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## Management's Discussion & Analysis of Financial Condition and Results of Operations

[All amounts following are unaudited and expressed in Canadian dollars unless otherwise indicated.]

This discussion and analysis covers our unaudited interim consolidated financial statements for the three and twelve month periods ended September 30, 2003 prepared in accordance with Canadian generally accepted accounting principles. See note 12 of the unaudited interim consolidated financial statements for a reconciliation to United States generally accepted accounting principles. It provides an update to the discussion and analysis contained in our Annual Report for the year ended September 30, 2002. This discussion and analysis should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section and the annual consolidated financial statements contained in our 2002 Annual Report.

On September 9, 2003, the Company announced its intention to change its fiscal year end from September 30 to December 31, effective as of December 31, 2003. For the transition year, the Company will report its annual consolidated financial statements for the fifteen month period ended December 31, 2003. Accordingly, these consolidated financial statements for the twelve month period ended September 30, 2003 represent interim financial statements.

### Critical Accounting Policies

The following critical accounting policies are in addition to our critical accounting policies disclosed in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section and the annual consolidated financial statements contained in our 2002 Annual Report.

#### *Goodwill*

We test goodwill for possible impairment annually and at any other time if an event occurs or circumstances change that would more likely than not reduce fair value of a reporting unit below its carrying value. Circumstances that could trigger an impairment include adverse changes in legal or regulatory matters, technological advances, decreases in anticipated demand and unanticipated competition. An impairment in goodwill would result in a charge to earnings.

#### *Product sales*

We recognize product sales revenue when the product is shipped to the customer provided we have not retained any significant risks of ownership or future obligations with respect to the product shipped. Revenue from product sales is recognized net of provisions for product sales subject to returns and allowances. These provisions are established in the same period as the related product sales are recorded and are based on estimates. A significant change in this estimate could have a material impact on our earnings.

### Changes in Accounting Policies

#### *Stock-Based Compensation and Other Stock-Based Payments*

Effective October 1, 2002, we adopted the recommendations of the new Canadian Institute of Chartered Accountants ("CICA") Handbook section 3870, Stock-Based Compensation and Other Stock-Based Payments. The standard encourages the use of a fair value based method for all other awards granted to employees, but only requires the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets. Awards that a company has the ability to settle in stock are recorded as equity, whereas awards that the entity is required to or has a practice of settling in cash are recorded as liabilities. The recommendations have been applied prospectively for all stock-based payments granted to non-employees on or after October 1, 2002. No compensation is recognized for stock options granted to employees and directors. We have adopted the disclosure only provision for stock options granted to employees and directors and consequently have disclosed the pro forma effects to the loss for the period and loss per share for the period as if the fair value method had been used as of the grant date. The adoption of this new recommendation had no impact on the interim unaudited consolidated financial statements.

#### *Goodwill and Other Intangible Assets*

Effective October 1, 2002, we adopted the Canadian Institute of Chartered Accountants new Handbook Section 3062 and the Financial Accounting Standards Board similar standard (SFAS 142), both entitled Goodwill and Other Intangible Assets. Goodwill and indefinite life intangible assets are no longer amortized but are tested for impairment at least annually. Intangible assets with finite lives acquired in a business combination, or other transaction, are to be amortized based on their estimated useful lives. As at October 1, 2002, there was no recorded goodwill and we determined that our intangible assets have finite lives and will continue to be amortized over their estimated useful lives. The adoption of Section 3062 and SFAS 142 did not have any impact on our financial position and results of operations as at October 1, 2002.

Goodwill acquired in the January 31, 2003 business combination will be tested for possible impairment on an annual basis and at any other time if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Intangible assets acquired in the January 31, 2003 business combination that have finite lives will be amortized over their estimated useful lives.

### *Recent pronouncements*

In October 2003 the Accounting Standards Board ("AcSB") approved amendments to the CICA Handbook section 3870, Stock-Based Compensation and Other Stock-Based Payments, requiring the recognition of stock based compensation expenses for all employee stock-based compensation transactions to replace the current standard requiring either the accounting for, or disclosure of, the effect of employee stock-based compensation expense on earnings. This amendment is applicable for fiscal years beginning on or after January 1, 2004 with early adoption permitted. If the amendment is adopted prior to January 1, 2004, the change in policy can either be applied retroactively, with or without restatement of prior periods, or prospectively. The Company is currently evaluating the impact of this amendment on its financial position and results of operations and considering whether to adopt the provisions for the fiscal period ending December 31, 2003.

### **Acquisition**

On January 31, 2003, we completed the acquisition of all of the common shares of Cohesion Technologies, Inc. ("Cohesion") in an all stock transaction, for total consideration of approximately \$73.3 million (U.S. \$47.9 million). Cohesion has created a patent portfolio that includes approximately 75 issued U.S. patents and 10 patent applications pending in the U.S. This patent portfolio has a strong depth of proprietary technology in the fields of collagen compositions and hydrophilic polymers.

Located in Palo Alto, California, Cohesion is focused on developing and commercializing proprietary biomaterial products used by physicians to facilitate their performance of surgical procedures, including bioresorbable hemostatic materials and biosealants for tissue repair and regeneration. As a result of this acquisition we now have 2 FDA approved products and 3 products approved for commercial sale in non-U.S. major markets.

This acquisition was accounted for using the purchase method of accounting. The assets, liabilities, revenue and expenses of Cohesion have been included in the interim unaudited consolidated financial statements of the Company from January 31, 2003, the date of acquisition.

### **Stock Split**

On March 3, 2003, the shareholders authorized a 2 for 1 stock split of our common share capital. All loss per share amounts discussed in the Management Discussion and Analysis of Financial Condition and Results of Operations and all common shares, options and per share amounts disclosed in the interim unaudited consolidated financial statements have been retroactively adjusted to give effect to the stock split.

### **License Agreement**

In April 2003, we finalized a Distribution and License Agreement and a Manufacturing and Supply Agreement with Baxter Healthcare Corporation ("Baxter"). These agreements give Baxter the right to manufacture and distribute the Company's surgical sealant product, CoSeal<sup>®</sup>, currently approved for sale in the U.S. and Europe, an option to license the Company's surgical anti-adhesive product, Adhibit<sup>™</sup>, which is not currently approved for sale in the U.S., and another product currently in development. We received an upfront fee of approximately \$11.6 million (U.S. \$8 million) in April 2003, of which approximately \$8.7 million (U.S. \$6 million) is not refundable and up to \$2.9 million (U.S. \$2 million) is refundable if we terminate the agreement, at our option, upon the failure of Baxter to achieve certain minimum sales and we elect to continue distributing the product. Our exposure to the potential refund expires at the end of 2006. We will receive up to a further \$5.4 million (U.S. \$4 million) upon the transfer of manufacturing of the CoSeal<sup>®</sup> product to Baxter, which is expected to be no later than September 2004, and up to an additional \$14.9 million (U.S. \$11 million) if Baxter exercises its option to license one other product and extend the exclusive distribution rights for two current products. Until manufacturing of CoSeal<sup>®</sup> is transferred to Baxter, we will manufacture CoSeal<sup>®</sup> for Baxter and receive a portion of the selling price to the third party customer. Thereafter, we will earn a percentage royalty. The agreements, or portions thereof, may be terminated by Baxter at any time, or by us if specified minimum sales are not achieved by Baxter. Unless otherwise terminated, the agreements expire upon the earlier of the expiration of the last issued patent or thirty years.

We recognize products sales to Baxter as revenue upon the sale of the product to the final customer once the final sales price is known. Until that time, the product transferred to Baxter is recorded at cost as deferred cost of goods sold. The non-refundable upfront payment of approximately \$8.7 million (U.S. \$6 million) is being recorded as revenue on a straight-line basis over the estimated period of 18 months to conclude the transfer of manufacturing to Baxter. The amount of \$2.9 million (U.S. \$2 million) that may be refundable, as well as the other payments due upon transfer of manufacturing and exercise of options will be recognized as revenue upon the lapse of the refundability period and upon exercise of the options, respectively. The amortization of the intangible asset related to CoSeal<sup>®</sup> is being amortized in proportion to the revenue earned.

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## Results of Operations

For the quarter ended September 30, 2003, we recorded a loss for the period of \$8.1 million (\$0.23 loss per share) compared to a loss for the same period in the prior year of \$1.9 million (\$0.06 loss per share). The loss for the twelve months ended September 30, 2003 was \$46.5 million (\$1.38 loss per share) compared to a loss of \$20.1 million (\$0.64 loss per share) during the same period in 2002.

The results of operations for the quarter were in line with our expectations. The loss for the quarter ended September 30, 2003 includes a foreign exchange loss of \$397,000 compared to a foreign exchange gain of \$4.4 million for the same period in the prior year. The loss for the twelve months ended September 30, 2003 includes a foreign exchange loss of \$14.9 million (\$0.44 loss per share) compared to a foreign exchange gain of \$629,000 (\$0.02 earnings per share) for the twelve month period ended September 30, 2002.

## Revenues

Revenue for the three and twelve month periods ended September 30, 2003 was \$5.9 million and \$14.3 million respectively compared to \$162,000 and \$7.3 million for the same periods in the prior year. Revenue for the three and twelve month periods ended September 30, 2003 includes \$2.5 million and \$7.7 million in product sales respectively, which is primarily from the sale of CoSeal® in the United States. As per the Distribution and License Agreement, Baxter began to sell the CoSeal® product in April 2003. We receive a percentage of the sales revenue for this product until the manufacturing process is transferred to Baxter.

License and research contract fee revenue for the current quarter was \$1.6 million, which consists of amortization of deferred revenue, compared to \$154,000 during the same period in the prior year. For the twelve months ended September 30, 2003, we recognized deferred revenue in the amount of \$4.3 million versus \$880,000 for the same period in the prior year. Revenue for the prior twelve month period included \$6.4 million in milestone payments from corporate partners. The increase in amortization of deferred revenue for the current quarter and year to date results from additional deferred revenue relating to Cohesion's license, marketing and distribution agreements with Baxter, U.S. Surgical and Tyco Healthcare Group. We received an upfront license fee of approximately \$11.6 million (U.S. \$8 million) in April 2003 from Baxter of which \$1.4 million and \$2.8 million has been recognized as revenue respectively in the three and twelve month periods ended September 30, 2003.

Royalty income from our collaborators under the drug-coated stent co-exclusive license was \$1.8 million in the current quarter and \$2.2 million for the twelve months ending September 30, 2003 (nil in the prior period). Included in the royalty revenue for the quarter is \$894,000 of the deferred sales milestone received from Boston Scientific in May, 2003. The remaining deferred sales milestone of \$5.4 million will be recorded as revenue over approximately the next nine months as it will be creditable against future royalty revenue. Royalty income is expected to increase throughout the remainder of the year. However, as commercial sales have just recently begun in Europe and other world markets (not including the U.S.), we are not able to estimate future royalty amounts.

## Expenditures

### *Cost of goods sold*

Cost of goods sold, relating to the Cohesion products, as a percentage of product sales, was approximately 87% for the three month period ended September 30, 2003 and approximately 63% for the twelve month period ended September 30, 2003. Cost of goods sold represents costs for the sale of the Cohesion products from the acquisition date of January 31, 2003. Our lower gross margins achieved in the fourth quarter are primarily due to the transfer of the sales, marketing and distribution rights of the CoSeal® product to Baxter resulting in a portion of the product revenue remaining with Baxter. Also, during the fourth quarter a change in the packaging requirements for the CoSeal® product resulted in additional one time manufacturing costs.

### *Research and development*

Research and development expenditures consist primarily of costs associated with pre-clinical testing and clinical trials of our product candidates as well as post approval product costs. We track expenditures by these three categories and by the type of cost incurred.

For the quarters ended September 30, 2003 and 2002, approximately 37% and 77%, respectively, of our research and development expenditures were spent in preclinical research and development projects, 47% and 23%, respectively, were spent on clinical development programs and 16% and nil, respectively, were spent on post approval programs. The decrease in preclinical research and development expenditures is a result of an increased number of projects moving into clinical trials compared to the same period in the prior year. The increase in clinical development program expenditures is primarily due to the advancement into the clinic of the Adhibit™ anti-adhesion programs, license and milestone payments related to the drug-coated stent program and initiation of the perivascular wrap clinical trial. The increase in post approval programs relates to Cohesion's approved products and continuing work for regulatory requirements.

For the quarter ended September 30, 2003, research and development expenditures increased by \$2.6 million over the comparative period to \$5.0 million. This increase is partially due to the inclusion of the Cohesion research and development expenditures for the quarter of \$1.5 million which consist primarily of salaries and clinical trial expenditures on the Adhibit™ and CoSeal® Lung clinical programs. The remainder of the increase relates to license and royalty payments of \$1.1 million in the current quarter, which are due to our licensors based on net royalty revenue received for the period.

Research and development costs for the twelve month period ended September 30, 2003 decreased by 4% to \$15.6 million. The decrease is due to the discontinuation of the secondary progressive multiple sclerosis clinical trial program in the comparative prior period (\$3.3 million), decrease in payments of milestones and royalty fees due to licensors upon receipt of milestone payments (\$1.5 million), salaries and benefits due to the retirement of senior officers in the prior year and reduction in the number of employees in the clinical department (\$790,000) and patent costs (\$391,000). The decrease was partially offset by an increase in laboratory supplies and preclinical expenditures (\$453,000), operating and occupancy costs (\$595,000) and by the research and development costs included for Cohesion (\$4.3 million).

We expect to continue incurring substantial research and development expenses in the near future due to the continuation and expansion of research and development programs for drug coating of medical devices and implants; potential technology in-licensing and regulatory related expenses; preclinical and clinical testing of various products under development; and the continued clinical studies for the perivascular wrap, pulmonary sealants, adhesion prevention gel, severe psoriasis and rheumatoid arthritis programs. We believe that research and development expenses for the remainder of fiscal 2003 will increase mainly due to the advancement into the clinic of our perivascular wrap program, other indications for CoSeal® and Adhibit™, and research and development on new potential products. There will also be incremental costs associated with hiring of additional research and development personnel to support the continued progress of our research and development programs.

#### *Selling, general and administrative expenses*

The \$48,000 decrease in selling, general and administrative expenses for the current quarter compared to the prior period is primarily due to a decrease in professional fees of \$1.0 million net of the inclusion of Cohesion's selling, general and administrative costs of \$970,000 for the quarter. Professional fees were higher in the prior year's quarter due to merger and acquisition related fees, corporate legal fees and corporate tax planning. Other changes included a decrease in non-Cohesion general and administrative salaries and benefits (\$263,000) and increases in operating costs (\$174,000) and occupancy costs (\$92,000). The decrease in non-Cohesion general and administrative salaries is due to the retirement allowance paid to a retiring senior executive in September 2002.

Selling, general and administrative expenses for the twelve month period ended September 30, 2003 increased by \$6.1 million compared to the same period in 2002. The increase is primarily due to the inclusion of Cohesion's selling, general and administrative costs of \$6.7 million net of a \$2.3 million decrease in professional fees. The Cohesion related costs include \$3.7 million in sales and marketing expenditures which were incurred prior to the elimination of the sales and marketing work-force in April 2003. Additional increases include operating costs (\$845,000), occupancy costs (\$451,000) and non-Cohesion salaries and benefits (\$351,000). These increases are a result of costs related to Director and Officer insurance premiums, personnel costs, costs to support our increased business development and corporate activities, and costs related to the occupancy of our new leasehold facility.

Selling, general and administrative expenses arising from the Cohesion acquisition have continued to decrease quarterly as a result of entering into the Distribution and License Agreement with Baxter. This agreement resulted in the elimination of the sales and marketing work-force and the reduction in the number of employees in the general and administrative department. We do not expect significant increases in selling, general and administrative costs for the remainder of fiscal 2003, however, general and administrative expenditures could fluctuate significantly depending on any potential acquisition and in-licensing transactions that we undertake during fiscal 2003.

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## *Amortization*

Amortization expense increased by \$2.1 million to \$2.9 million for the quarter ended September 30, 2003 compared to \$800,000 for the same period in the prior year. For the twelve month period ended September 30, 2003 amortization expense increased to \$9.0 million compared to \$3.1 million in the comparable period in the prior year. The increase for both periods primarily relates to amortization of the identifiable intangible assets acquired from Cohesion in the amount of \$1.8 million for the current quarter and \$4.8 million for the twelve month period ending September 30, 2003. The amortization of the intangible asset related to CoSeal<sup>®</sup> is being amortized in proportion to the revenue earned from the Baxter license agreement, resulting in an acceleration of amortization expense on the CoSeal<sup>®</sup> intangible asset. The remaining increase is a result of the additional amortization on the leasehold improvements and furniture and equipment acquired in 2002. We believe that amortization expense for fiscal 2003 will increase over that of fiscal 2002 due to the amortization of capital asset and intangible asset additions incurred in fiscal 2002 and 2003.

## *Segment Reporting*

We operate in three segments: medical device coatings/implants, therapeutics and non-drug loaded biomaterials. The non-drug loaded biomaterials segment was a result of the acquisition of Cohesion. Segment costs are based on actual research and development costs incurred directly for the segment and an allocation of general and administration costs based on estimated usage as reflected by the amount of research and development expenditures incurred. Our research and development expenditures are derived from our preclinical programs in our medical device coatings/implants and non-drug loaded biomaterials segments and our clinical programs for severe psoriasis and rheumatoid arthritis in our therapeutics segment and our pulmonary sealant study and adhesion prevention gel in our non-drug loaded biomaterials segment.

The discussion of the overall results of operations for the three month and twelve month periods ended September 30, 2003 and September 30, 2002, as described above can be summarized by our segments as detailed below.

The loss for the three month period ended September 30, 2003 for medical device coatings/implants increased to \$3.3 million from \$2.5 million compared to the same period in the prior year. This increase in the loss for the period was net of an increase in segment revenues of \$1.8 million from the drug-coated stent royalties. The increase in the loss was primarily a result of continued focus of our research and development efforts on this segment and the related expenditures. Additional expenditures included the license and royalty payments to licensors based on net royalty revenue received during the period. The increase in the twelve month loss to \$14.5 million versus \$7.1 million for the same period in the prior year is primarily due to the reduction in milestone revenue (\$4.5 million) relating to the drug-coated stent product received in the prior period. There was also an increase in our preclinical research and development activities and a corresponding increase in the allocated general and administration costs.

The loss for therapeutics for the three month period ended September 30, 2003, decreased from \$1.3 million to \$886,000 compared to the same period in the previous year mainly due to the discontinuation of our secondary progressive multiple sclerosis program during fiscal 2002. This also resulted in a lower allocation of general and administration expenses. The loss for the twelve month period ended September 30, 2003 decreased from \$10.7 million to \$3.7 million in the current year and was also due to the discontinuation of the multiple sclerosis program.

The loss for biomaterial products for the three and twelve month periods ended September 30, 2003 is related to the sale of approved products, research and development activities, the pulmonary sealant and adhesion prevention gel clinical study activities of Cohesion.

The decrease in non allocable corporate expenses from \$3.2 million to \$1.3 million in the current quarter reflects the decrease of the proportion of total expenditures associated with general and administration activities.

### Investment and Other Income

A net foreign exchange loss of \$397,000 was recorded during the quarter ended September 30, 2003 as compared to a net foreign exchange gain of \$4.4 million for the same period in 2002. The net foreign exchange loss was attributable to the effect of the strengthening Canadian dollar (in comparison to the U.S. dollar) on our U.S. dollar investment portfolio. The U.S. dollar exchange rate decreased from 1.355 to 1.350 during the current quarter, compared to an increase from 1.519 to 1.589 for the same quarter in the prior year. The net foreign exchange loss of \$397,000 included a realized gain on short-term investments that matured during the quarter and an unrealized loss on U.S. dollar-denominated short-term investments held at September 30, 2003 of approximately \$583,000. The increase in the Canadian dollar (in comparison to the U.S. dollar) from 1.589 to 1.350 for the twelve month period ended September 30, 2003 resulted in a net foreign exchange loss of \$14.9 million compared to a net foreign exchange gain of \$629,000 in the same period in the prior year. We maintain U.S. dollar cash and cash equivalents and short term investments to meet our anticipated U.S. dollar operating and capital expenditures in future periods.

Investment and other income decreased by 24% to \$515,000 for the current quarter compared to \$682,000 in the same period in 2002. This decrease is primarily due to the decline in U.S. market yields available on short-term investments, declining to an average investment yield of 1.4% for the quarter ended September 30, 2003 from 2.56% for the same period in 2002, together with a decrease in the balance of cash and cash equivalents and short-term investments. For the twelve month period ended September 30, 2003, investment and other income decreased to \$2.0 million from \$3.5 million in the prior year also due to decreased U.S. investment yields and a lower investment base.

### Liquidity and Capital Resources

At September 30, 2003 we had working capital of approximately \$113.2 million and cash resources, comprising cash and cash equivalents and short-term investments, in the amount of \$124.8 million. In aggregate, our cash resources decreased by \$11.6 million from \$136.4 million at September 30, 2002.

We have retained approximately 80% of the funds raised in our initial U.S. public offering in March 2000. These U.S. denominated funds are retained in their original currency to be used for future U.S. denominated operating and capital expenditures. As a result of this strategy, our U.S. denominated short-term investments and cash assets give rise to reported foreign exchange gains and losses due to period end translation to Canadian dollars for our reporting currency. As such, the foreign exchange gains and losses are only realized when there is actual conversion of these U.S. denominated assets to our reporting currency, such as settlement of Canadian denominated expenditures. At September 30, 2003 we had approximately \$96 million (U.S. \$71 million) of our cash and cash equivalents and short term investments denominated in U.S. currency which will be used to meet our anticipated U.S. dollar expenditures in future periods, compared to approximately \$104.1 million (U.S. \$65.6 million) at September 30, 2002.

The increase in the foreign exchange loss for the current twelve month period is directly related to the wider spread in the strengthening Canadian dollar currency on its U.S. counterpart (an increase from 1.589 to 1.350). This decrease in the U.S. dollar rate against the Canadian dollar rate, applied to the average balance of U.S. dollar denominated assets accounts for our reported foreign exchange loss for the period. The increasing strength in the Canadian dollar currency against its U.S. counterpart is subject to the current economic and political climates that we cannot control. We do not use derivatives to hedge against exposures to foreign currency, interest rate and other market risks arising from our balance sheet financial instruments because our future operating and capital expenditures are anticipated to be largely in US denominated currency.

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Cash used in operating activities was \$5.8 million during the current quarter compared to cash used of \$4.8 million for the same period in the prior year. The increase in cash used primarily reflects the increase in the loss for the current quarter. The cash impact of the loss for the quarter, after adjustments for items not involving cash and excluding the change in non-cash working capital, was \$6.8 million compared to \$4.6 million in the same period in the prior year, an increase in the use of cash of \$2.2 million. Net changes in non-cash working capital items provided cash of \$1.0 million in the current quarter compared to cash used of \$155,000 for the quarter ended September 30, 2002. The change in non-cash working capital items primarily reflects the increase of accounts payable and accrued liabilities during the quarter net of increases in inventory and deferred cost of goods sold balances held at September 30, 2003. For the twelve month period ending September 30, 2003 the cash used in operating activities increased by \$8.4 million compared to the same period in the prior year. The increase in cash used for this period was due to the use of cash for non-cash working capital items of \$8.6 million, which primarily consisted of payment of accounts payable and accrued liabilities and the increase in inventory and deferred cost of goods sold balances.

Cash provided by investing activities increased by \$13.0 million for the quarter ended September 30, 2003 compared to the same period in the prior year. Proceeds on maturing short-term investments, net of purchases, were \$13.0 million and \$1.0 million for the quarters ended September 30, 2003 and 2002 respectively. For both quarters, the increase in net proceeds was a result of re-investing maturing short-term investments for less than 90 days, resulting in a change in the balance sheet classification to cash and cash equivalents. For the twelve month periods ended September 30, 2003 and 2002, net cash provided by investing activities was \$30.4 million and \$24.0 million respectively primarily due to proceeds on maturing short-term investments that were re-invested with less than 90 day terms due to the yields available in the market place at that time.

Capital asset additions for the current quarter were \$437,000 compared to \$3.0 million for the same period in the prior year. Additions to capital assets of \$4.3 million for the twelve month period ending September 30, 2003 includes the final payments on leasehold improvements, office furniture and equipment for our new leased facility, which we commenced leasing on October 1, 2002. The leasehold improvements were offset by a tenant allowance of \$715,000. Cash used for long term investments was primarily a result of exercising 1,000,000 warrants of NeuColl, Inc, for a cost of \$704,000 (U.S.\$500,000) The exercise of these

warrants increased our equity interest in NeuColl, Inc. (which resulted from the Cohesion acquisition) to 46.6%. At the date of acquisition we did not allocate any value to this equity investment as previous years equity losses had reduced the investment value to nil. The cost of medical technologies for the twelve months ended September 30, 2003 of \$2.4 million represents the payment of the amount included in accounts payable and accrued liabilities at September 2002, which was due to certain licensors upon the European CE Mark approval of our drug-coated stent technology. Common shares were issued as consideration for the net assets, intangible assets and goodwill acquired from Cohesion resulting in minimal cash outlay upon the acquisition.

Net cash provided by financing activities for the three and twelve month periods ended September 30, 2003 and 2002 was primarily a result of proceeds received from the issuance of our common shares on the exercise of stock options through ours and Cohesion's Employee Stock Option Plans.

At September 30, 2003, as a result of the acquisition of Cohesion, we had a capital lease obligation of \$1,453,000 which expires in August 2004. With respect to this capital lease obligation we are required to maintain and segregate cash approximating \$1,868,000 which is reflected as current restricted cash.

We are exposed to market risks related to changes in interest and foreign currency exchange rates. At the end of the quarter, we had an investment portfolio consisting of high grade securities with maturity dates not exceeding nine months, selected based on the expected timing of expenditures for continuing operations and prevailing interest rates. We have not entered into any forward currency contracts or other financial derivatives to hedge foreign exchange risk. We are subject to foreign exchange rate changes that could have a material effect on future operating results or cash flows. We do not believe that our results of operations or cash flows would be affected to any significant degree by a sudden change in market interest rates relative to our investment portfolio, due to the short-term nature of our investments.

## **Risks Related to Our Business**

One of our partners, Boston Scientific, is involved in several legal proceedings concerning challenges to its stent business and expects that it will be involved in additional legal proceedings in the future. Current material litigation proceedings relate to the stent design, Express2™, used in Boston Scientific's version of our lead product. That stent design has been alleged to infringe patent rights held by Cordis Corporation, a subsidiary of Johnson & Johnson Inc. Cordis is seeking

preliminary and permanent injunctions to prohibit Boston Scientific from making, using, selling, offering for sale or importing the Express2™ stent into the United States. If Cordis is successful in obtaining an injunction, we and our partner, Boston Scientific, would not be able to commercialize the paclitaxel-eluting coronary stent in the United States until the relevant patent expires, unless the injunction is lifted or we or one of our partners are able to complete clinical trials for a version of the product using another stent design that does not infringe Cordis' patent. As a result, if Cordis obtains an injunction, commercialization of our lead product would likely be significantly delayed. While we are not named as a party in the Cordis lawsuit or injunction, our ability to successfully commercialize our lead product depends on Boston Scientific's ability to sell its Express2™ stent in the United States.

#### **Subsequent Event**

##### *Public Offering*

In October 2003, we completed a public offering of 5,750,000 common shares at a price of \$59.01 per share (US \$43.75 per share) for gross proceeds of \$339 million (US \$252 million). Our total net proceeds amounted to \$321 million (US \$238 million) after underwriting discounts and commissions, and other expenses. The proceeds of the offering are expected to be used to fund our clinical studies, research and product development, working capital and general corporate purposes, including acquisitions.

##### *Acquisition*

On November 14, 2003, we entered into an agreement and plan of merger to acquire all of the outstanding shares of STS Biopolymer, Inc. ("STS") for cash consideration of approximately US \$23 million. STS is a privately owned company located in Henrietta, New York, specializing in the development and manufacture of state-of-the-art biocompatible coatings for medical devices. The cash consideration will be used to pay down existing third party debt of STS and the remainder paid to the shareholders of STS. The transaction is expected to close by the end of December 2003 and is subject to the approval of STS's shareholders as well as other customary closing conditions. The acquisition will be accounted for using the purchase method of accounting.

#### **Forward-Looking Statements and Cautionary Factors That May Affect Future Results**

Statements contained herein that are not based on historical fact, including without limitation statements containing the words "believes," "may," "plans," "will," "estimate," "continue," "anticipates," "intends,"

"expects" and similar expressions, constitute "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995.

Statements regarding the transaction between us and Cohesion, future financial and operating results, benefits and synergies of the transaction, future opportunities for the combined company, discovery and development of products, potential acquisitions, strategic alliances and intellectual property, and any other statements about our or Cohesion managements' future expectations, beliefs, goals, plans or prospects should also be considered to be forward-looking statements.

Statements in this press release regarding the proposed transaction between us and STS, the expected timetable for completing the transaction, future financial and operating results, benefits and synergies of the transaction, future opportunities for the combined company, discovery and development of products, potential acquisitions, strategic alliances and intellectual property, and any other statements about our or STS managements' future expectations, beliefs, goals, plans or prospects should also be considered to be forward-looking statements.

Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, events or developments to be materially different from any future results, events or developments expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions, both nationally and in the regions in which we operate; technology changes; competition; changes in business strategy or development plans; the ability to attract and retain qualified personnel; existing governmental regulations and changes in, or the failure to comply with, governmental regulations; adverse results in drug discovery and clinical development processes; failure to obtain patent protection for discoveries; commercialization limitations imposed by patents owned or controlled by third parties; dependence upon strategic alliance partners to develop and commercialize products and services based on our work; patents liability and other claims asserted against us; the requirement for substantial funding to conduct research and development and to expand commercialization activities; other factors referenced in our filings with the Securities and Exchange Commission; and any other factors that may affect performance.

Risks and uncertainties related to economic and industry factors as discussed in detail in the "Management's Discussion and Analysis of Financial Conditions and Results of Operations" section of our 2002 Annual Report remain substantially unchanged.