	Federal	Provincial
	\$	\$
Amount of losses for tax purposes carried forward:		
2008	397,000	401,000
2009	1,185,000	1,184,000
2010	1,383,000	1,014,000
2014	4,480,000	3,554,000
2015	1,940,000	2,076,000
2016	3,550,000	3,547,000
2017	3,225,000	3,226,000
	<u>16,160,000</u>	<u>15,002,000</u>
Eligible research and development expenses to be deferred over an undetermined period	25,109,000	29,696,000
Amount of temporary variances to be deferred over an undetermined period	<u>(2,433,000)</u>	<u>(2,433,000)</u>
	<u>38,836,000</u>	<u>42,265,000</u>

In addition, the Company has investment tax credits amounting to approximately \$104,000, which are available until 2012, \$728,000 until 2013, \$952,000 until 2014, \$1,095,000 until 2015, \$1,258,000 until 2016 and \$1,150,000 until 2017.

### 4 - ACCOUNTS RECEIVABLE

	2007	2006
	\$	\$
Investment tax credits receivable	1,076,780	2,412,701
Sales taxes receivable	105,717	114,100
Trade accounts receivable	61,292	454,745
Others	50,127	3,802
	<u>1,293,916</u>	<u>2,985,348</u>

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 5 - PROPERTY, PLANT AND EQUIPMENT

	2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Computer equipment	1,309,101	840,801	468,300
Furniture and equipment	2,056,082	1,014,245	1,041,837
Leasehold improvements	1,491,798	662,242	829,556
Assets under capital leases			
Computer equipment	165,963	139,520	26,443
Furniture and equipment	94,282	59,412	34,870
	<u>5,117,226</u>	<u>2,716,220</u>	<u>2,401,006</u>
	2006		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Computer equipment	1,289,467	662,335	627,132
Furniture and equipment	1,930,355	770,442	1,159,913
Leasehold improvements	1,491,798	441,028	1,050,770
Assets under capital leases			
Computer equipment	165,963	128,187	37,776
Furniture and equipment	107,310	58,475	48,835
	<u>4,984,893</u>	<u>2,060,467</u>	<u>2,924,426</u>

### 6 - INTANGIBLE ASSETS

	2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Patents	1,370,299	72,600	1,297,699
Commercial license agreements	1,253,785	-	1,253,785
Acquired technology	7,149,621	-	7,149,621
	<u>9,773,705</u>	<u>72,600</u>	<u>9,701,105</u>
	2006		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Patents	1,031,562	-	1,031,562
Commercial license agreements	1,216,897	-	1,216,897
Acquired technology	7,149,621	-	7,149,621
	<u>9,398,080</u>	<u>-</u>	<u>9,398,080</u>

During 2007, the Company acquired \$338,737 (\$465,480 in 2006) in Patents and \$36,888 (\$1,372 in 2006) in Commercial license agreements.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 7 - CREDIT FACILITIES

During 2007, the demand loan was reimbursed with the receipt of the 2005 related investment tax credits receivable. In 2006, the Company had credit facilities totaling \$1,625,000 with a Canadian bank. The credit facilities were composed of: i) a loan for \$1,125,000, secured by 2005 investment tax credits receivable and secured by a first call of \$1,125,000 on the universality of the Company's property, bearing interest at prime rate plus 1.5% (7.5% in 2006), maturing with the receipt of the related investment tax credit receivable; and ii) an accounts receivable factoring facility for a total amount of \$500,000 available as credit facility. Pursuant to the terms and conditions of this credit facility, the Company was subject to certain debt covenants with regards to maintaining financial ratios which were all respected as of December 2006. As of December 31, 2007, the demand loan and the credit facilities are no longer available.

### 8 - LONG-TERM DEBT

	<u>2007</u>	<u>2006</u>
	\$	\$
Obligations under capital leases, bearing interest at a weighted average rate of 12.80% (12.84% in 2006), payable in monthly instalments, maturing at different dates until April 2009	13,331	44,309
Instalments due within one year	<u>11,843</u>	<u>29,799</u>
	<u>1,488</u>	<u>14,510</u>

The instalments on long-term debt for the next years are as follows:

	Obligations under capital leases
	\$
2008	12,605
2009	<u>1,507</u>
Total minimum lease payments	14,112
Amount included in minimum lease payments	
Interest expense	781
	<u>13,331</u>

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 9 - CONVERTIBLE DEBENTURES

The following table illustrates variations in the years:

	Liability component	Equity component
	\$	\$
Balance as of December 31, 2005 (a)	14,069,871	1,551,780
Imputed interest	2,098,866	-
Payment of interest	(1,302,634)	-
Balance as of December 31, 2006	<u>14,866,103</u>	<u>1,551,780</u>
Presentation of deferred financing costs against the convertible debentures (Note 2)	(1,027,528)	-
Restatement in prior period related to Section 3855 "Financial Instruments" (Note 2)	(128,294)	-
Imputed interest	2,482,774	-
Payment of interest	(1,302,624)	-
<b>Balance as of December 31, 2007</b>	<b><u>14,890,431</u></b>	<b><u>1,551,780</u></b>

- (a) Debentures issued having a par value of \$18,354,000, unsecured, bearing interest at the rate of 7% (effective rate of 17.12%), maturing on March 22, 2010. The liability and the equity components represent \$15,084,379. The remaining amount of \$3,269,621 is the fair value of the warrants granted, recorded as contributed surplus. As part of this financing, the Company paid \$1,590,411 in financing costs which are recorded as reduction of the long-term debt. The debentures are convertible into common shares of the Company at the option of the holders, in whole or in part at any time and from time to time. The conversion price in effect on any conversion date shall be equal to \$1.35.

The liability component of the convertible debentures is the discounted value, at the date of issue, of the cash payments of interest and principal due under the terms of the convertible debentures, discounted at the rate of interest that would apply to a debt security without a conversion option, with similar maturity and risk. The equity component represents the value attributed to the difference between the amount issued and the liability component.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 10 - CAPITAL STOCK

#### Authorized

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

#### Issued and fully paid

The following table indicates changes in the Company's capital stock over the years:

	Number of shares	Amount \$
Balance as of December 31, 2005	50,386,369	27,499,929
Shares issued related to interest due on convertible debentures	2,158,071	1,302,634
Stock options exercised	48,000	38,016
Balance as of December 31, 2006	<u>52,592,440</u>	<u>28,840,579</u>
Shares issued related to public offering less expenses of \$834,517	35,323,156	9,503,724
Shares issued related to interest due on convertible debentures	7,810,218	1,302,624
Stock options exercised	166,667	29,279
<b>Balance as of December 31, 2007</b>	<b><u>95,892,481</u></b>	<b><u>39,676,206</u></b>

During the first quarter of 2007, the Company completed a share and warrant financing with various investors. The Company issued 35,323,156 units at \$0.35 each as follows: each unit consists of one common share and half warrant. Each full warrant grant the right to subscribe to a common share for a price of \$0.45 for three years. The fair value of the warrants using the proportional allocation method, has been established to \$1,870,888 or \$0.106 per warrant. The Company issued 1,233,675 warrants bearing the same characteristics as fees for this financing for a fair value of \$153,978. No shares were included in this payment. In total, the fair value of the warrants issued in the financing was \$2,024,866.

During 2007, expenses related to shares issued including warrants amounted to \$988,495. The fair value of the warrants is accounted for as contributed surplus.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 10 - CAPITAL STOCK (Continued)

#### Warrants

As part of its financing operations, the Company issued warrants to investors entitling them with the right to purchase shares at a predetermined price. Each warrant issued can be used to purchase one common share of the Company.

At the time of issue, the fair value of the warrants issued, as part of the financing, is recognized as a decrease in capital stock upon issuance of shares or is recognized as a decrease of the debt. The consideration is recognized as contributed surplus in the balance sheet.

No warrants were issued during the year 2006. In 2007, the fair value of each warrant granted was estimated at the grant date using the Black-Scholes option pricing model, based on the following weighted average assumptions: expected volatility of 60%, risk-free interest rate of 3.91%, no expected dividends and expected life of 3 years. The weighted average exercised price of the warrants granted in 2007 is \$0.45.

Outstanding warrants at the end of the years as well as the changes during the years are summarized in the table below:

	Number	Weighted average exercise price \$
Outstanding, as of December 31, 2005	7,984,397	1.60
Expired	<u>(370,886)</u>	<u>2.00</u>
Outstanding, as of December 31, 2006	7,613,511	1.58
Granted	18,895,253	0.45
Expired	<u>(543,822)</u>	<u>1.35</u>
<b>Outstanding, as of December 31, 2007</b>	<b><u>25,964,942</u></b>	<b><u>0.76</u></b>

As of December 31, 2007, the following warrants were outstanding:

Range of exercise prices	Number of warrants	Weighted average remaining contractual life (in years)	Weighted average exercise price \$
\$0.45 to \$0.61	18,895,253	2.21	0.45
<u>\$1.48 to \$1.60</u>	<u>7,069,689</u>	<u>2.25</u>	<u>1.60</u>
<u>\$0.45 to \$1.60</u>	<u>25,964,942</u>	<u>2.22</u>	<u>0.76</u>



## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 11 - RELATED PARTY TRANSACTIONS

The Company carried out the following related party transactions:

	<u>2007</u>	<u>2006</u>
	\$	\$
Expenses - General and administrative		
Professional fees paid under agreements entered into entities controlled by directors	-	102,839
	<u>-</u>	<u>102,839</u>

These transactions were accounted for at the exchange amount.

### 12 - STOCK-BASED COMPENSATION

The Company has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Company. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date and the number of options to be granted. The exercise price of stock options is the market value of the Company's common shares at the market close on the date they are granted.

In 2007, the fair value of the stock options granted is estimated at the grant date using the Black-Scholes option pricing model, based on the following weighted average assumptions: expected volatility of 60%, risk-free interest rate of 4.23% (4.11% in 2006), no expected dividends and expected life of 6 years (4 years in 2006). The weighted average fair value of the stock options granted during 2007 is \$0.22 (\$0.47 in 2006).

The Company's stock option plan at the end of the years as well as the changes during the years are summarized in the table below:

	<u>Number</u>	<u>Weighted average exercise price</u>
		\$
Outstanding, as of December 31, 2005	4,246,642	1.01
Granted	765,000	0.95
Exercised	(48,000)	0.53
Forfeited	<u>(387,913)</u>	<u>1.30</u>
Outstanding, as of December 31, 2006	4,575,729	0.98
Granted	4,075,000	0.22
Exercised	(166,667)	0.17
Forfeited	<u>(2,176,062)</u>	<u>0.97</u>
<b>Outstanding, as of December 31, 2007</b>	<u><b>6,308,000</b></u>	<u><b>0.51</b></u>
Exercisable, at year end of 2007 (4,106,406 at \$0.98 in 2006)	<u>3,520,884</u>	<u>0.72</u>

As of December 31, 2007, the Company recorded \$325,437 (\$566,922 in 2006) as stock-based compensation.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 12 - STOCK-BASED COMPENSATION (Continued)

As of December 31, 2007, the following stock options were outstanding:

Range of exercise prices	Number of outstanding options	Weighted average remaining contractual life (in years)	Weighted average exercise price
			\$
\$0.16 to \$0.23	2,675,000	9.86	0.16
\$0.24 to \$0.36	1,400,000	9.38	0.32
\$0.37 to \$0.53	483,000	0.04	0.53
\$0.54 to \$0.79	150,000	3.88	0.63
\$0.80 to \$1.17	765,000	5.07	1.02
\$1.18 to \$1.73	835,000	2.20	1.46
<u>\$0.16 to \$1.73</u>	<u>6,308,000</u>	<u>7.26</u>	<u>0.51</u>

As of December 31, 2007, the following stock options were exercisable:

Range of exercise prices	Number of exercisable options	Weighted average exercise price
		\$
\$0.16 to \$0.23	765,140	0.16
\$0.24 to \$0.36	717,188	0.32
\$0.37 to \$0.53	483,000	0.53
\$0.54 to \$0.79	79,688	0.63
\$0.80 to \$1.17	640,868	1.04
\$1.18 to \$1.73	835,000	1.46
<u>\$0.16 to \$1.73</u>	<u>3,520,884</u>	<u>0.72</u>

The vesting period may be as follows: a) over 36 months, with no more than a third of options vesting over 12 months, b) 25% of options upon signing and the balance over three years at a rate of one third per year, or c) 20% of options upon signing and the balance over three years at a rate of 30%, 25%, 25% respectively per year.

### 13 - COMMITMENTS

The Company has entered into a lease agreement, expiring on September 30, 2009, which calls for the payment of \$439,217 for the rental of premises. The lease has a two-year renewal option. Minimum payments during the next years amount to \$250,970 in 2008 and \$188,247 in 2009.

During 2006, the Company has entered into agreements for a total amount of \$427,658 with different entities to participate in research and development projects. As of December 31, 2007, minimum payments under these agreements amount to \$50,000 in 2008. In 2007, an amount of \$184,274 (\$189,018 in 2006) was recorded as an expense.

By virtue of a commercial license agreement signed on May 11, 2004, the Company has begun to pay annual royalties on implant net sales since January 2005. Minimum royalties are \$25,000 per year. In addition, the Company is committed to pay \$125,000 in June 2008, in October 2009, in March 2012 and in September 2012 if certain performance objectives are attained. This agreement will expire, on a per-country basis, on the date patents expire or by mutual agreement between the parties in accordance with the applicable terms.

## Notes to Consolidated Financial Statements

as of December 31, 2007 and 2006

### 14 - INFORMATION INCLUDED IN THE CONSOLIDATED STATEMENT OF OPERATIONS

	2007	2006
	\$	\$
Government grants	-	4,461
Interest on cash and cash equivalents	(576,119)	(390,799)
Research and development tax credits	(1,031,191)	(1,171,409)
Amortization of property, plant and equipment	694,266	704,900
Amortization of deferred financing costs	-	325,752
Amortization of intangible assets	72,600	-
Interest on long-term debt and convertible debentures	2,482,774	2,154,876
Exchange rate loss	55,552	7,266
Stock-based compensation	325,437	566,922
Other financial expenses	15,993	36,063

### 15 - FINANCIAL INSTRUMENTS

The fair value of accounts receivable, accounts payable and accrued liabilities approximate the carrying amount since they will mature shortly.

The fair value of long-term debt and the convertible debentures are determined by discounting contractual cash flows at the market interest rate on the balance sheet date for similar loans. The fair value of the long-term debt and the convertible debentures approximate the carrying amount.

The Company is exposed to currency risk due to its sales denominated in U.S. dollars.

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, and accounts receivable. The cash equivalents consist mainly of short-term investments, such as money market securities and banker's acceptance. In 2007, the Company has cash and cash equivalents for an amount of \$4,521,620 with a reputable financial institution and \$7,920,757 in Money market security, from which management believes the risk of loss to be remote.

As of December 31, 2007, the Company has assets and liabilities in foreign currency including cash and cash equivalents in the amount of US\$ 387,650 (US\$ 542,839 in 2006), accounts receivable in the amount of US\$ 57,859 (US\$ 389,736 in 2006) and accounts payable in the amount of US\$ 179,746 (US\$ 85,642 in 2006).

### 16 - SEGMENT INFORMATION

During 2007, the Company generated revenues from non-refundable advance royalties for an amount of \$2,215,135 (\$2,759,229 in 2006), from support activities for an amount of \$56,465 (\$4,706 in 2006) and from transfer of manufacturing of the Power Knee product for an amount of \$0 (\$435,610 in 2006). All revenues are derived from a European medical device company located in Iceland.

The business information is not available at the end of December 31, 2007.

At this time, the business unit information is not available.

All property, plant and equipment are located in Canada.

### 17 - COMPARATIVE FIGURES

Some comparative figures have been reclassified to conform with the presentation adopted in the current year.