



HAEMACURE
HAEMACURE CORPORATION
2003
ANNUAL REPORT

PROFILE

Haemacure Corporation is a Canadian company specializing in the development and commercialization of innovative biological adhesives, biomaterials and surgical devices for the acute surgical wound-care market.

Its head office is located in Montreal, Quebec (Canada) and it operates a wholly-owned subsidiary in Sarasota, Florida (USA).

The Corporation is traded under the stock symbol HAE on the Toronto Stock Exchange.

MISSION

As a leading surgical sealant company servicing the acute surgical wound-care market, Haemacure aims to develop, manufacture and commercialize innovative products that are beneficial to both patients and operating room professionals, while increasing shareholder value.

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Message to Shareholders

The fiscal year ended October 31, 2003, brought significant changes to Haemacure, as all activities related to the Hemaseel® APR fibrin sealant licensed from Baxter were terminated and the Company reorganized. The Company will now focus its attention and resources on securing the manufacture of its proprietary fibrin sealant and thrombin products, completing Phase III clinical trials and filing submissions to regulatory authorities, in order to launch these products on the market by early 2007.

I am pleased to have this opportunity to update you on the major change undertaken by Haemacure at the end of fiscal 2003. I would like first to summarize the circumstances that led us to terminate the *Hemaseel APR* project and then expand on the *Hemaseel HMN* project.

HEMASEEL APR

In 1997, Haemacure entered into a license agreement with Baxter Healthcare S.A. ("Baxter") for the sale and manufacture of the *Hemaseel APR* fibrin sealant in the United States only. The following year, we developed an organization for the sale of this product. Thanks to innovative marketing and educational tools aimed at surgeons, such as the Haemacure Education Resource Center and regional speaker programs, the Company succeeded in capturing more than 25% of the U.S. fibrin sealant market. Our efforts were recognized with the *2002 Frost & Sullivan Competitive Strategy Award*. The *Hemaseel APR* sales revenues covered more than the direct sales and marketing costs and enabled us to maintain a sales and marketing force to eventually launch *Hemaseel HMN*.

In order to improve Haemacure's financial situation, we attempted in late 2002 to modify our license agreement with Baxter, with the involvement of the U.S. Federal Trade Commission ("FTC"). Under the proposed amendment, Haemacure would have continued to sell *Hemaseel APR*, terminated the requirement to manufacture *Hemaseel APR* ourselves and focused on its *Hemaseel HMN* product. Unfortunately, our proposal was not accepted by the FTC. The involvement of the FTC was essential as the license agreement was subject to a Consent Order of the FTC applying to Baxter.

In winter 2003, we retained the services of an investment banking firm to assist in a comprehensive evaluation of strategic alternatives. The directors and management of the Company unanimously found the alternatives identified not to be in the best interests of Haemacure's shareholders.

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HAEMACURE
2003

Haemacure developed a novel technology for the processing of the fibrinogen and thrombin protein components of **Hemaseel HMN** and **Hemaseel Thrombin**.

Haemacure entered into a manufacturing agreement with ZLB Central Laboratory of the Swiss Red Cross, whereby the latter agreed to build at its cost a manufacturing plant for **Hemaseel HMN** and supply Haemacure with product for clinical trials and commercial sale.

Haemacure entered into a license agreement with Baxter for the sale and manufacture of **Hemaseel APR** in the United States only. The objectives were to generate cash flows earlier and to develop a sales organization to eventually launch **Hemaseel HMN**.

Haemacure completed Phase I and Phase II and partially completed Phase III clinical trials for **Hemaseel HMN**.

1996

1997

1999

After a comparative analysis of the *Hemaseel APR* and *Hemaseel HMN* projects, three major reasons prompted us to terminate all *Hemaseel APR* related activities:

- The continuing erosion of the selling price of the product.
- A lack of financing to obtain FDA approval to manufacture the product, which required additional investments of approximately US\$15 million to US\$20 million. In particular, a new FDA requirement in respect of clinical trials increased the project cost by approximately US\$3 million and postponed its completion date by more than 12 months.
- The fulfillment of Haemacure's future financial obligations under the license agreement with Baxter and the manufacturing agreement with Bio Products Laboratory ("BPL") totaled US\$30 million over the next three years.

Accordingly, we entered into negotiations with the FTC, Baxter and BPL and announced, in October 2003, the termination of the *Hemaseel APR* project. Haemacure was thus relieved of all financial obligations to Baxter and BPL, and Baxter agreed to pay Haemacure US\$5.4 million over a three-year period, of which US\$3.4 million has already been received. For additional details, please see Management's Discussion and Analysis of Operating Results and Financial Position, and the notes to the financial statements.

HEMASEEL HMN AND HEMASEEL THROMBIN

The termination of the *Hemaseel APR* project allows Haemacure to focus its efforts and resources on its patented technology for the manufacture of two human plasma-derived products: *Hemaseel HMN*, a proprietary and superior fibrin sealant, and *Hemaseel Thrombin*, an hemostatic agent that may be used alone or in combination with other biomaterials.

Why *Hemaseel HMN*?

- Haemacure has complete ownership of and worldwide rights to its technology and all derived products, whereas its rights to *Hemaseel APR* were limited to the United States only.
- From a financial perspective, the cost of completing the *Hemaseel HMN* project is estimated at US\$10 million, versus US\$15 million to US\$20 million for the *Hemaseel APR* project.
- From a time schedule perspective, the regulatory timeline for the *Hemaseel HMN* project is about the same as for *Hemaseel APR*.
- From a manufacturing perspective, *Hemaseel HMN* and *Hemaseel Thrombin* are obtained from a simpler technology process that produces higher yields.
- Finally, *Hemaseel HMN* is superior to *Hemaseel APR* in terms of preparation, ease of use and clinical benefits. *Hemaseel HMN* also does not contain bovine components, thus eliminating the immunological risks associated with such components.

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HAEMACURE
2003

ZLB Bioplasma AG, a subsidiary of CSL Limited, acquired from ZLB Central Laboratory the business unit that was to manufacture Hemaseel HMN.

ZLB Bioplasma AG informed Haemacure that it would not proceed with the Hemaseel HMN project.

Haemacure and ZLB Bioplasma AG settled the termination of the 1996 manufacturing agreement with ZLB Central Laboratory.

Haemacure terminated its license with Baxter for Hemaseel APR and focused on Hemaseel HMN.

2000 2001 2002 2003

OUTLOOK

The *Hemaseel HMN* fibrin sealant has completed Phase I and II clinical trials and undergone partial Phase III trials. The product was tested on 150 patients and no adverse reactions were reported. We are active in arranging for the manufacture of product for both clinical trials and commercialization. We plan on resuming Phase III clinical trials in the first quarter of fiscal 2005, complete them in the fourth quarter of that year and file regulatory submissions to the FDA and European authorities by late 2005 for both *Hemaseel HMN* and *Hemaseel Thrombin*. Approvals to launch the products are projected for late 2006 or early 2007.

As for financing, Haemacure will have available for this project the US\$2 million to be received from Baxter and the US\$4.5 million to be received from ZLB Bioplasma AG ("ZLB AG") pursuant to the settlement agreement concluded in March 2002 for their cancellation of the *Hemaseel HMN* project. Payment by ZLB AG is to be made as follows: US\$1.5 million upon commissioning of the *Hemaseel HMN* manufacturing facility; US\$1.5 million upon FDA approval of an Investigational New Drug Application; and US\$1.5 million upon achieving 50% of the FDA's target patient enrolment. In addition, in February 2004, Haemacure retained the services of a private merchant bank to handle a private placement of \$5 million, the proceeds thereof will be used to complete the *Hemaseel HMN* project.

Following this major reorganization, Haemacure is now almost a debt-free and obligation-free company, with state-of-art technology, proven and growing worldwide markets, and limited anticipated competition. With proprietary products, thorough knowledge of the marketplace and already-developed marketing tools and delivery devices, the Company is now better able to control its destiny, to the benefit of all of its shareholders.

In conclusion, I would like first to sincerely thank the people who worked diligently on the *Hemaseel APR* project. I also wish to thank the remaining staff, whose commitment and dedication will be instrumental in the busy days that lie ahead. Finally, I want to convey my sincere appreciation and gratitude to our shareholders, old and new, who continue to support Haemacure.



Marc Paquin
President and Chief Executive Officer

TARGETING LARGE AND GROWING MARKETS

In 2003, the worldwide market for fibrin sealant and thrombin was in excess of US\$300 million and is expected to reach nearly US\$500 million by 2007, when Haemacure plans to launch **Hemaseel HMN** and **Hemaseel Thrombin**.

Prior to 1998, the U.S. commercial fibrin sealant market was non-existent. In 2003, the U.S. market reached approximately US\$65 million and is expected to grow to US\$90 million by 2007. The worldwide market, excluding the U.S., is expected to grow to US\$150 million by 2007.

The U.S. thrombin market was approximately US\$15 million in 1998. It is now supplied by one supplier, an American manufacturer of bovine-derived thrombin, who reported sales of US\$61 million in 2001 and of US\$141.7 million in 2003. The world market is expected to reach US\$250 million by 2007.

Sources: Frost & Sullivan, King Pharmaceuticals, Inc., Baxter and Haemacure.

Management's Discussion and Analysis of Operating Results and Financial Position

The following management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements for the year ended October 31, 2003 and the notes related thereto.

OVERVIEW

Fiscal 2003 was marked by a re-focusing of the Company on its *Hemaseel*[®] HMN technology, a valuable R&D asset, with the discontinuance of all sales and marketing, and regulatory activities related to the fibrin sealant *Hemaseel APR*. This decision, announced on October 31, 2003, was reached in view of the continuing erosion in prices of *Hemaseel APR*, the funding required to obtain U.S. Food and Drug Administration (FDA) approval, Haemacure's future financial obligations in relation to the product, and the lack of financing. This discontinuance was effected through the entering into of agreements with Baxter Healthcare S.A. (Baxter) and Bio Products Laboratory (BPL) providing, in general, for the termination of the 1997 license agreement with Baxter and the 2000 manufacturing agreement with BPL, the settlement of all claims as between the parties and the mutual release of any liability under the terminated agreements, including the payment of termination fees under these agreements. The impact of this discontinuance of activities on assets, liabilities and results is discussed below.

The year was also marked by the successful settlement in the third quarter of Haemacure's claim against the maker of *Gelfoam*[®] whereby the Corporation was paid \$830,000 for commissions earned during prior quarters; by the sale in the second quarter of certain redundant equipment resulting in a gain of \$860,000 and finally, by the positive impact on the financial results of the rise of the Canadian dollar against the US dollar.

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2003

OPERATING RESULTS

Fiscal 2003 (in millions of Cdn \$)

	Q1	Q2	Q3	Q4	Fiscal 2003
Sales	5.34	5.13	5.84	5.16	21.47
Baxter settlement	—	—	—	11.89	11.89
BPL settlement	—	—	—	(18.93)	(18.93)
Net loss	(2.13)	(0.99)	(0.98)	(8.92)	(13.02)
Loss per common share	(0.08)	(0.03)	(0.03)	(0.32)	(0.46)

REVENUES

For the fiscal year ended October 31, 2003, revenues totaled \$21.47 million (US\$14.96 million), compared to \$21.32 million (US\$13.55 million) for the previous year. Sales of *Hemaseel APR* reached \$19.3 million, compared to \$20.1 million the previous year. Sales of devices grew to \$1.28 million, an increase of 31% over sales of \$976,375 the previous year.

As a result of the settlement with the maker of *Gelfoam*, commission revenues totaled \$905,323, compared to \$236,004 for the previous year.

GROSS MARGIN

The gross margin for 2003 was 52%, compared to 57% the previous year. This decrease in margin is due in part to the rise in the Canadian dollar that has the effect of the Company reporting the cost of products sold at an exchange rate higher than the one used to report revenues. The decrease is also attributable to an inventory write-down in the amount of \$408,000 at the end of the year to reflect the net realizable value of products held for resale. The decrease was offset by an increase in commission revenues, which generate a 100% margin.

OPERATING EXPENSES

Operating expenses totaled \$17.8 million, down 15.4% from \$21.1 million in 2002.

Selling and marketing expenses totaled \$9.3 million, compared to \$10.4 million for the prior year. General and administrative expenses totaled \$5.6 million, compared to \$5.9 million, while Research and development and regulatory expenses declined to \$540,420 from \$1.5 million. The decreases are mainly the result of reduced research and development and regulatory activities, the continued application of tight cost management measures and the strength of the Canadian dollar.

In 2003, the Corporation reported a net gain on foreign exchange of \$1.76 million compared to a loss of \$113,058 the prior year. This gain is comprised mainly of an amount of \$1.4 million pertaining to future milestone payments of US\$6.75 million payable to Baxter under the *Hemaseel APR* license, recorded under Other liabilities, and an amount of \$435,430 pertaining to the term loan of US\$2.25 million. This loan was repaid in full in October 2003.

Interest and other financial expenses increased to \$2.3 million in 2003, up from \$1.4 million the prior year. This increase is mainly due to the US\$2.25 million term loan, obtained at the end of October 2002, and the expensing in 2003 of related debt issue costs and the debt issue costs related to the setting up of a line of credit with UPS Capital.

SETTLEMENT WITH A SHAREHOLDER

During 2003, Haemacure received from ZLB Bioplasma AG (ZLB AG) manufacturing equipment that could be used towards the manufacture of *Hemaseel HMN*. This equipment was later deemed redundant and sold for its estimated value, and a gain of \$860,000 was recorded (see note 12i) of the financial statements). This equipment was received as per the terms of the Settlement, Termination and Release Agreement entered into with ZLB AG in March 2002.

SETTLEMENT WITH A SUPPLIER

On October 31, 2003, the Corporation entered into a settlement agreement with Baxter providing for the termination of the *Hemaseel APR* license agreement and the payment by Baxter to Haemacure of \$7.12 million over a period ending in January 2006. As a result of such termination, the license net book value of \$3.9 million, recorded under Other assets, was written-off and the present value of future milestone payments to be made under the license agreement, recorded under Other liabilities, was reversed, in the amount of \$8.05 million. The Corporation recorded a gain of \$11.89 million resulting from this settlement. As of the end of January 2004, US\$2.0 million remain to be received from Baxter. See note 12ii) of the financial statements.

SETTLEMENT WITH A MANUFACTURER

On October 31, 2003, Haemacure entered into a settlement agreement with BPL providing for the termination of the *Hemaseel APR* manufacturing agreement. Pursuant to this settlement agreement, the Corporation paid \$890,000 to BPL in December 2003 from an amount received from Baxter, and BPL forgave all amounts due and committed to be spent by the Corporation under the manufacturing agreement, including \$1.9 million in accounts payable, in exchange for manufacturing equipment installed at BPL's facilities and certain supplies. Haemacure recorded an expense of \$18.9 million resulting from this settlement, of which \$17.8 million represented a fixed assets write-down. See note 12iii) of the financial statements.

NET RESULT

Haemacure incurred a loss before settlements and taxes of \$6.8 million, down from a loss of \$8.8 million the prior year. Including the settlements with ZLB AG, Baxter and BPL, Haemacure posted a net loss of \$13.02 million, or \$0.46 per share, compared to net income of \$3.7 million, or \$0.13 per share, the prior year.

ASSETS, LIQUIDITY AND CAPITAL RESOURCES

The settlements reached with Baxter and BPL streamlined Haemacure's balance sheet. In October 2003, as a result of the settlement with Baxter, Haemacure recorded an amount of \$5.68 million as Other receivables, and an amount of \$2.4 million as Accounts receivable from a supplier representing the present value of payments to be received in January 2005 and 2006.

Current assets totalled \$9.6 million as at October 31, 2003, compared with \$14.2 million the prior year. The working capital ratio remained almost the same, rising from 1.37 the prior year to 1.38 at the end of fiscal 2003.

Cash and cash equivalents amounted to \$618,759, down from \$1.8 million for the prior year. Despite income and liabilities forgiven recorded further to the settlements reached with Baxter and BPL, the financial statements include a going concern assumption note (see note 1 of the financial statements) as the Corporation's ability to continue operating as a going concern is dependent on its raising additional financing and achieving a profit on its business.

As a result of the discontinuance of the sale of *Hemaseel APR*, inventories decreased to \$523,687 down from \$3.5 million for the prior year, including a write-down of \$408,000 to reflect the net realizable value of products held for resale.

Fixed assets decreased to \$565,424 from \$18.8 million for the prior year. The decrease is attributable to the write-off of fixed assets and certain supplies transferred to BPL as part of the settlement.

Other assets decreased to \$25,565 from \$6.4 million for the prior year. The decrease is mainly attributable to the write-off of \$3.9 million representing the net book value of the *Hemaseel APR* license and the annual amortization of other assets of \$1.5 million. Also, as at October 31, 2003, deferred debt issue costs in the amount of \$286,990 were charged to expense with respect to the line of credit with UPS Capital and deferred debt issue costs in the amount of \$698,491 were expensed due to the repayment of the US\$2.25 million term loan. These charges included the annual amortization and write-offs of the remaining balances. See notes 8 and 9 of the financial statements.

As at October 31, 2003, the Corporation had drawn an amount of \$2.2 million against its line of credit, compared to an amount of \$3.5 million the prior year. This decrease is mainly due to reduced inventories at year-end. The Corporation repaid the line of credit on December 15, 2003.

Due to the full repayment in October 2003 of the US\$2.25 million term loan obtained in October 2002, long-term debt decreased to \$1.1 million from \$2.4 million for the prior year, as did the current portion of the long-term debt, which went from \$2.1 million last year to \$2,170 at the end of fiscal 2003.

OUTLOOK

Haemacure is currently assessing the best means of completing the development of its patented, all-human fibrin sealant *Hemaseel HMN* and thrombin and bringing these products to market. The termination of the license agreement with Baxter and of the manufacturing agreement with BPL relieved Haemacure of financial obligations and provides it with partial financing for the completion of its *Hemaseel HMN* and *Hemaseel Thrombin* project. Haemacure will have available for this project the US\$4.5 million to be received from ZLB AG, and the US\$2 million to be received from Baxter over the next two years. Payment of the amounts to be received from ZLB AG is conditional upon achieving certain milestones related to the completion of the clinical trials and the manufacture of the fibrin sealant *Hemaseel HMN*. Additional financing will be required.

RISKS AND UNCERTAINTIES

The information set forth in the management's discussion and analysis section of this annual report contains certain "forward-looking statements" which express management's views and expectations regarding future events. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, some of which are beyond Haemacure's control and difficult to predict. These risks and uncertainties could cause actual results to differ materially from those expressed or implied in such statements. Among other things, these risks and uncertainties include the following:

Reliance on External Financing

Haemacure will require additional financing to fund its operations, complete its project and obtain the required regulatory approvals. Such funding may come from internally generated cash flows, from further equity financing, whether by way of private placement or public offering, through a strategic alliance or from other sources. No assurance can be given that such funding will be available.

Uncertainties Related to Commercialization and Development

Except for devices, the Corporation's fibrin sealant and thrombin products are in final stages of development. Haemacure has not received marketing approval for any of these products from any regulatory body. The development and commercialization of new products are highly uncertain, as is the timing associated with these activities. Among other things, potential products that may appear to the Corporation to be promising may not reach the market for any number of reasons, including the possibility that they are found to be ineffective or cause harmful side effects during clinical trials, or that they fail to receive the necessary regulatory approvals, be difficult to manufacture on a commercial scale, be uneconomical, fail to achieve market acceptance or be precluded from commercialization because of proprietary rights held by third parties. No assurance can be made that any of the Corporation's development programs will be successfully completed, that clinical trials will yield the anticipated results, or that such trials will begin or be completed as planned.

Absence of Profitability

Haemacure commenced operations in 1991 and has not realized profit from operations since then, and there can be no assurance that it will attain and maintain profitability in the future. There is currently a growing market for fibrin sealant and thrombin products and Haemacure believes that this market will continue to grow. However, the market may not grow as expected by Haemacure and its assumptions may prove incorrect for a variety of reasons, including the failure to obtain the required regulatory approvals, competition from other products and the degree of commercial viability of the Corporation's products.

Product Liability Claims

The development, manufacture and sale of Haemacure's products may expose the Corporation to product liability claims. Although no claims have been filed against Haemacure to date, there can be no assurance that it will not experience losses due to product liability claims in the future. The Corporation currently has general liability insurance and product liability insurance. However, there can be no assurance that such coverage will be available to it in the future on reasonable terms, if at all. In addition, there can be no assurance that all of the activities encompassed within Haemacure's business are or will be covered under its policies. Any claims or series of claims against the Corporation, regardless of their merit or eventual outcome, could have a material adverse impact on its business, financial position and operating results.

Competition

The Corporation's potential competitors have greater financial, marketing and other resources than Haemacure. There can be no assurance that the Corporation will be able to compete successfully with existing or new competitors. Haemacure believes it unlikely that other fibrin sealant and thrombin products will be approved for use in the near future. There is no guarantee that any new products from competitors will not have a material adverse impact on the Corporation's sales in the future.

Management's Report

The accompanying consolidated financial statements of Haemacure Corporation and all the information in this Annual Report are the responsibility of Management.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. The financial statements include some amounts that are based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that financial statements are presented fairly, in all material respects. Financial information used elsewhere in the Annual Report is consistent with that in the financial statements.

Haemacure Corporation's policy is to maintain systems of internal accounting and administrative controls of high quality, consistent with reasonable costs. Such systems are designed to provide reasonable assurance that the financial information is relevant, accurate and reliable and that the Corporation's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out his responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board and all its members are outside Directors. The committee meets periodically with Management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities, and to review the Annual Report, the financial statements and the external auditors' report. The committee reports its findings to the Board for consideration when it approves the financial statements for issuance to the shareholders.

The consolidated financial statements have been audited by Ernst & Young LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. The external auditors have full and free access to the Audit Committee.



Marc Paquin
President and Chief Executive Officer



Lyne Paré, CA
Director, Finance and Administration

Auditors' Report

To the Shareholders of
Haemacure Corporation

We have audited the consolidated balance sheets of **Haemacure Corporation** as at October 31, 2003 and 2002 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, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Montreal, Canada
November 28, 2003
[except for notes 8, 12 iii) and 15 i) which are as of December 15, 2003]

Ernst & Young LLP
Chartered Accountants

Consolidated Balance Sheets

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

As at October 31
[in Canadian dollars]

	2003 \$	2002 \$
ASSETS [notes 8 and 9]		
Current assets		
Cash and cash equivalents	618,759	1,822,077
Accounts receivable – trade	2,516,199	3,054,242
Other receivables [note 4]	5,952,540	5,670,970
Inventories [note 5]	523,687	3,473,878
Prepaid expenses	30,569	185,639
	9,641,754	14,206,806
Fixed assets [note 6]	565,424	18,756,562
Accounts receivable from a supplier [note 12 ii]	2,396,631	—
Other assets [note 7]	25,565	6,423,674
	12,629,374	39,387,042
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Bank indebtedness [note 8]	2,204,529	3,501,345
Accounts payable and accrued liabilities	4,779,119	4,804,573
Current portion of long-term debt [note 9]	2,170	2,100,704
	6,985,818	10,406,622
Long-term debt [note 9]	1,073,978	2,446,840
Other liabilities [notes 10 and 12 ii]	—	8,945,455
	8,059,796	21,798,917
Shareholders' equity	4,569,578	17,588,125
	12,629,374	39,387,042

Commitments and contingencies [notes 12 i) and 15]

See accompanying notes.

On behalf of the Board:



Pierre Alary
Director



Louis M. Riopel
Director

Consolidated Statements of Operations

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

Years ended October 31
[in Canadian dollars]

	2003 \$	2002 \$
Sales	21,470,904	21,317,797
Cost of sales	10,391,908	9,078,981
Gross margin	11,078,996	12,238,816
EXPENSES (INCOME)		
Selling and marketing	9,340,248	10,371,606
General and administrative	5,617,112	5,915,749
Research and development	410,614	1,115,098
Regulatory approvals	129,806	399,912
Loss (gain) on foreign exchange	(1,757,346)	113,058
Amortization of fixed assets	291,297	267,822
Amortization of other assets	1,529,594	1,529,594
Interest on bank indebtedness [note 8]	473,309	408,644
Interest on other liabilities	521,020	525,960
Interest on long-term debt [note 9]	1,123,270	80,340
Other financial expenses	175,628	377,607
Investment income	(10,556)	(17,234)
	17,843,996	21,088,156
Loss before undernoted items	(6,765,000)	(8,849,340)
Settlement with a shareholder [note 12 i)]	859,740	12,709,600
Settlement with a supplier [note 12 ii)]	11,890,542	—
Settlement with a manufacturer [note 12 iii)]	(18,925,408)	—
Income (loss) before income taxes	(12,940,126)	3,860,260
Current tax expense	84,421	2,269,089
Tax benefit of previously unrecognized future income tax assets	—	(2,140,000)
Provision for income taxes [note 13]	84,421	129,089
Net income (loss)	(13,024,547)	3,731,171
Earnings (loss) per common share [note 11]		
Basic and diluted	(0.46)	0.13
Weighted average number of outstanding common shares [note 11]		
Basic	28,400,917	28,400,700
Diluted	28,400,917	28,428,932

See accompanying notes.

Consolidated Statements of Shareholders' Equity

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

Years ended October 31
[in Canadian dollars]

	2003		2002	
	Number of shares	Amount \$	Number of shares	Amount \$
Share capital [note 11]				
Common shares				
Balance at beginning of year	28,400,917	87,566,948	28,399,617	87,563,828
Issued upon the exercise of warrants	—	—	1,300	3,120
Balance at end of year	28,400,917	87,566,948	28,400,917	87,566,948
Deficit				
Balance at beginning of year		(71,647,823)		(75,378,994)
Net income (loss)		(13,024,547)		3,731,171
Balance at end of year		(84,672,370)		(71,647,823)
Additional paid-in capital [note 11]		1,675,000		1,669,000
Total shareholders' equity		4,569,578		17,588,125

See accompanying notes.

Consolidated Statements of Cash Flows

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

Years ended October 31
[in Canadian dollars]

	2003 \$	2002 \$
OPERATING ACTIVITIES		
Net income (loss)	(13,024,547)	3,731,171
Items not affecting cash		
Amortization of fixed assets	291,297	267,822
Amortization of other assets	1,529,594	1,529,594
Amortization and write-off of debt issue costs	985,481	199,119
Accrued interest on long-term debt	35,169	36,453
Accrued interest on other liabilities	521,020	525,960
Loss on disposal and write-off of fixed assets	125,546	20,173
Services paid by the issuance of warrants	6,000	49,500
Settlement with a manufacturer – impairment of fixed assets	17,810,790	—
Settlement with a supplier	(6,540,083)	—
Foreign exchange loss	47,165	37,978
Unrealized foreign exchange gain	(1,812,839)	(173,052)
	(25,407)	6,224,718
Net change in non-cash working capital balances related to operations [note 17]	4,642,548	(6,627,087)
Cash flows relating to operating activities	4,617,141	(402,369)
FINANCING ACTIVITIES		
Increase in bank indebtedness	—	4,790,045
Repayment of bank indebtedness	(1,296,816)	(2,179,022)
Issuance of common shares	—	3,120
Increase in long-term debt	—	3,504,600
Debt issue costs	(25,811)	(693,789)
Repayment of long-term debt	(3,107,874)	(1,778)
Cash flows relating to financing activities	(4,430,501)	5,423,176
INVESTING ACTIVITIES		
Disposition of temporary investments	—	127,104
Acquisition of fixed assets	(36,495)	(4,048,734)
Net change in non-cash working capital balances related to investing activities	(1,306,298)	230,688
Cash flows relating to investing activities	(1,342,793)	(3,690,942)
Effect of exchange rate changes on cash and cash equivalents	(47,165)	(37,978)
Net change in cash and cash equivalents	(1,203,318)	1,291,887
Cash and cash equivalents at beginning of year	1,822,077	530,190
Cash and cash equivalents at end of year [note 17]	618,759	1,822,077
Supplemental information		
Interest paid	575,929	253,412
Income taxes paid	144,377	84,670

See accompanying notes.

Notes to Consolidated Financial Statements

October 31, 2003 and 2002 [in Canadian dollars]

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, manufacturing, marketing and selling biological adhesives and biomaterials 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 following the settlement agreements disclosed in note 12, and, for all practical purposes, is focusing on the completion of the development of Hemaseel HMN and Hemaseel Thrombin. As a consequence, the Corporation's status is considered to have returned to that of a company 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's remaining activities are subject to the risks inherent in any Corporation that operates in the field of biotechnology. The success of the Corporation is dependent on bringing its technology to the market, obtaining the necessary regulatory approvals and achieving future profitable operations. It will be necessary for the Corporation to raise additional funds for the continuing development and marketing of its technologies.

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 recently exited its Hemaseel APR product line. As of November 1, 2003, the Corporation will be in the development stage and will not generate 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 and to conduct clinical trials. The Corporation is seeking additional funds through additional financing whether by way of private placement or public offering.

The Corporation's ability to continue as a going concern is dependent on raising additional financing, bringing its technology to market and achieving and maintaining profitable operations. The outcome of these matters cannot be predicted at this time. 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.

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 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 successfully marketed its Hemaseel HMN technology, the carrying value of the Corporation's fixed assets is subject to uncertainty. Future events could result in material changes to the carrying values of fixed assets recognized in the consolidated financial statements.

Revenue recognition

Revenue from sale of products is recognized upon shipment of the product. Commission revenue is earned when an exclusive manufacturer ships product directly to the customer, and recognized when the Corporation receives confirmation of the sale by the manufacturer.

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.

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 turnover and the expiry date of the products.

Fixed assets

Fixed assets are recorded at cost, net of related government assistance and investment tax credits, and are amortized over their estimated useful life using the declining balance method, except for leasehold improvements which are amortized using the straight-line method, at the following rates:

Laboratory equipment	20%
Office equipment	20%
Computer equipment	30%
Leasehold improvements	Lease term

No amortization is recorded on construction-in-progress. Amortization will be recorded when the production process begins. The Corporation does not capitalize interest during construction. [see note 12 iii)]

Notes to Consolidated Financial Statements

2) SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

Government assistance and investment tax credits

Government assistance and investment tax credits are recorded as a reduction of the related expenditures or fixed assets 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 mainly comprised of manufacturing and distribution rights, and debt issue costs. Manufacturing and distribution rights are recorded at cost and amortized using the straight-line method over a period of 12 to 15 years [8 to 15 years in 2002]. The debt issue costs are deferred and amortized using the straight-line method over a period of three years for the bank indebtedness and using the effective yield method for the long-term debt.

Research and development

Research costs are charged against income in the year of expenditure. 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.

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 statement of operations of the reporting period. The accounts of a foreign subsidiary are translated using the temporal method. [see note 3]

Basic and diluted earnings

Basic and diluted earnings (loss) per share are calculated using the treasury stock method. Basic earnings (loss) per share is calculated using the weighted average number of voting shares outstanding during the year.

Stock-based compensation and other stock-based payments

The Corporation has a stock option incentive plan which is described in note 11. The Corporation does not recognize compensation expense when stock options are granted to employees, officers and directors at the prevailing market price and where there are no cash settlement features. However, direct awards of stock to employees and non-employees and stock option awards granted to non-employees are accounted for in accordance with the fair value method of accounting for stock based compensation. [see note 3]

Impairment of long-lived assets

Long-lived assets and certain identifiable intangibles are reviewed for impairment 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 net recoverable value.

3) CHANGE IN ACCOUNTING POLICIES

Stock-based compensation and other stock-based payments

Effective November 1, 2002, the Corporation adopted the new recommendations of the Canadian Institute of Chartered Accountants ["CICA"] relating to stock-based compensation and other stock-based payments. As permitted, the Corporation has applied this change prospectively for new awards granted on or after November 1, 2002. Direct awards of stock to employees and stock and stock option awards granted to non-employees will be accounted for in accordance with the fair value method of accounting for stock-based compensation. The Corporation does not recognize compensation expense when stock options are granted to employees, officers and directors at the prevailing market price and where there are no cash settlement features. In periods prior to November 1, 2002, the Corporation did not recognize compensation expense when stock or stock options were issued to employees, officers and directors. The fair value of direct awards of stock is determined using the quoted stock market price of the Corporation's stock and the fair value of stock options is determined using the Black-Scholes option pricing model. Pro forma information regarding net loss has been determined as if the Corporation had accounted for stock options granted after October 31, 2002 under the fair value method. [see note 11]

Effective November 1, 2003, the Corporation will early adopt the new recommendations of the CICA relating to stock-based compensation. These new rules, which will be applied prospectively for awards granted on or after November 1, 2003, will require the Corporation to account all stock option awards using the fair value method.

Notes to Consolidated Financial Statements

3) CHANGE IN ACCOUNTING POLICIES [Cont'd]

Intangible assets

Effective November 1, 2002, the Corporation prospectively adopted the new recommendation published by the Canadian Institute of Chartered Accountants relating to the method of valuation and the presentation and disclosure requirements for intangible assets. The new recommendations require recognized intangible assets to be amortized over their useful life to an enterprise, unless the life is determined to be indefinite. The amortization method and estimate of the useful life of an intangible asset should be reviewed annually. Intangible assets, which are subject to amortization, are tested for impairment by comparing the net carrying amount with the net recoverable amount whereas for intangible assets not subject to amortization, the net carrying amount is compared to the asset's fair value. The impact of the adoption of the new recommendations did not result in any change to the recognized intangible assets of the Corporation because its intangible assets are not considered to have an indefinite life.

Translation of foreign currencies

On November 1, 2001, the Corporation retroactively adopted the new accounting recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for foreign exchange gains or losses on monetary items and non-monetary items carried at market that have a fixed or ascertainable life extending beyond the end of the following year. Previously, these gains and losses were deferred and amortized on a straight-line basis over the term of the related items. The new recommendations require that these gains and losses be included in the determination of net income as they arise. This change in accounting policy has been applied retroactively and has had the impact of increasing net income for 2002 by \$306,788.

4) OTHER RECEIVABLES

	2003 \$	2002 \$
Accounts receivable from a supplier [note 12 ii)]	5,675,892	—
Accounts receivable from a shareholder [note 12 i)]	—	5,451,600
Commodity taxes and other	276,648	219,370
	5,952,540	5,670,970

5) INVENTORIES

	2003 \$	2002 \$
Products held for resale	523,687	3,473,878

As at October 31, 2003, the inventories were written down by an amount of \$408,087 [\$10,014 in 2002] to reflect the net realizable value of the products held for resale.

6) FIXED ASSETS

	2003		2002	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Laboratory equipment	1,292,895	1,016,960	1,584,173	1,187,432
Office equipment	295,624	169,518	366,863	198,474
Computer equipment	265,099	152,605	404,067	147,175
Leasehold improvements	344,488	293,599	361,420	257,572
Construction-in-progress [note 12 ii) and iii)]	—	—	17,830,692	—
	2,198,106	1,632,682	20,547,215	1,790,653
Less: accumulated amortization	1,632,682		1,790,653	
Net book value	565,424		18,756,562	

7) OTHER ASSETS

	2003 \$	2002 \$
Manufacturing and distribution rights, at cost [notes 10 and 12 ii)]	49,346	12,242,752
Less: accumulated amortization	23,781	6,778,748
	25,565	5,464,004
Debt issue costs [notes 8 and 9]	—	959,670
	25,565	6,423,674

8) BANK INDEBTEDNESS

On November 20, 2001, the Corporation signed a revolving credit facility agreement, which had a term of three years, for an amount equivalent to a maximum of US\$6,000,000 [approximately \$7,920,000] based on eligible accounts receivable and inventory. The facility bears interest at US prime rate plus 2.25% [effective rate as at October 31, 2003: 6.25% and 7% as at October 31, 2002] and is collateralized by accounts receivable, inventories, equipment and intangible assets located in the United States. As at October 31, 2003, the Corporation has drawn an amount of \$2,204,529 against this revolving credit facility.

Notes to Consolidated Financial Statements

8) BANK INDEBTEDNESS [Cont'd]

As a result of the settlement agreements disclosed in note 12 ii) and iii), the lender agreed to waive the early termination fee, maintain the effective interest rate in effect as at October 31, 2003 and allow the Corporation to liquidate its accounts receivable and inventory in the normal course of business.

Debt covenants

Under the revolving credit facility agreement, the Corporation and its subsidiary are committed to respect certain financial covenants including a limitation on capital expenditures, minimum tangible net worth and minimum earnings before interest, income taxes, depreciation and amortization, as defined in the agreement. The Corporation and its subsidiary are also committed to respect certain negative covenants including limitations on the ability to pay dividends and make certain payments. Subsequent to October 31, 2002, the Corporation obtained a waiver from its lender of a breach of a covenant related to the limitation on capital expenditures, which existed at October 31, 2002.

As at October 31, 2003, the Corporation was not in compliance with the covenants relating to levels of minimum tangible net worth and earnings before interest, income taxes, depreciation and amortization. The lender agreed to waive those defaults, provided that the debt gets repaid by December 19, 2003. As a result, previously deferred debt issue costs of \$127,500 were charged to expense in 2003. The Corporation repaid the balance of the loan on December 15, 2003.

9) LONG-TERM DEBT

	2003 \$	2002 \$
Loan from Investissement Québec a)	1,073,087	1,037,918
Term loan of US\$2,250,000 bearing interest at 12.90%, repayable in monthly installments of US\$186,379, principal and interest, repaid on October 30, 2003 b)	—	3,504,600
Other	3,061	5,026
	1,076,148	4,547,544
Less: current portion	2,170	2,100,704
	1,073,978	2,446,840

a) 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% [4% as at October 31, 2003 and 3% as at October 31, 2002]. Interest for the year ended October 31, 2003 amounting to \$35,169 [\$36,453 in 2002] has been capitalized to the loan in accordance with the provisions of the loan agreement. The loan and interest thereon will be repayable in installments equal to 10% of gross sales of the products stemming from the sale of internally developed fibrin sealants [Hemaseel HMN]. As of October 31, 2003, 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.

b) This term loan is secured by a specific movable hypothec assigning and hypothecating the US\$3,500,000 payment due pursuant to the settlement with a shareholder [note 12 i)] and a chattel mortgage pledging to the lender the Corporation's manufacturing equipment located in England.

In addition, if the Corporation elects not to repay the outstanding term loan on March 31, 2003, it shall, within five business days of that date, ensure that an irrevocable, standby letter of credit is issued in favor of the lender by a Canadian chartered bank for an amount equal to US\$1,125,000.

On March 31, 2003, the Corporation elected not to repay the outstanding term loan and an irrevocable standby letter of credit was issued in favor of the lender by a Canadian chartered bank of an amount equal to US\$1,125,000. On October 30, 2003, the lender called upon the standby letter of credit to repay in full the term loan. As a result, previously deferred debt issue costs of \$111,000 were charged to expense in 2003.

The minimum annual long-term debt principal repayments, excluding those relating to the IQ loan, are as follows over the next years:

	\$
2004	2,170
2005	891

10) OTHER LIABILITIES

In April 1997, the Corporation entered into a licensing and manufacturing agreement to obtain the rights to manufacture and sell Hemaseel APR, a fibrin sealant, in the United States. Under this agreement, the Corporation was committed to make milestone payments. Following the settlement with a supplier [see note 12 ii)], the carrying value of this liability as of October 31, 2003 was written down to zero.

As of October 31, 2002, other liabilities represented the present value, discounted using a rate of 8.25%, of the milestone payments to be made by the Corporation related to the purchase of the rights to manufacture and sell fibrin sealant in the United States. As of October 31, 2002, a total consideration of US\$4,750,000 [\$7,130,950] has been paid. The discounted value of the milestone payments, as of the date of the initial calculation, was included in other assets [note 7].

Notes to Consolidated Financial Statements

11) 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, 2003 and 2002, 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. In conjunction with the cessation of commercial activities in the United States, the Board of Directors approved, as of October 31, 2003, the accelerated vesting on all unvested options held by employees who were laid-off. 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, 2003 and 2002 and the changes during the years then ended is shown below:

	2003		2002	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding options, at beginning of year	1,726,356	2.72	1,396,469	3.50
Granted	88,500	0.70	496,362	1.03
Expired/forfeited	(79,367)	3.25	(166,475)	4.18
Outstanding options, at end of year	1,735,489	2.59	1,726,356	2.72
Exercisable options, at end of year	1,735,489	2.59	1,539,356	2.85

The fair value of options granted during the year ended October 31, 2003 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: weighted-average risk-free interest rate of 4.56%; dividend yield of nil; weighted-average volatility factor of the expected market price of the Corporation's common shares of 0.663, and weighted-average expected life of the option of 10 years. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense on a straight-line basis over the option's vesting period. The Corporation's pro forma net loss would have been \$13,068,992 for the year ended October 31, 2003. Basic and diluted loss per share figures would have been unchanged at \$0.46 for the year ended October 31, 2003. The weighted average grant date fair value of stock options granted during the year ended October 31, 2003 was \$0.54.

The following table contains information regarding outstanding fixed-price stock options as at October 31, 2003:

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 \$
0.52 to 1.00	392,362	8.23	0.88	392,362	0.88
1.21 to 1.35	271,700	7.47	1.26	271,700	1.26
2.05 to 2.60	610,010	6.36	2.24	610,010	2.24
3.10 to 4.00	166,917	5.50	3.80	166,917	3.80
4.10 to 5.00	45,100	3.54	4.22	45,100	4.22
5.60 to 6.00	79,400	5.02	5.62	79,400	5.62
6.30 to 7.00	170,000	2.73	6.92	170,000	6.92
0.52 to 7.00	1,735,489	6.42	2.59	1,735,489	2.59

In addition, with respect to the issuance of shares during the year ended October 31, 2001, the Corporation granted the underwriters, an option to purchase 541,667 shares exercisable at \$1.30 per share on or before June 26, 2003. The Corporation calculated the fair value of these options, using the Black-Scholes option pricing model, and recognized \$290,000 as share issue costs charged to deficit and recorded a corresponding amount as additional paid-in capital. During the year ended October 31, 2003, these options expired unexercised.

Notes to Consolidated Financial Statements

11) SHARE CAPITAL [Cont'd]

Warrants

A summary of the status of the Corporation's warrants as at October 31, 2003 and 2002 and the changes during the years then ended is shown below:

	2003		2002	
	Warrants	Weighted average exercise price	Warrants	Weighted average exercise price
Outstanding warrants, at beginning of year	1,090,812	0.94	4,123,648	2.40
Granted	37,500	1.25	1,065,812	0.91
Exercised	—	—	(1,300)	2.40
Expired	(50,000)	1.95	(4,097,348)	2.40
Outstanding warrants, at end of year	1,078,312	0.90	1,090,812	0.94

During the year ended October 31, 2002, the Corporation entered into an agreement with one of its suppliers for services to be rendered over the next year. As part of the compensation payable to the supplier, the Corporation is required to issue up to 82,500 warrants subject to performance criteria, each of which entitles the holder to purchase one common share at a price of \$1.25. The 82,500 warrants expire on March 20, 2007. In 2003, 37,500 warrants [45,000 warrants in 2002] were issued in respect of the agreement and the Corporation recorded an expense of \$6,000 [\$15,000 in 2002] and recorded a corresponding amount as additional paid-in capital. The Corporation calculated the fair value of these warrants, using the Black-Scholes option pricing model.

During the year ended October 31, 2002, in connection with the new term loan of US\$2,250,000 [see note 9], the Corporation granted 817,241 warrants to its lender and 178,571 warrants to the agent in the transaction. The 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.

During the year ended October 31, 2000, the Corporation entered into an agreement with one of its suppliers for services to be rendered over the next two years. As part of the compensation payable to the supplier, the Corporation is required to issue up to 50,000 warrants subject to performance criteria, each of which entitles the holder to purchase one common share at a price of \$1.95. The 50,000 warrants expired unexercised on April 30, 2003, one year after the termination of the agreement. In 2002, the Corporation recorded an expense of \$34,500 and a corresponding amount as additional paid-in capital in connection with this obligation. The Corporation calculated the fair value of these warrants using the Black-Scholes option pricing model.

During the year ended October 31, 2000, the Corporation issued 4,104,148 warrants in connection with the issuance of common shares. These warrants entitle the holder to purchase one common share of the Corporation at a price of \$2.40 until December 31, 2001. During the year ended October 31, 2002, 4,097,348 warrants expired unexercised.

Earnings (loss) per share

The following is a reconciliation of the numerator and denominator of the basic and diluted earnings (loss) per share computations for the years ended October 31, 2003 and 2002.

	2003	2002
	\$	\$
Numerator		
Net income (loss) – numerator for basic and diluted earnings (loss) per share	(13,024,547)	3,731,171
Denominator		
Denominator for basic earnings (loss) per share		
Weighted-average number of outstanding common shares	28,400,917	28,400,700
Effect of dilutive securities		
Stock options and warrants	—	28,232
Denominator for diluted earnings (loss) per share		
Adjusted weighted-average number of outstanding common shares and assumed conversions	28,400,917	28,428,932

For 2003, the Corporation's diluted loss per share is equivalent to its basic loss per share, since all of the Corporation's potentially issuable securities would have an anti-dilutive effect. These securities are stock options and warrants.

Notes to Consolidated Financial Statements

12) SETTLEMENTS

i) Settlement with a shareholder

On March 1, 2002, the Corporation entered into a settlement agreement with ZLB Bioplasma AG ["Bioplasma"] with regard to the discontinuance of license and supply agreements regarding Hemaseel HMN, the Corporation's proprietary fibrin sealant. Under the terms of termination, Bioplasma will pay the Corporation US\$8,000,000 [\$12,700,000] in three cash payments spread over a one-year period. During the year ended October 31, 2002, the Corporation recorded a revenue of \$12,700,000 of which an amount of \$7.2 million was received in cash and an amount of \$5,500,000 was recorded as other receivable. This amount was received in March 2003. In addition, Bioplasma agreed to transfer to the Corporation specific equipment that could be used towards the manufacturing of Hemaseel HMN. During the year ended October 31, 2003, the equipment was sold for its estimated value and a gain of \$859,740 was recorded.

In addition, the two parties have also entered into a licensing agreement that provides for the transfer of all technology and know-how held by Bioplasma related to Hemaseel HMN to the Corporation. Bioplasma will also provide future cash payments of US\$4,500,000 [\$7,000,000], payable solely upon the Corporation reaching certain milestones towards the development and setting up of a manufacturing facility for Hemaseel HMN. In return, Bioplasma will receive a 3% royalty on all net revenues received by the Corporation on Hemaseel HMN fibrin sealant sales for a ten-year period starting upon commercialization.

ii) Settlement with a supplier

On October 31, 2003 the Corporation entered into a settlement agreement with a supplier with regard to the termination of the 1997 license and supply agreements regarding Hemaseel APR. Under the terms of termination, the supplier will pay the Corporation US\$5,400,000 [\$7,120,000] over a period ending in January 2006 and the Corporation paid in November 2003 outstanding accounts payable amounting to US\$1,600,000 [\$2,100,000]. As a result of this settlement, the Corporation wrote-off other assets pertaining to the Hemaseel APR license having a book value of \$3,909,000 and reversed other liabilities related to the forgiven milestone payments payable to the supplier for an amount of \$8,052,000. In addition, the supplier and the Corporation have released each other from all claims under the agreements, including a license termination fee of US\$1,500,000 [\$2,000,000] otherwise payable by the Corporation and the supplier bought certain equipment under construction related to the Hemaseel APR project for US\$675,000 [\$890,000].

During the year ended October 31, 2003, the Corporation recorded as income resulting from this settlement an amount of \$11,890,000 as detailed below:

	\$
Cash payments to be received by the Corporation on:	
November, 2003 – US\$2,400,000	3,143,000
January 12, 2004 – US\$1,000,000	1,318,000
Present value of US\$1,000,000 payments to be received on January 12, 2005 and 2006 [calculated using a rate of 5.5%]	2,396,000
	6,857,000
Settlement of other liabilities [note 10]	8,052,000
Sale of equipment under construction	890,000
Less: impairment charge of other assets [note 7]	(3,909,000)
	11,890,000

As a consequence of the termination of the 1997 license and supply agreements regarding its Hemaseel APR product, the Corporation discharged all its employees related to this business activity and has recorded a provision for severance costs of \$225,000. This provision has been equally expensed in general and administrative expenses, and selling and marketing expenses.

iii) Settlement with a manufacturer

On October 31, 2003, the Corporation also entered into a settlement agreement with Bio Products Laboratory ["BPL"], terminating a manufacturing agreement entered into in 2000 under which BPL was to manufacture Hemaseel APR at its facility in the United Kingdom. The closing of this settlement took place on December 10, 2003 and is reflected in the financial statements as of October 31, 2003.

Under the terms of the settlement, the Corporation will pay US\$675,000 [\$890,000] to BPL, from the amount it received from a supplier [see note 12 ii)] and BPL has forgiven all amounts due by the Corporation, including US\$1,400,000 [\$1,900,000] in accounts payable in return for the fixed assets under construction located in United Kingdom having a carrying value of \$19,700,000. Also, BPL and the Corporation have released each other from all claims under the agreement and the Corporation has transferred to BPL substantially all of the equipment installed at BPL for the Hemaseel APR project and certain supplies. In addition, subject to regulatory approval, the Corporation will issue a common share purchase warrant to the manufacturer, giving BPL the right to purchase up to 300,000 common shares of the Corporation at a price of \$3.00 per share for a period of two years. This warrant is estimated to have a nominal value.

As a result, the Corporation recorded an expense on settlement of \$18,900,000, including a reduction of \$220,000 of other receivables during the year ended October 31, 2003.

Notes to Consolidated Financial Statements

13) INCOME TAXES

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

	2003 %	2002 %
Statutory federal and provincial rate	33.4	35.5
Increase (decrease) in taxes payable resulting from:		
Non-deductible expenses	2.0	1.3
Non-taxable portion of the settlement income	(1.9)	(58.4)
Recognized (unrecognized) tax benefits of operating losses and other available deductions	(41.5)	29.4
Foreign tax rate differential	1.8	0.9
Large corporation tax	0.6	3.3
Financing fees	(1.5)	(2.3)
Other	6.4	(6.4)
	(0.7)	3.3

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

	2003 \$	2002 \$
Future income tax liabilities		
Carrying value of U.S. fixed assets in excess of tax basis	77,000	151,000
Tax basis of other liabilities in excess of carrying value	—	277,000
Total future income tax liabilities	77,000	428,000
Future income tax assets		
Tax basis of Canadian capital and other assets in excess of carrying value	7,857,000	3,748,000
Canadian non-capital losses carried forward	907,000	2,789,000
U.S. net operating losses carried forward	17,091,000	17,404,000
Research and development expenditures	1,607,000	1,597,000
Financing fees	246,000	420,000
Other	—	44,000
Total future income tax assets	27,708,000	26,002,000
Valuation allowance	27,631,000	25,574,000
Net future income tax assets	77,000	428,000
Net future income tax	—	—

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 financial statements. These losses, if not utilized, will expire as follows:

	Canadian Federal losses \$	Canadian Provincial losses \$	U.S. Federal losses \$
2006	4,098,000	—	—
2007	1,000	—	—
2011	—	—	12,000
2012	—	—	946,000
2018	—	—	5,649,000
2019	—	—	7,555,000
2020	—	—	10,898,000
2021	—	—	6,063,000
2022	—	—	8,003,000
2023	—	—	6,293,000
	4,099,000	—	45,419,000

Notes to Consolidated Financial Statements

13) INCOME TAXES [Cont'd]

The Corporation has accumulated Canadian scientific research and experimental development expenditures of \$5,342,000 which have not been deducted for federal income tax purposes and \$4,784,000 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 \$794,000. The benefits of these expenses have not been recorded in the financial statements.

14) GOVERNMENT ASSISTANCE

The Corporation has available non-refundable investment tax credits of \$440,000 [2002 – \$440,000] related to research and development expenditures which may be utilized to reduce federal income taxes payable in the future years end expire as follows:

	\$
2006	160,000
2007	206,000
2008	55,000
2009	19,000
	<u>440,000</u>

The benefits of these non-refundable investment tax credits have not been recognized in the financial statements.

15) COMMITMENTS AND CONTINGENCIES

- i) The Corporation's total commitments under operating leases amount to approximately \$1,590,500. The minimum payments, before taking into consideration the sub-lease mentioned below, for the next five years are as follows:

	\$
2004	708,000
2005	329,000
2006	245,500
2007	170,500
2008	137,500
	<u>1,590,500</u>

In 1998, the Corporation sub-leased to a third party part of its premises until the expiry of the head lease, equivalent to its commitment.

Expected sub-lease rentals to be received for the next years are as follows:

	\$
2004	294,000
2005	113,000
	<u>407,000</u>

Rent expense for the year ended October 31, 2003 amounted to \$627,514 [\$630,746 in 2002]. Sub-lease revenue for the year ended October 31, 2003 amounted to \$288,934 [\$276,672 in 2002].

- ii) The Corporation entered into an agreement with a medical device manufacturer on January 23, 2003 whereby it must purchase a minimum number of units from this manufacturer in the next four quarters. The initial term of the agreement is from January 23, 2003 to December 31, 2005, however the Corporation is only committed to four quarters' worth of purchases and has calculated its commitment to be \$335,000 to be paid in fiscal year 2004.
- iii) In the normal course of business, there are other pending claims by and against the Corporation, the largest one amounting to approximately US\$190,000 and for which a provision was recorded by the Corporation. Litigation is subject to many uncertainties and the outcome of individual matters is not predictable. In the opinion of management, final determination of these other litigations will not materially affect the Corporation's consolidated financial position or the results from its operations.

Notes to Consolidated Financial Statements

16) FINANCIAL INSTRUMENTS

Concentration of credit risk

Cash and cash equivalents are placed with financial institutions. Concentration of credit risk with respect to accounts receivable is limited because of the Corporation's large number of customers. As at October 31, 2003 and 2002, no customers represented more than 10% 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, accounts receivable – trade and other receivables. Short-term financial liabilities comprise bank indebtedness and accounts payable and accrued liabilities.

ii) Long-term financial assets and liabilities

The fair value of the accounts receivable from a supplier and the long-term debt are estimated using discounted cash flow analyses, based on the Corporation's current incremental borrowing rates for similar types of arrangements. There is no material difference between the carrying value and the fair value of the accounts receivable from a supplier and the long-term debt, with the exception of the IQ loan for which the fair value is not readily determinable due to its specific nature.

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

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, bank indebtedness, accounts payable and accrued liabilities, long-term debt and other liabilities denominated in US dollars. As at October 31, 2003, financial assets, consisting principally of accounts receivable, denominated in US dollars totaled US\$8,560,786 [US\$6,657,035 as at October 31, 2002] and financial liabilities denominated in US dollars totaled US\$4,812,428 [US\$12,083,679 as at October 31, 2002]. The Company does not enter into arrangements to hedge its foreign currency risk.

17) STATEMENTS OF CASH FLOWS

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and bank balances.

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

	2003 \$	2002 \$
Accounts receivable – trade	538,043	123,892
Other receivables	(281,570)	(5,379,432)
Inventories	2,950,191	(285,565)
Prepaid expenses	155,070	296,701
Accounts payable and accrued liabilities	1,280,814	(1,382,683)
	4,642,548	(6,627,087)

During the year ended October 31, 2002, following the settlement with a supplier, the Corporation received credit notes amounting to \$1,134,841 for fixed assets purchased in the year ended October 31, 2001. This non-monetary transaction reduced the cost of fixed assets under construction during the year.

18) SEGMENT DISCLOSURES

The Corporation considers it is operating in only one segment, which is the sector related to the market of acute surgical wound care. The Corporation allocates sales to individual countries according to the locations of the customers.

Geographic information

	Sales		Fixed assets	
	2003 \$	2002 \$	2003 \$	2002 \$
Canada	—	—	360,433	524,483
United States	21,470,904	21,317,797	204,991	401,387
England	—	—	—	17,830,692
	21,470,904	21,317,797	565,424	18,756,562

19) COMPARATIVE FIGURES

Certain of the 2002 figures have been reclassified in order to conform with the presentation adopted in 2003.

Corporate Information

BOARD OF DIRECTORS

Louis M. Riopel¹²⁴⁵
Chairman
Président, Rio-Dev Inc.

Pierre Alary, CA¹³
Vice President and Chief Financial Officer
Bombardier Inc.

Paul Baehr¹³⁵
Chairman and Chief Executive Officer
Ibex Technologies Inc.

Wayne G. Johnson
Chairman and Chief Executive Officer
Bio Ventures Inc.

Marc Paquin²
President and Chief Executive Officer
Haemacure Corporation

Neil Wiener
Partner
Heenan Blaikie

¹Member of the Audit Committee
²Member of the Executive Committee
³Member of the Compensation Committee
⁴Member of the Corporate Governance Committee
⁵Member of the Corporate Finance and Development Committee

MANAGEMENT

Marc Paquin
President and Chief Executive Officer

Christian Hours, Ph.D.
Vice President and Chief Technology Officer

Lyne Paré, CA
Director, Finance and Administration

Gilles Lemieux, B.A.A., LL.L.
Secretary

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1 Place Ville-Marie, Suite 2400
Montreal, Quebec H3B 3M9

LEGAL COUNSEL

Heenan Blaikie
1250 René-Lévesque Blvd. West, Suite 2500
Montreal, Quebec H3B 4Y1

TRANSFER AGENT AND SHARE REGISTRAR

National Bank Trust Inc.
1100 University St., 9th Floor
Montreal, Quebec H3B 2G7

ANNUAL GENERAL AND SPECIAL MEETING OF SHAREHOLDERS

April 22, 2004, at 9:30 a.m.
Montreal Stock Exchange
La Tour de la Bourse, 4th floor
800 Square Victoria
Montreal, Quebec

STOCK INFORMATION

The shares of Haemacure Corporation are listed on the TSX under the ticker symbol HAE. Total number of outstanding shares on October 31, 2003 was 28,400,917.

Those wishing to obtain a copy of the Annual Information Form deposited with the Commission des valeurs mobilières du Québec are invited to write to the corporate head office of Haemacure Corporation at 2001 University St., Suite 430, Montreal, Quebec H3A 2A6 or to fax requests to (514) 282-3358 or to send an e-mail to glemieux@haemacure.ca. Up-to-date information – including quarterly financial news releases and filings – is accessible on the Internet at: www.haemacure.com.

Ce rapport annuel est également disponible en français.

