

MANAGEMENT'S  
DISCUSSION AND ANALYSIS  
(Amended)

Annual Report  
September 30, 2006



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## AMENDED MANAGEMENT'S DISCUSSION AND ANALYSIS

*The annual consolidated financial statements of CV Technologies Inc. (the Company) are prepared in accordance with Canadian generally accepted accounting principles (GAAP). All references to GAAP refer to Canadian generally accepted accounting principles. These accounting principles require the Company to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. Management believes that the estimates and assumptions, which it relies upon, are reasonably based on information available at the time that these estimates and assumptions were made. These estimates and assumptions have been discussed with the Audit Committee of the Board of Directors of CV Technologies Inc. Actual results may differ under different assumptions and conditions. The following information should be read in conjunction with the restated audited consolidated financial statements for the year ended September 30, 2006 and accompanying notes. All amounts are expressed in Canadian dollars, unless specified otherwise. Additional information is available at [www.sedar.com](http://www.sedar.com).*

*This discussion and analysis for the twelve month period ended September 30, 2006 is prepared and contains disclosure of material changes occurring up to and including June 14, 2007.*

### **Forward-looking Statements**

*Management's discussion and analysis (MD&A) contains certain forward-looking information and statements within the meaning of applicable securities laws. The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information or statements including, without limitation: those comments predicting the timing and/or initiation of clinical trials, clinical trial results, and associated regulatory clearances, financing and acceptance of COLD-fx<sup>®</sup> in the marketplace. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking statements. In addition to the risks outlined in the Risks and Uncertainties section, this MD&A contains forward-looking information and statements pertaining to the following: the impact of competition; consumer confidence and spending levels; general economic conditions; interest and currency exchange rates; unseasonable weather patterns; the cost and availability of capital; the cost and availability of grants/funding; and product development. The Company believes that expectations and assumptions reflected in the forward-looking information and statements contained herein are reasonable but no assurance can be given that these expectations and assumptions are correct and that the results, performance or achievements expressed in, or implied by, forward-looking statements within this disclosure will occur, or if they do, that any benefits may be derived from them. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.*

*The forward-looking information and statements contained in this MD&A speak only as at the date of this MD&A, and none of the Company or its subsidiaries assumes any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.*

### **Restatement of Financial Results**

*As disclosed in the Company's financial statements, the Company has restated its previously reported consolidated financial statements for the year ended September 30, 2006. The restatement of the Company's consolidated financial statements followed an internal review of the Company's consolidated financial statements and its revenue recognition policy as it related to product returns in the U.S.*



*In the fourth quarter of 2006, the Company entered the U.S. market and recognized revenue with the revenue recognition criteria described in the notes to the consolidated financial statements. Given that the U.S. was a new market and COLD-fX<sup>®</sup> was a new product for this market, the Company has now realized that in an absence of history of returns, the criteria to recognize revenue was not met. The appropriate application of the revenue recognition policy would have prevented the recognition of such revenues until the right of return had expired. Analysis of the Company's revenue recognition policy followed the determination of slower than anticipated consumer product purchases which indicated greater than anticipated risk of product return. Prior to this restatement, the Company recorded revenue from the U.S. with estimates for product returns. However, subsequent experience has now indicated that there was significant uncertainty in estimating product returns from this new market. This uncertainty should have precluded the recognition of revenue until the risk of returns was substantially eliminated.*

*The Board of Directors determined that restatement of the Company's consolidated financial statements and the appropriate application of its revenue recognition policy was warranted to correct the effects of this policy application oversight, to ensure consistency with GAAP, and to correct an overstatement of U.S. product sales. The effect of the restatement, including the identification and correction of related misstatements in the previously issued consolidated financial statements, are reflected in the Company's restated consolidated financial statements and accompanying notes.*

*The appropriate application of the revenue recognition policy also affected the Company's policy on the translation of foreign currencies. Given the effects of the restatement and the change in the financial condition of its wholly owned subsidiaries, the Company has re-evaluated its classification of its foreign subsidiaries as self-sustaining. The Company concluded that COLD-fX Pharmaceuticals (USA) Inc. and fX Life Sciences International GmbH should have been classified as integrated rather than self-sustaining foreign operations. The translation of these subsidiaries, which operate in US dollars, has been amended from the current rate method to the temporal method.*

*The total cumulative impact of the restatement of the financial statements for the fiscal year ended September 30, 2006 was to decrease shareholders' equity by \$3.4 million. The cumulative impact on shareholders' equity as at September 30, 2006 was primarily the result of a reversal of \$5.6 million in net revenue recognized on U.S. shipments, which resulted in a decrease of net earnings by \$3.5 million. Total assets decreased by \$1.2 million and total liabilities increased by \$2.2 million.*

*This Management's Discussion and Analysis has been amended to reflect the effect of the above corrections to the previously filed Management's Discussion and Analysis for the fiscal year ended September 30, 2006.*



## Company Overview

CV Technologies Inc. (TSX: CVO) is a life sciences and technology company, founded in 1992 and headquartered in Edmonton, Alberta, Canada. The Company has developed, commercialized and patented a proprietary technology, known as ChemBioPrint, which is used to discover and biologically standardize natural products that deliver consistent, verifiable and provable health benefits. In 2003, the Company shifted from research and development to product commercialization. Using the ChemBioPrint discovery and standardization platform, the Company's scientists are able to identify precisely the chemical profile and biological activity of natural products. The process involves a combination of chemical and biological fingerprinting ensuring the creation and scientific substantiation of its natural health products to be safe, effective and consistent. The Company is committed to using a pharmaceutical model (rigorous drug discovery and testing methods) to develop natural therapeutics for health maintenance and disease prevention. Its efforts in scientific research and product innovation are key factors enabling the Company to secure the trust of consumers, trade professionals, healthcare practitioners and government.

The Company's lead product, COLD-fx<sup>®</sup>, is designed to aid in the prevention and relief of colds and flu by strengthening the immune system. In February 2007, Health Canada issued a Natural Product Number (NPN) for COLD-fx<sup>®</sup> with the claim it "helps reduce the frequency, severity and duration of cold and flu symptoms by boosting the immune system". A U.S. Food and Drug Administration (FDA) regulated Phase II Clinical Trial showed COLD-fx<sup>®</sup> reduces the risk of getting a lab-confirmed influenza and respiratory syncytial virus (RSV) infection in a nursing home senior population by 89%. A Canadian trial in the general population, which was reported in the Canadian Medical Association Journal October 2005, showed COLD-fx<sup>®</sup> reduced the average number of infections per person by 25% and reduced the number of recurrent infections by 56%. Severity was reduced by 31% and duration was reduced by 35%. All the Company's products are designed to support normal physiological/body functions with a user-friendly, natural formula. Utilizing its patented ChemBioPrint technology, the Company has developed and commercialized a selection of premium quality natural health products for health maintenance and disease prevention.

The three principle commercial products are:

- COLD-fx<sup>®</sup>                      Helps reduce the frequency, severity and duration of cold and flu symptoms by boosting the immune system
- REMEMBER-fx<sup>®</sup>              Helps enhance memory and mental alertness
- CELL-fx<sup>®</sup>                      Helps relieve symptoms of bone and joint pain and assists in the formation of connective tissue

While the Company has no current plans to market PRESSURE-fx<sup>®</sup> in Canada, it does have a distribution partner currently selling PRESSURE-fx<sup>®</sup> in the U.S. Management is contemplating the re-launch of AD-fx<sup>®</sup> and MENTA-fx<sup>®</sup> in 2008 for the Canadian market. No decision on a launch date has been reached at this time.



## Vision and Strategy

Over the next five years, the Company will endeavor to become the leader in preventative health care as indicated by the following:

- Further planning and development of Canadian, American and international markets
- Further increase of product and brand recognition
- Research and development of a healthy pipeline of products
- Launch of collaborative clinical trials and research and development to strengthen the science behind its products

CV Technologies Inc. expects to accomplish these goals through rigorous research and development, product awareness through marketing and public relations, scientific and professional education, emphasis on the science behind its products, collaboration with retail chains and distributors/wholesalers, commercialization of new products, cost management and profitability, satisfied customers, and strong product science to meet the highest levels of regulatory approval.

## Key Performance Indicators

Performance indicators of growth include:

- International and domestic sales
- Scientifically proven commercial products
- Regulatory approvals
- Consumer acceptance
- Unique, proprietary and patentable technologies and intellectual property such as ChemBioPrint
- Effective processes in building product awareness, brand management and strategic planning
- Ability to manage costs of production and supply chain
- Capacity and ability to develop new science-based products
- Effectively building organizational infrastructure, control systems and managing corporate culture

Specific issues that CV Technologies must manage include, but are not limited to, the following:

- Consumer acceptance and purchasing behaviors in new markets
- Regulatory approval of products, domestically and internationally
- Potential shortages of raw materials and corresponding fluctuations in the cost of materials
- Potential unplanned production downtime
- Potential product recalls or returns



## Highlights

- ✓ Net product sales increase of 29.9%
- ✓ Entry and distribution into U.S. market
- ✓ Approval of construction and financing of a new office headquarters and research centre, including a 10 year land lease for \$1 per year with an option to purchase at \$1.2 million by the end of the lease

## Results of Operations

### Profitability

Consolidated net earnings after tax were \$639 thousand compared to \$10.1 million for the prior year, a decrease of \$9.5 million from the previous year. Earnings before tax were \$4.1 million compared to \$8.5 million for the same period last year. The fourth quarter consolidated loss before income taxes was \$3.0 million compared to \$1.7 million profit for the same quarter last year, a decrease of \$4.7 million. The fourth quarter consolidated loss after income taxes was \$3.0 million compared to \$3.3 million profit for the same quarter last year, a decrease of \$6.3 million.

A reversal of U.S. net product sales of \$5.6 million, higher fixed operating costs, expenditures in planning, business development and higher cost of goods manufactured for the U.S. entry affected consolidated net earnings. These operating results reflected the necessary investments in distribution, marketing and business development expenditures incurred in preparation and execution of the launch of COLD-fX<sup>®</sup> into the U.S. market. The quarter was affected by the reversal of revenue recognition related to initial stocking of U.S. retailers and drug store chains.

In the fourth quarter of 2005, a \$1.6 million income tax recovery was recorded with increased certainty of utilization of loss carry forwards and Scientific Research and Experimental Development ("SR&ED") investment tax credits resulting in increased net earnings. For fiscal year 2006, the Company recognized a tax expense of \$3.5 million because of having utilized all of the prior year's loss carry forwards.

### Revenue

Net product sales for the year were \$41.4 million compared to \$31.9 million in fiscal year 2005 (29.9% increase). The Company reported net sales of \$8.3 million for the fourth quarter, exceeding the \$7.2 million in the same quarter of fiscal year 2005 by \$1.1 million (15.3%). Canadian net sales grew by \$1.1 million in the fourth quarter compared to the same quarter last year. Net sales of \$5.6 million previously recognized in shipments to stock U.S. retailers has been reversed until customer risk of return is substantially eliminated.

Despite a year of industry slow sales and softness in the cold and health supplements categories, the Company was able to increase its Canadian sales and maintain its leadership position within these categories.

Partnerships with the NHL and with legendary hockey player Mark Messier were developed to assist North American consumer awareness, trade marketing and public awareness initiatives. Messier joined the team as an official spokesperson in June 2006 to support U.S. and Canadian marketing and public relations efforts. He joins hockey commentator Don Cherry in the Company's brand building efforts.



Sales growth was accomplished through increasing sales volume of the Company's lead product COLD-fx<sup>®</sup>, national retail partnerships with major Canadian retailers, and sales of REMEMBER-fx<sup>®</sup> and CELL-fx<sup>®</sup>. The Company continued to focus on marketing and advertising of the Company's lead products and significant product awareness programs through mainstream media coverage and the education of healthcare professionals.

With the mild cold and flu season of the past year and predominately sporadic and localized outbreaks, management believes good progress was achieved in expanding Canadian sales through brand building. The Company continued to receive exposure on regional and national radio and TV, major daily newspapers, through word-of-mouth endorsements, and third party validation and publicity resulting from the success of its clinical trials. Expanded distribution channels and targeted advertising and merchandising have enhanced the Company's presence in the marketplace. The Canadian business experienced national and regional growth along with increased productivity with retail partners. Despite a soft year within the categories, demand for COLD-fx<sup>®</sup> continued to grow and opportunities exist for further business development across Canada, particularly in Ontario and Quebec.

Because of clinical data and strengthened credibility, this past year involved continued efforts in building awareness within the medical and professional segments along with investing in additional programs.

This past year in Canada, CELL-fx<sup>®</sup> and REMEMBER-fx<sup>®</sup> products received increased retail distribution and brand awareness to enhance consumer awareness and acceptance and advance category penetration. Marketing programs involved print, broadcast, trade and online support.

The fourth quarter represented a period of significant investment in staff, sales support, marketing, and infrastructure to support shipments and future growth in North America, and in particular the U.S. market.

Management established growth objectives for fiscal year 2006 in the areas of sales, distribution, and operations. The achievement of those objectives contributed to the 29.9% increase in annual net sales that occurred during a winter that saw a decline for the cough and cold category.

## Gross margin

Cost of goods sold increased from 24.3% to 32.1% of net product sales in fiscal years 2005 and 2006, respectively. Cost of goods sold increased from 28.2% to 49.2% of net product sales in the fourth quarters of fiscal years 2005 and 2006, respectively. Increased product costs were the result of enhanced merchandising, expanded use of off-shelf displays, establishing an expanded supply chain in the U.S. and increased transportation costs between various contract manufacturers.

Gross margin in the fourth quarter decreased from 71.8% in 2005 to 50.8% (21.0% difference) in the same quarter in fiscal year 2006. This decrease was attributed partially to incremental costs of approximately \$900 thousand, some of which were one-time investments, associated with the development and establishment of the supply chain and charges required to expedite manufacturing and shipments in the U.S. Cost of goods sold was further affected by increased usage of Point of Sales (POS) displays in the U.S. market and Canada.

Imports into the U.S. were subject to a duty that is being formally challenged. The effect of duty was minimal on gross margin as U.S. sales were nominal in the fourth quarter, but did increase the cost of inventory. As U.S. product sales occur, gross margin will be reduced by these duties.



The incremental and one-time costs associated with entry into the U.S. included listing fees for new retailers, transportation costs associated with initial movement of product between Canada and the U.S. as well as within each country, tooling and die charges unique to labels and display materials, quality assurance audit costs, manufacturing travel associated with vendor set up, and an initial run of labels which required write off and associated rework.

Distribution costs and quality control expenses increased with the inventory build-up in preparation for anticipated sales in Canada and the U.S. These costs are not part of inventory costing and valuation. In addition, increased transportation costs between manufacturing locations were also expensed as certain contracted manufacturers failed to meet production targets. The Company incurred additional costs to expedite work orders at Contract Manufacturing Organizations (CMO's) and secondary packagers. The Company's manufacturing management expanded to manage the increased logistics and manufacturing activities of third party contractors and service providers. Included in these labor costs were overtime costs within the manufacturing team. Gross margins were also reduced by larger sales discounts and allowances offered upon initial stocking and listing by U.S. retailers. Allowances in excess of the customer's sales were charged to advertising and marketing.

Late in fiscal year 2006, the Company established a separate U.S. supply chain through outsourcing. Supply of proprietary extract was further secured with the qualification of additional vendors. In Canada, additional packaging partners were qualified in Ontario and Quebec. The Company is continuing its efforts to balance supply channels and mitigate supply risk for raw materials and packaging manufacturers. The Company continues to focus on increased economies of scale, risk management, improved procurement and rigorous cost management, while investing in the development of new markets.

The capacity of the Company's supply chain for COLD-fx<sup>®</sup> continues to expand to meet increasing demand. The strategy to outsource production and logistical activities aims to reduce fixed costs and maximize production capacity and flexibility.

## Operating expenses

The operating costs percentage of sales has increased from 49.2% to 58.8% over the prior year. The Company made significant investments in planning and structuring for entry into the U.S. and other international markets. Ongoing activities in brand building and advertising to increase sales volumes also contributed to the increase in the cost-to-sales percentage.

Operating expenses for fiscal year 2006 were \$24.3 million as compared to \$15.7 million in the prior year.

This \$8.7 million (55.5%) increase in operating expenses over the prior year was primarily comprised of the following:

- Advertising and marketing expenses increased by \$2.9 million (56.2%) to support the 29.9% increase in Canadian net sales, and promotional and sales activities to enter the U.S. Continued efforts at brand building for COLD-fx<sup>®</sup>, REMEMBER-fx<sup>®</sup> and CELL-fx<sup>®</sup>, media investment and promotional activities are instrumental in developing and sustaining the North American business. This past year involved a combination of continued investment in brand building across Canada, including a special effort and focus on Quebec, and awareness and marketing programs associated with the U.S. launch. In fiscal year 2006, this spending was 19.7% of net product



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sales compared to 16.4% in fiscal year 2005. With the U.S. launch, the fourth quarter spending increased by \$1.8 million (2006 – 30.8%, 2005 - 10.6% of net sales in the same quarter).

- Contracting, consulting and professional fees increased by \$2.7 million (215%). In the fourth quarter, the Company continued to engage a number of contractors and professionals in sales, marketing, recruiting and regulatory affairs in execution of its plans to enter the U.S. Some of these expenditures were one-time, non-recurring consulting costs. Investments of approximately \$0.8 million were incurred in support of planning, development and execution of the U.S. strategy and international planning. Also included in these costs were ongoing contracts in support of sales, marketing, regulatory and financial services. In fiscal year 2006, these expenditures were 9.7% of net sales compared to 4.0% in fiscal year 2005. With the U.S. launch, the fourth quarter fees increased by \$1.4 million (2006 – 18.0%, 2005 – 0.8% of product sales in the same quarter).
- Salaries, benefits, and stock-based compensation increased by \$1.5 million (31.4%). Additional employees were hired in sales, operations, and administration, increasing wages by \$1.7 million (94.3%). The number of employees grew from 34 in September 2005 to 77 in September 2006. The quarter over quarter increase in salaries was \$913 thousand (204%). Salaries of research and development staff are classified under research and development within the income statement. The stock option expense decreased by \$0.2 million (7.7%). The stock option expense in fiscal year 2005 represented the vesting of all options granted after October 1, 2002 and before March 3, 2005 and the five year recognition of all subsequent options issued. The year to year decrease was offset by an additional grant of 335,000 options during the year and reduction in the estimate of the forfeiture rate.
- Administration, occupancy and insurance costs increased by \$0.7 million (57.9%). These costs were related to an increased number of employees to meet the demand in logistics, administration, operations and science and regulatory related activities. Increased rent and relocation of staff to a new location in the Edmonton Research Park contributed to the higher costs. Additional staff were also hired to prepare for entry into the U.S. market and offices were opened in the U.S. and Switzerland. Insurance costs also rose with the increase in sales and assets. These costs were 4.8% of net sales in fiscal year 2006 compared to 4.0% in fiscal year 2005.
- Clinical studies and research and development expenses for the year increased by \$0.7 million (38.5%) over last year. Costs were incurred in clinical research and development associated with ongoing studies. The Company is continuing its clinical trial in collaboration with Capital Health of Edmonton and the University of Alberta and commenced a multi-centre clinical trial involving senior citizens. These expenditures were 6.3% of net sales in fiscal year 2006 compared to 5.9% in fiscal year 2005. In the past twelve months, the Company expanded its research staff and capacity to develop new products, and manage intellectual property and regulatory environment requirements associated with its products.
- The balance of \$0.2 million involved various operating expenditures and activities

## Income taxes

CV Technologies' expansion strategy required an entity dedicated solely to international brand building, manufacturing and investing in research and development. fX Life Sciences GmbH (fX Life Sciences) was



incorporated in Zug, Switzerland. The selection of this location was based on various factors including reputation, regulatory credibility, political stability, proximity to other companies that have similar intellectual property and health products, as well as the reputation and proximity of possible partners or purchasers of its technology and other business considerations. The objectives of this approach included protection of the intellectual property (IP), branding and goodwill in Canada and provision of a more flexible model for distributing products internationally. Critical to this model, the parent company CV Technologies Inc. sold its international intellectual property rights (excluding Canada) to its subsidiary, fX Life Sciences in July 2006. This process involved establishing a price of \$16.2 million using a third party valuation.

The sale of the IP discussed above is eliminated upon consolidation, while the resulting Canadian taxes payable on the transaction (\$2.7 million) from the capital gain do not eliminate. The Company has classified this asset as a prepaid intra-group tax asset, which will be amortized over the life of the transferred asset. Under CICA section 3465.35 addressing intra-group transfers, taxes paid or recovered by the transferor should be recorded as an asset or liability in the consolidated statements until the gain or loss is recognized by the consolidated entity.

While Canadian earnings attracted tax, investments in U.S. market created a loss in foreign operations. Since the Company is taxed in the countries in which it operates, application of losses from one country against the taxable income of another country is not possible.

In the fourth quarter of 2005, a \$1.6 million income tax recovery was recorded with increased certainty of utilization of loss carry forwards and Scientific Research and Experimental Development ("SR&ED") expenditures resulting in increased net earnings. In fiscal year 2006, the Company recognized a tax expense of \$3.5 million after utilizing all of the prior year's loss carry forwards.

Stock compensation is also a cost that is not deductible in calculating taxable income in Canada.

### Research and development expenses

In October 2005, the Company initiated a multi-centre clinical trial involving healthy senior citizens in Edmonton, Toronto and Vancouver to test the effects of COLD-fX<sup>®</sup> on influenza and cold viral infections. The principal investigator is Edmonton's Medical Officer of Health, Dr. Gerald Predy. Additional investigators include internationally recognized influenza expert and Head of Geriatrics at the University of British Columbia and Providence Health Care, Dr. Janet McElhaney, as well as infectious disease expert Dr. Andrew Simor, Head of Microbiology at Sunnybrook and Women's College Health Sciences Centre in Toronto. Under a protocol amendment authorized by Health Canada, the Company is continuing this study over the winter of 2006/2007 and has added a fourth site in Halifax, led by Dr. Shelly McNeil, MD, Associate Professor of Internal Medicine at Dalhousie University. The Company decided to extend the trial an additional year due to low recruitment because of last year's mild winter.

The Company is also exploring opportunities to conduct post-market clinical research collaborations with leading U.S. medical organizations as part of its strategy to generate further scientific evidence and COLD-fX<sup>®</sup> awareness within the health care community.

The Company continues to review the potential of a Phase III clinical trial to support a U.S. Over-The-Counter (OTC) new drug cold and flu application.



In May 2006, the Company announced the results of a collaborative study with McGill University in Montreal investigating the effects of CVT-E002 (the active ingredient in COLD-FX<sup>®</sup>) in treating immune deficiency related cancers as part of its ongoing strategy to develop natural compounds for disease prevention and health maintenance. This study investigated the potential of CVT-E002 to ameliorate leukemia caused by viral infection. The positive results supported the hypothesis that CVT-E002 may have potential as a cancer therapy and may support the immune system during cancer treatment.

The study, launched in November 2004 and led by Dr. Sandra Miller, Professor, Department of Anatomy and Biology in the Faculty of Medicine at McGill University, was extended to gather further information on the mechanism of action of CVT-E002 in ameliorating viral-induced leukemia in a laboratory model. The study is continuing on schedule and further development of CVT-E002 for cancer-related indications is in the early planning stage. The first year of the study was funded in part by the National Research Council (NRC) under the Industrial Research Assistance Program (IRAP).

CV Technologies Inc. has a U.S. patent for formulation of therapeutic applications for preventative, immune-related indications, such as cold and flu infections, hepatitis, HIV, and primary and supportive cancer therapy.

IRAP has also recently decided to support a research program to elucidate further the mechanism of action of CVT-E002. As part of this program, the Company entered into a research contract with Dr. Kenneth Rosenthal, Professor and Director of Molecular Medicine in the Department of Pathology and Molecular Medicine at McMaster University in Hamilton, to investigate the ability of CVT-E002 to stimulate the innate immune responses via pattern recognition receptors. Previous immunologic studies indicated that CVT-E002 activates the innate immune system, including natural killer cells. Pattern recognition receptors are important for innate immune recognition. They play a key role in host defense against infection and have been recognized recently as an important target for discovery of treatments for infectious diseases and cancer treatments. This research will enable the Company to understand the detailed molecular and biochemical mechanism of action of CVT-E002 to further understand how it modulates the immune system and provides the clinical effects already demonstrated. Discussions to initiate additional projects under this program are underway with other research groups.

In February 2007, Health Canada's Natural Health Products Directorate issued a product licence and Natural Product Number (NPN) for COLD-FX<sup>®</sup> with a comprehensive claim it "helps reduce the frequency, severity and duration of cold and flu symptoms by boosting the immune system".

## U.S. Launch

On April 28, 2006, the Board approved management's strategy and plans to enter the U.S. selling COLD-FX<sup>®</sup> as a U.S. Food and Drug Administration (FDA) regulated New Dietary Ingredient (NDI). The Company continues to investigate the possibility of seeking FDA approval for the active ingredient of COLD-FX<sup>®</sup> as an over-the-counter (OTC) drug for the prevention or reduction of the risk of cold and flu by conducting Phase III clinical trials. This business decision will be made at a later date.

During the fourth quarter, the Company began its initial shipments to U.S. national accounts, representing a milestone in the Company's objectives of securing quality North American distribution through large retailers and pharmacies. Having a presence with several large retailers and drug store chains will help support this initiative. The expanded customer base will permit broad distribution and establish a presence allowing further product awareness and synergies for advertising and brand building in North America.



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U.S. product sales in the fourth quarter of fiscal year 2006 represent the estimated sell-through of product to consumers. Initial shipments to stock retailers were reversed until consumer uptake occurs or the risk of return is substantially eliminated. Customer payments received on account prior to year-end were recorded as customer deposits (liability) as retailers could request a refund on returned goods to rebalance their inventories with consumer sales. Product sales to U.S. consumers are expected to slow during the summer and increase at the end of the fiscal 2007 year. Customers have stocked their stores and consumer awareness and acceptance will ultimately determine future sales volumes and growth rates.

## Segmented Revenue

(in thousands)

	1 <sup>st</sup> Quarter Dec 31, 2005	2 <sup>nd</sup> Quarter Mar 31, 2006	3 <sup>rd</sup> Quarter Jun 30, 2006	4 <sup>th</sup> Quarter Sep 30, 2006 Restated	Fiscal Year 2006 Restated
Canada	18,939	10,873	3,242	8,282	41,336
U.S.	-	2	-	8	10
Other	1	40	-	-	41
Total	18,940	10,915	3,242	8,290	41,387
	1 <sup>st</sup> Quarter Dec 31, 2004	2 <sup>nd</sup> Quarter Mar 31, 2005	3 <sup>rd</sup> Quarter Jun 30, 2005	4 <sup>th</sup> Quarter Sep 30, 2005	Fiscal Year 2005
Canada	11,304	10,474	2,775	7,189	31,742
U.S.	-	3	61	-	64
Other	-	44	-	-	44
Total	11,304	10,521	2,836	7,189	31,850

Consolidated advertising expenditures in the fourth quarter were \$2.6 million (30.8%) of net product sales. Media and advertising expenses related to the U.S. were approximately \$1.3 million. The Company will report higher spending in the U.S. in the first quarter of 2007, and will reduce spending in the remainder of fiscal year 2007.

The large increase in advertising expenditures experienced was the result of efforts to build brand awareness of COLD-fX<sup>®</sup> through mass media channels, and to support a national launch by retailers in October in the U.S. The Company has fixed expenses under contract with the NHL, Mark Messier International and other commitments.

In fiscal 2007, when it was determined that the advertising and marketing expenditures were not generating the anticipated sales, the Company sharply reduced spending. The Company anticipates a continuation of marketing sponsorship, professional education, and promotion expenditures in a consistent and strategic manner for the remainder of 2007 fiscal year, with a reduction in media advertising expenditures. Expenditures in the first quarter will be significantly greater than sales. However, a reduction and alignment of marketing expenditures will take place in the last half of fiscal year 2007 as the Company implements a more disciplined approach to growth and controls. Part of that discipline will be demonstrated by a more targeted marketing plan, which is expected to involve alternative distribution channels other than mass retailers and more targeted communication channels to reach consumers.



# CV Technologies Inc.

Annual Report for the Twelve Month Period Ended

September 30, 2006

## Summary of Quarterly Results

(in thousands)

<b>Fiscal year 2006</b>	<b>1<sup>st</sup> Quarter Dec 31, 2005</b>	<b>2<sup>nd</sup> Quarter Mar 31, 2006</b>	<b>3<sup>rd</sup> Quarter Jun 30, 2006</b>	<b>4<sup>th</sup> Quarter Sep 30, 2006 Restated</b>	<b>Fiscal Year 2006 Restated</b>
Product sales	18,940	10,915	3,242	8,290	41,387
Gross margin	13,414	8,253	2,220	4,213	28,100
Gross margin %	70.8%	75.6%	68.5%	50.8%	67.9%
Earnings (loss) before tax	7,463	2,087	(2,428)	(2,982)	4,140
Earnings (loss) after tax	4,416	987	(1,772)	(2,992)	639
EPS – Basic	\$0.04	\$0.01	\$(0.02)	\$(0.02)	\$0.01
EPS – Diluted	\$0.04	\$0.01	\$(0.02)	\$(0.02)	\$0.01
Total assets	32,319	34,277	33,545	43,132	43,132
Total liabilities	7,458	7,331	7,737	19,607	19,607
<b>Fiscal year 2005</b>	<b>1<sup>st</sup> Quarter Dec 31, 2004</b>	<b>2<sup>nd</sup> Quarter Mar 31, 2005</b>	<b>3<sup>rd</sup> Quarter Jun 30, 2005</b>	<b>4<sup>th</sup> Quarter Sep 30, 2005</b>	<b>Fiscal Year 2005</b>
Product sales	11,304	10,521	2,836	7,189	31,850
Gross margin	8,355	8,352	2,250	5,162	24,119
Gross margin %	73.9%	79.4%	79.3%	71.8%	75.7%
Earnings (loss) before tax	4,196	3,081	(466)	1,725	8,536
Earnings (loss) after tax	4,196	3,081	(466)	3,282	10,093
EPS – Basic	\$0.05	\$0.03	\$(0.00)	\$0.02	\$0.10
EPS – Diluted	\$0.04	\$0.03	\$(0.00)	\$0.02	\$0.09
Total assets	13,819	17,762	17,909	23,717	23,717
Total liabilities	4,020	2,377	2,182	3,876	3,876
<b>Fiscal year 2004</b>	<b>1<sup>st</sup> Quarter Dec 31, 2003</b>	<b>2<sup>nd</sup> Quarter Mar 31, 2004</b>	<b>3<sup>rd</sup> Quarter Jun 30, 2004</b>	<b>4<sup>th</sup> Quarter Sep 30, 2004</b>	<b>Fiscal Year 2004</b>
Product sales	1,756	1,164	1,227	2,270	6,417
Gross margin	1,299	814	890	1,544	4,547
Gross margin %	74.0%	69.9%	72.5%	68.0%	70.9%
Earnings (loss) before tax	266	(269)	(55)	209	151
Earnings (loss) after tax	266	(269)	(55)	209	151
EPS – Basic	\$0.00	\$(0.00)	\$(0.00)	\$0.00	\$0.00
EPS – Diluted	\$0.00	\$(0.00)	\$(0.00)	\$0.00	\$0.00
Total assets	6,095	5,614	5,497	7,500	7,500
Total liabilities	2,126	1,898	1,503	2,846	2,846

COLD-FX<sup>®</sup> is the Company's best selling product. Consumers use the product to strengthen their immune system to prevent and treat colds and flu. As a result, COLD-FX<sup>®</sup> sales exhibit a seasonal sales pattern. Customers commence purchasing in the fourth quarter, which carries forward into the first and second quarters of the following year. The spring and summer months are slow selling periods, while late summer, fall and winter experience significantly greater sales volume with the increase in the frequency and severity of colds and flu. Retailers typically commence purchasing in late August and September and replenish stock as required.



## Liquidity and Capital Resources

### Cash and working capital

The Company was in a positive cash position of \$7.9 million and had \$16.0 million in working capital as of September 30, 2006. The Company also continued to maintain its working capital position but used cash in preparation for entering the U.S. and in construction of its new Edmonton office headquarters and research centre.

In fiscal year 2006, cash flow generated from operations was \$4.2 million (\$6.1 million for the prior year). For the fourth quarter of 2006, the cash flow used by operations was \$7.8 million (\$1.4 million in the same quarter of the prior year). The primary differences in cash flow were net earnings, an increase in inventory, payables, taxes payable, and adjustments for future income taxes and a prepaid intra-group tax asset.

Sales and gross margin contributed to continuing positive cash flows, while higher fixed operating costs and expenditures in planning for international growth and U.S. market entry affected net earnings and cash flow. The results for the fourth quarter reflected the necessary investments made in preparation for the Company's launch of COLD-fx<sup>®</sup> into the U.S. market.

<b>Comparative liquidity</b> (in thousands)	<b>Fiscal Year</b> <b>Sep 30, 2006</b> <b>Restated</b>	<b>Fiscal Year</b> <b>Sep 30, 2005</b>	<b>Fiscal Year</b> <b>Sep 30, 2004</b>
Cash and cash equivalents (indebtedness)	7,913	5,952	(181)
Working capital	16,385	16,928	1,924
Long-term liabilities	745	70	108

In July 2006, the Company entered into a letter of agreement that would increase the maximum borrowing limit on the Company's demand operating credit facility to \$15.0 million with margining based on receivables, inventory, and tax credits and is in the process of completing the conditions precedent. Although the Company has not utilized its credit facility as shown in the liquidity summary above, the Company expects to use this facility from time to time to fund operations as expansion continues in Canada and into the international marketplace. (See Subsequent Events section)

<b>Major cash flow components</b> (in thousands)	<b>Quarter 4</b> <b>Sep 30, 2006</b> <b>Restated</b>	<b>Quarter 4</b> <b>Sep 30, 2005</b>	<b>Fiscal Year</b> <b>Sep 30, 2006</b> <b>Restated</b>	<b>Fiscal Year</b> <b>Sep 30, 2005</b>	<b>Fiscal Year</b> <b>Sep 30, 2004</b>
Operating activities	(7,805)	(1,436)	4,180	6,124	(2,513)
Financing activities	94	258	296	855	2,539
Investing activities	(1,334)	(471)	(2,515)	(846)	(190)



## Cash flow in operations

The cash used in operations during the fourth quarter of fiscal year 2006 was \$7.8 million compared to \$1.4 million used for the same quarter last year. This use of cash in operations in the fourth quarter was primarily attributed to a \$6.0 million increase in receivables, a \$6.6 million increase in inventory, a \$2.6 million increase in a prepaid intra-company tax asset, and a \$0.8 million increase in prepaid expenses and deposits, offset by a \$6.0 million increase in trade and accrued payables, a \$3.6 million increase in taxes payable, loss of \$3.0 million, an increase of \$1.8 million in customer deposits and \$0.6 million for non-cash stock compensation expense.

The quarter over quarter reduction of \$6.4 million in cash from operating activities was primarily the result of a decrease in net earnings of \$6.3 million, an increase in receivables of \$1.8 million, an increase in inventory of \$4.8 million, the addition of a prepaid intra-company tax asset of \$2.6 million, prepaid expenses of \$0.9 million and offset by an increase in payables of \$4.3 million, an increase in customer deposits on product shipped with right-of-return of \$1.8 million, an increase future income taxes of \$0.6 million, and income taxes payable of \$3.6 million.

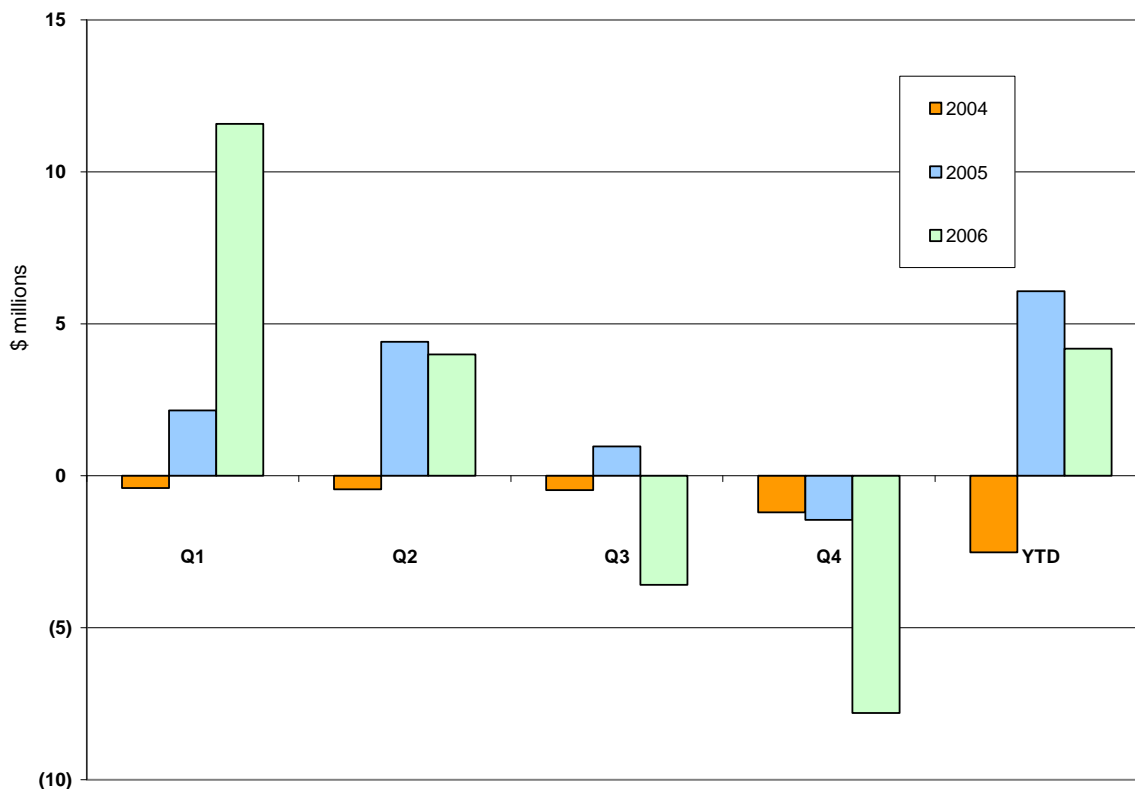
The year over year reduction in cash (\$2.0 million) from operating activities was primarily the result of a decrease in net earnings of \$9.5 million offset by an increase of \$1.8 million in future income taxes and \$6.0 million related to a net change in non-cash working capital items.

The Company manages supply risk by establishing a scheduling program to ensure a one-year supply of bulk ingredients and a finished goods inventory to meet seasonal demand is maintained. Inventory valuation is based on direct manufacturing costs. Product sales of \$50 million require a basic investment of approximately \$8 million in finished goods and bulk ingredients.

The following chart illustrates quarterly cash flows from operations in fiscal years 2004, 2005 and 2006.



## Cash Flow From Operations



### Cash flow from financing activities

The Company's financing activities in the fourth quarter of fiscal year 2006 generated \$94 thousand in cash (\$258 thousand in the same quarter last year). Financing activities in fiscal year 2006 provided \$296 thousand in cash (\$855 thousand in the prior year). The exercise of stock options in the fourth quarter generated \$99 thousand (650,000 common shares at an average of \$0.152 per share) from the exercise of options compared to \$263 thousand for the same quarter last year. Repayment of leases in the fourth quarter was \$18 thousand compared to \$5 thousand in the same quarter in fiscal year 2005. On a year over year basis, the issuance of capital stock through the exercise of options decreased \$1.8 million in 2006 to \$0.3 million and the repayment of the demand loan of \$1.3 million in 2005. The Company did not borrow any funds in 2006.

### Cash flow used in investing activities

The Company's investing activities in the fourth quarter used \$1.3 million (\$0.5 million in the same quarter last year). Investing activity for the fiscal year 2006 totaled \$2.5 million compared to \$0.8 million in 2005. Investing activities primarily consisted of amounts paid on architectural and engineering costs, and foundations in the construction of the new office head quarters and research centre, and office, computer, software and laboratory equipment purchases, and expenditures on patents and trademarks in support of the Company's business strategy. The purchase price of the leased land was capitalized at its



discounted value, with a corresponding liability realized. Expenditures for patents and registered trademarks were incurred in the protection and development of intellectual property.

On July 11, 2006, CVT Capital Inc., a wholly owned subsidiary and property-management company, entered into an arrangement to finance the construction of a 28,320 square foot building in Edmonton to provide office space and a research centre. The building will be located on a 4.6 acre parcel of land leased by the Company under the Edmonton Economic Development Corporation's Biotechnology Lease Program. Construction is underway with occupancy scheduled for the late summer of 2007. The land lease term is 10 years, renewable for a second term of 10 years, and has an option to purchase for \$1.2 million. The cost of the building construction is estimated to be \$9.5 million, with available financing of \$4.7 million in debt.

## Liquidity

Expenditures for advertising and inventory significantly reduced cash balances in the fourth quarter. Cash was also invested in inventory. High inventory levels are anticipated to extend into the next cold and flu season because of slow sell-through to U.S. customers and the seasonal decrease in sales experienced in Canada in spring and summer.

In the restated annual 2006 and first quarter 2007 interim consolidated financial statements, the Company has reversed the revenue recognition of U.S. product shipments with an implicit or explicit right of return and reclassified customer payments on shipments of inventory as customer deposits.

At the end of March 31, 2007, customer deposits of \$17.4 million represented payments on shipments of inventory with a right of return. When the risk of product return is substantially eliminated, the revenue from the product shipped is recognized and liability is eliminated. If the product is returned, the customer is entitled to a refund of the deposit. Subsequent to March 31, 2007, the Company refunded \$5.8 million of customer deposits. Additional returns have been authorized requiring refund of approximately \$5.9 million. There is no certainty that actual returns may be substantially higher or lower than the risk identified, and the timing of the actual returns and the effect of cash refunds on the Company's cash position is difficult to predict. The Company is also discussing plans with U.S. retailers to delay customer refunds until the fall selling season. The initial response has been positive.

As of March 31, 2007, estimated inventories were \$20.2 million. Although a large inventory positively affects working capital, the turnover of the U.S. inventory is anticipated to be slow over the next 6 to 12 months. Consequently, the Company has decided that it is prudent to bring some U.S. product into Canada for sale this fall. Bottled U.S. product, which has undergone the same quality testing as performed in Canada, can be repackaged making it available for Canadian sales. The additional costs to repackage inventory are anticipated to reduce gross margins by 5 to 7%. Because sales are seasonally slow during the summer, initiation of the cycling of inventory into receivables and cash receipts in Canada is anticipated to take place in the fourth quarter of fiscal year 2007, and the first two quarters of fiscal year 2008. As of December 31, 2006, the estimated consolidated inventory is \$20.7 million, of which \$3.5 million is product shipped to customers with the right of return.

The Company's U.S. experience has shown that shipments and the resulting invoices may be at risk of payment delay as customers are monitoring their sales to consumers. Though the customer has been invoiced and payment is expected, US receivables are not recognized in the consolidated financial statements until the risk of return is substantially eliminated. The turnover of payment on invoiced U.S.



# CV Technologies Inc.

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shipments is expected to be slow. In Canada, cash receipts of accounts receivable are typically within 30 to 60 days. In the summer months, cash flow from collection of receivables decreases, with slowing sales.

The timing of refunds on customer deposits related to returned product and slow summer sales will affect cash flow and likely require the Company to utilize its bank line or alternative sources of funding. There is uncertainty on when customer returns will occur and when customer refunds will be expected. The current bank line of credit has an inventory ceiling of \$5 million or 50% of inventory, whichever is lower (See Subsequent Events).

Until the Company completes the restatements and meets the conditions set forth in the cease trade order, the Company can not finalize discussions on bank or equity financing. Management is closely monitoring its cash flows. The Company continues to work diligently to have such cease trade orders lifted.

The Company's working capital and capital expenditure requirements depend upon numerous other factors including the success and timing of the introduction of new products or entry into new markets, consumer demand, right of returns held by customers, timing of market development programs, construction costs and long-term focus on product research and development activities. The Company anticipates developing a need for additional capital to fund operations, capital asset additions, research and development, new product launches, and strategic initiatives.



## Aggregate contractual obligations and off-balance sheet financing

The Company has entered into operating and capital lease agreements in the ordinary course of its business. In addition, the Company has entered into various agreements for financial assistance in research and development activities and clinical studies, and several advertising and marketing agreements. The commitments relating to these agreements, payable over the next five years, are as follows:

### **Contractual Obligations**

(in thousands)

<b>Leases</b>	<b>Total</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Operating leases <sup>1</sup>	1,041	362	314	248	117	-
Capital leases	1,176	16	3	2	-	1,155
Total lease obligations	2,217	378	317	250	117	1,155

<b>Research and development assistance</b>	<b>Remaining obligation</b>	<b>Total assistance available</b>	<b>Total assistance received</b>	<b>Max funds to be paid</b>	<b>Funds repaid to date</b>	<b>Max remaining term</b>
National Research Council <sup>2</sup>	0	495	495	742	742	Repaid
AVAC <sup>3</sup>	0	525	517	1,000	1,000	Repaid
Total research and development assistance obligations	0	1,020	1,012	1,742	1,742	

<b>Commitments</b>	<b>Total</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Agreements and contracts <sup>4</sup>	3,087	1,548	1,316	223	-	-

1. The Company recognizes rental expense on premises on a straight-line basis over the initial term of the lease. Lease inducements received by the Company as free rent periods are deferred and amortized on a straight-line basis over the term of the lease as a reduction in rental expense.
2. The Company is obliged to repay the financial assistance by way of 1.5% of the Company's gross revenues, which commenced April 1, 2002, up to a maximum of \$742,000, which is 150% of the original contribution amount. The obligation to pay terminates at the earlier of the full repayment of the \$742,000 or 10 years after the start of the repayment period. The Company is not obliged to repay any of the grants received should the Company have no future revenues on product sales.
3. The Company is obliged to repay the financial assistance by way of 1.5% of the Company's gross revenues after January 1, 2002 up to 200% of the original contribution amount or to a maximum of \$1 million. The Company is not obliged to repay any of the assistance received should the Company have no future revenues on product sales.
4. The Company has entered into a number of contractual obligations related to future advertising and marketing expenditures.

The Company anticipates it will exercise its option to purchase the leased land upon which the office headquarters and research centre is constructed before the option expires in 2015.

### Deferred revenue

Deferred revenue represents a deposit of \$150 thousand from a customer in exchange for a guaranteed volume of inventory to be available at any time.

### Majority interest

On October 29, 2002, the Company entered into a joint venture with Centaur Pharmaceuticals, a private company, in the creation of Vet Ex Inc. The joint venture, in which the Company holds a 60% interest, has



licensed the veterinary rights for the Company's nutraceutical products and ChemBioPrint technology. The Company has recorded its interest in Vet Ex Inc. using the proportionate consolidation method.

In June 2006, the Company provided notice to Centaur Pharmaceuticals that it will end its participation in the joint venture. The deactivation of the joint venture was finalized in February of 2007.

### Related party transactions

During the year, the Company paid \$14,914 (2005 - \$30,080) in supplemental study fees to an independent third party on behalf of Vet Ex Inc., which is controlled by the Company. This project involves an animal study on the effect of HT1001 on memory and cognition in adult dogs. This study would contribute to the understanding of the cognitive effects of REMEMBER-FX<sup>®</sup>.

As at September 30, 2006, 60% of this transaction was eliminated through proportionate consolidation and the remaining balance is included in accounts receivable.

### Share capital and stock-based compensation

During the fiscal year 2006, the Company granted 335,000 options to purchase common shares to employees and consultants.

On November 25, 2005, the Board granted 50,000 options for common shares exercisable at a fair market value of \$4.32 per share vesting at 20% per year. The fair value of options granted was \$182 thousand or \$3.64 per option.

On February 27, 2006, the Board granted 30,000 options for common shares exercisable at a fair market value of \$3.42 per share vesting at 20% per year. The fair value of options granted was \$84 thousand or \$2.81 per option.

On June 9, 2006, the Board granted 200,000 options for common shares exercisable at a fair market value of \$3.29 per share vesting at 20% per year. The fair value of options granted was \$538 thousand or \$2.69 per option. A portion of these options were in excess of the approved stock option plan and were later approved at the February 21, 2007 shareholders' meeting.

On September 8, 2006, the Board granted 55,000 options for common shares exercisable at a fair market value of \$4.04 per share vesting at 20% per year. The fair value of options granted was \$163 thousand or \$2.96 per option. A portion of these options was in excess of the approved stock option plan and later passed at the Annual General Meeting held in February 2007.

In November 2005, the Board of Directors also approved a compensation model weighted more to cash with less reliance on stock options. The Board recognized that annual salaries must be competitive in the marketplace to enable the Company to retain talented employees and attract new, high quality employees who can add value and support the rapid growth the Company has been experiencing.

An Employee Bonus Program was implemented effective for the 2006 fiscal year. The Program is based on growing sales volumes and earnings. The Board believes these measures are appropriate at this stage of the Company's development for employee compensation and shareholder value.



Director compensation moved to a cash based system effective March 1, 2006. The structure of Director's fees is as follows: Annual Retainer-\$5,000, Board meeting-\$1,000, Committee Chair-\$1,000, and Committee meeting-\$500. The Compensation Committee annually reviews and recommends to the Board the form and amount of Director compensation.

## Outstanding shares

As of June 14, 2007;

- Number of issued and outstanding common Class A shares 103,551,006
- Number of outstanding, unexercised stock options 10,592,935

(Exercise price ranges from \$0.15 to \$4.32 per share with expiration dates ranging from 2007 to 2011.)

## **Corporate Update**

To execute its international strategy, a new wholly-owned subsidiary, fX Life Sciences International GmbH (fX Life Sciences) based in Switzerland was formed to supply and manufacture products in international markets. This approach protects the intellectual property and goodwill in Canada and provides a more flexible supply model for international manufacturing and distribution of finished products throughout the world.

COLD-fX Pharmaceuticals USA Inc., a wholly owned Delaware Corporation headquartered in the Chicago area, was established to focus on distribution, sales and customer service to retailers and major drug chains within the U.S. marketplace.

CV Technologies Inc. is in the process of winding up ChemBioPrint Asia Limited, which is inactive.

## Management Changes during the Year

On December 8, 2005, Harry Buddle was elected to the position of Vice-Chairman. Mr. Buddle serves as a member of the Audit and Compensation Committees.

On May 9, 2006, Bruce Buchanan resigned as a Board Director for personal and family health reasons.

On September 2, 2006, Paul Bokenfohr was appointed an Officer and Vice President, Human Resources and Administration for the Company.



## Subsequent Events and Activities

### Stock options and compensation

Subsequent to September 30, 2006, 777,666 options were exercised for cash proceeds of \$203,070.

On December 8, 2006, the directors approved a compensation system to align with industry standards. Effective January 01, 2007, director compensation moved to cash compensation increasing the annual retainer to all Board members, the Board chair and committee chairs. The revised compensation system is as follows: Annual Retainer-\$25,000, Board Chair-additional \$15,000, Committee Chair-additional \$5,000, Board Meeting-\$1,000 and Committee meeting-\$500. The Compensation Committee annually reviews and recommends to the Board the form and amount of Director compensation.

On December 14, 2006, the Company granted 100,000 options exercisable at \$2.98. The compensation expense is recognized over the five year vesting period of the options.

On May 10, 2007, Dr. Jacqueline Shan voluntarily surrendered and relinquished all rights and privileges associated with the March 2005 option grant. The forfeiture of these options results in a recovery of \$3.6 million of stock-based compensation expense previously recognized. This was accepted by the Board of Directors at their May 14, 2007 meeting.

### Treasury common shares

Pursuant to a shareholder resolution on February 21, 2007, the Company adopted amendments to the Company's stock option plan that permits the Board of Directors to grant to employees, officers and directors options to purchase from Treasury up to 22,170,442 common shares. This change is an increase of 3,000,000 common shares from the previous limit of 19,170,442 common shares.

### Change in senior management

On February 21, 2007, the marketing responsibilities of P. Norman Oliver were reassigned to John Rea, who was appointed Vice President, Marketing and Communications. Dr. Sharla Sutherland was appointed Vice President, Regulatory & Scientific Affairs.

P. Norman Oliver, Senior Vice President Sales & Customer Development was no longer associated with CV Technologies Inc. as of March 26, 2007. Mr. Oliver's initial responsibilities included marketing and sales in Canada and the U.S. Mr. Oliver's most recent responsibilities included sales and customer development. Those duties have been reassigned internally on an interim basis.

On May 7, 2007, the Company announced the appointment of Ross Montagano as Chief Operating Officer, effective May 28, 2007.

### Business development

On February 7, 2007, the Company announced that doctors and nurses at Hackensack University Medical Centre (HUMC) in New Jersey would participate in a randomized, double-blind, placebo-controlled trial of COLD-FX<sup>®</sup> to evaluate improvements in the immune health of front line medical workers.



HUMC infectious diseases researcher, Dr. Steven Sperber, will head the study that will include blood tests to investigate the hypothesis that COLD-fx<sup>®</sup> works by simultaneously boosting two different immune pathways: the innate response (macrophages and Natural Killer (NK) cells) and the Th1 adaptive response. Both pathways are critical for fighting viruses and maintaining good health. The hypothesis is supported by previously published clinical research which demonstrated that regular intake of COLD-fx<sup>®</sup> over one cold season enhanced NK cells and T-helper cells.

If confirmed, COLD-fx<sup>®</sup> will be the first dietary supplement clinically proven to work synergistically by enhancing both of these immune pathways. There are currently no approved medicines that act in this novel manner. The study will complement additional Canadian government-funded research being conducted at McMaster University in Ontario on the precise molecular mechanism of action of COLD-fx<sup>®</sup>.

Dr. Sperber is recruiting healthy staff members from HUMC for the trial including doctors and nurses. The parameters being measured are blood immune factors which are highly sensitive and therefore do not require a high number of trial subjects.

As previously mentioned, Health Canada approved a new wide-ranging health claim for COLD-fx<sup>®</sup> on February 13, 2007. After an extensive review, the NHPD issued a product license and NPN for COLD-fx<sup>®</sup>. The comprehensive treatment claim for COLD-fx<sup>®</sup> approved by Health Canada states that the product "helps reduce the frequency, severity and duration of cold and flu symptoms by boosting the immune system". The approved dosage was two capsules per day. Comprehensive therapeutic claims require support by the highest level of scientific evidence: randomized, double-blind, placebo-controlled clinical trials. The Company is seeking a separate NPN for a higher acute dose similar to the dosing regimen of the previous DIN for COLD-fx<sup>®</sup> under an application that was submitted to the NHPD on March 9, 2007.

On February 13, 2007, the status of Vet Ex Inc., the joint venture with Centaur Pharmaceuticals became inactive.

On March 1, 2007, the Company announced that a major U.S. scientific review (monograph) of COLD-fx<sup>®</sup>, conducted by leading American cold and flu experts, was published by the American Botanical Council (ABC), North America's leading nonprofit research and education organization on herbal medicines. Five independent U.S. physicians and scientists, well recognized in the field of natural medicines, were involved in the writing and peer review of this scientific report on COLD-fx<sup>®</sup>, which concludes the cold and flu remedy delivered "impressive" benefits to users.

On March 26, 2007, the Company announced that sell-through of COLD-fx<sup>®</sup> to U.S. consumers was slow and that there was significant risk of returns. Product returns are currently taking place from U.S. customers who expect refund or credit on accounts.

On April 19, 2007, the Alberta Securities Commission (ASC) issued an Interim Cease Trade Order (ICTO) halting trading of the Company's securities for 15 days. The action followed the Company's April 11, 2007 announcement that it was voluntarily planning to restate its consolidated financial statements for the year ended September 30, 2006, as well as its interim consolidated financial statements for the three month period ended December 31, 2006 due to revenue recognition issues in the U.S. market. The Company, under the guidance of the Board of Directors decided to correct the Company's revenue as it relates to the entry into new markets or introduction of new products where the right of return is uncertain. The Company has corrected the application of this policy because of the difficulty in estimating consumer uptake and the risk of product return by retailers.



On May 2, 2007, the ASC issued a Consent Order extending the Interim Cease Trade Order (ICTO) of April 19, 2007 until the earlier of the satisfaction of the conditions set forth below or June 15, 2007.

The conditions set forth in the Consent Order include that:

- (i) All deficiencies, inconsistencies and omissions in the Company's previously delivered Financial Statements have been corrected by filing revised or amended Financial Statements pursuant to Part 4 of National Instrument 51-102 Continuous Disclosure Obligations (NI 51-102) that are in accordance with acceptable accounting principles as required by section 3.1 of National Instrument 52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currency;
- (ii) The Company has issued a press release pursuant to Part 11 of NI 51-102 explaining the reasons for requiring revised or amended Financial Statements;
- (iii) The Company is not in default of any other filing requirements under the Securities Act (Alberta); and
- (iv) The staff of the ASC has confirmed in writing that CV Technologies Inc. has satisfied the three foregoing conditions.

If all four conditions are not satisfied by June 15, 2007, CVQ and Staff of the ASC are directed to appear before the ASC for further advice and direction.

The Company was subject to a similar Temporary Order of the Ontario Securities Commission (OSC) dated April 23, 2007, which ceases all trading in and all acquisitions of the securities of the Company, whether direct or indirect, for a period of 15 days from April 23, 2007. A hearing before the OSC in respect of the Temporary Order was held on May 4, 2007.

On May 7, 2007, the OSC implemented an Order that has the effect of continuing the foregoing cease trade for an indefinite period. Staff of the OSC have confirmed to the Company that as the ASC is the principal regulator of the Company in accordance with CSA Staff Notice 51-312 Harmonized Continuous Disclosure Review Program (CSA Staff Notice 51-312), it is the intention of Staff of the OSC to apply the principles described in CSA Staff Notice 51-312 for the purposes of assessing the satisfaction of the Company's voluntary plan to restate its consolidated financial statements for the year ended September 30, 2006, as well as its interim consolidated financial statements for the three month period ended December 31, 2006.

The Company was subject to a Cease Trade Order of the British Columbia Securities Commission (BCSC) dated May 24, 2007, which ceases all trading in and all acquisitions of the securities of the Company, whether direct or indirect, until:

- (i) The Company files an interim financial statement for the financial period ended March 31, 2007 and a Form 51-102F1 Management's Discussion and Analysis for the financial period ended March 31, 2007.
- (ii) The Executive Director makes an order under section 164 of the Securities Act revoking this cease trade order.

## Lease obligations

The Company has renewed existing leases and entered into new leases related to premises. These leases expire at various dates ranging from May 31, 2008 to October 31, 2009. As of March 31, 2007 the cumulative obligation of these leases is \$111,924.



## Financing facilities

On June 12, 2007, the Company entered into a commitment letter granting the Company a demand operating line of credit up to a maximum of \$10,000,000. The demand operating line of credit is based on 75% of accounts receivable plus 50% of finished goods inventory for the period of September to February or 65% of finished goods inventory for the period of March to August. Inventory has a maximum limit of \$6.0 million. As part of the operating line facility, the Company has the ability to issue up to \$1 million of letters of guarantees. Interest under the operating line facility is based on the Bank of Canada prime rate or Bankers' Acceptance rate plus 1.5% per annum.

In addition, the new financing arrangement offers a three year term financing for the construction of the new headquarters and research centre on land held under a capital lease. The amount of term financing will be based on 65% of the revised appraised value of the building or 65% of the cost of the building, whichever is lower. The interim facility will bear interest at the Bank of Canada rate plus 0.75% per annum; the Company can also fix the interest rate.

The collateral security lodged by the Company to support both financing facilities is a General Security Agreement constituting a first ranking security interest in all personal property of the Company, a Collateral Mortgage constituting a first fixed charge on the Company's headquarters and research centre on the subleased land and a guarantee provided by an insider of the Company, secured by common shares.



## Outlook

The execution of the U.S. expansion is underway and is based on securing partnerships with larger retailers and drug store chains, and gaining a reputable distribution network. Continued awareness and consumer acceptance will be part of the challenge during the initial stage of U.S. expansion. The Company is implementing a number of sales, marketing and public relations strategies and programs to achieve these goals. These strategies include the pursuit of marketing and distribution strategic partners in the U.S. and other markets.

It will be critical to achieve consumer sales volume at levels deemed acceptable for the return on investment that retailers have made. Sales monitoring and investment in brand building will continue in fiscal year 2007 and is necessary to ensure successful consumer sales levels and management of inventories against expectations of all partners. U.S. sales have developed very slowly in the first and second quarters of 2007 and losses are anticipated for fiscal year 2007.

The fourth quarter of fiscal 2006 showed quarter over quarter growth. These sales excluded the pipeline-fill of American retailers to ensure product is on the shelves in preparation for consumer awareness and marketing programs. Management will execute its U.S. strategy and continue a more targeted marketing and commercialization approach of its products in the U.S. and Canadian market place. Management will also work to enhance demand for REMEMBER-fx<sup>®</sup> and CELL-fx<sup>®</sup> in Canada. Management will strive to continue to build sales and profits through effective brand management, targeted sales and marketing efforts, public relations activities, focusing on operational excellence in cost management, expanding its supply chain management to meet growing demand and expanding awareness and sales of its products.

The Company is also realigning its manufacturing priorities with the objective of converting existing inventory into receivables and cash as soon as possible. This plan includes shipping excess U.S. inventory to Canada for repackaging and sale. The Company continues to reduce its operating expenses while actively seeking a strategic business partner in the U.S. to assist in marketing and distribution. The Company plans to contain and lower costs in sales and marketing, distribution, operations and quality control activities for the remainder of 2007. The Company looks to strengthen its team with the addition of Ross Montagano, who will join the team in late May as Chief Operating Officer.

In the upcoming fiscal 2007 year, management plans to improve consumer awareness and education of healthcare professionals to fully develop its business and to focus on a strategy of educating consumers and building awareness of the year-round preventative use of COLD-fx<sup>®</sup>. With the publication in the Canadian Medical Association Journal of a study demonstrating the efficacy of COLD-fx<sup>®</sup> for the prevention and relief of upper respiratory infections and obtaining a Natural Product Number (NPN), awareness of COLD-fx<sup>®</sup> has spread domestically and internationally. The Office of Dietary Supplements Division of the National Institutes of Health (NIH) in the U.S. selected the COLD-fx clinical trial results, published last year in the Canadian Medical Association Journal, for inclusion in its Annual Bibliography of Significant Advances in Dietary Supplements Research. Management believes the future for COLD-fx<sup>®</sup> is very promising.

The Company will continue to explore carefully the option of a FDA application for the active ingredient of COLD-fx<sup>®</sup> as an OTC drug for the prevention of cold and flu, which would allow the Company to make strong and specific medical claims and afford label exclusivity in the U.S. This approach would require the successful completion of a Phase III clinical trial, which would enhance product differentiation from the U.S. competition.



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Management is committed to making the Company's products strong performers within their categories. The Company will continue to prove its leadership in the discovery and commercialization of science-based natural therapeutics for health maintenance and disease prevention, and to prove itself as a well-recognized and respected supplier to consumers and the natural health products industry while providing a return on investment to shareholders.



## Restatement of Previously Issued Financial Statements

The Company has restated its previously reported consolidated financial statements for the fiscal year ended September 30, 2006. The restatement of the Company's consolidated financial statements followed an internal review of the Company's consolidated financial statements and accounting records that was undertaken as part of an analysis of the proper approach to account for anticipated product returns in the U.S. market. The Company will also restate its consolidated financial statements for the three month period ended December 31, 2006. For additional information, see accompanying restated audited consolidated financial statements for the year ended September 30, 2006 and the three month period ended December 31, 2006.

The descriptions of corrections are as follows:

### Consolidated Statement of Earnings

- Net product sales decreased by \$5.6 million (11.9%) to \$41.4 million: Revenues from U.S. operations were reversed because of the correction in the application of the Company's revenue recognition policy to deal with the risk of product returns. The net product sales previously reported were to initially stock customers. U.S. shipments occurred late in the year and the estimated fourth quarter product sales from sell-through to consumers was \$8 thousand.

	Previous	Restated	Change
Net product sales	46,973,073	41,387,088	(5,585,985)

- Cost of goods sold decreased by \$1.4 million (9.4%). As a percentage of product sales, the cost of goods sold increased from to 32.1%. The residual internal freight, warehousing and manufacturing management costs increased the cost of goods sold relative to sales.

	Previous	Restated	Change
Cost of goods sold	14,661,462	13,286,800	(1,374,662)

- Gross margin decreased by \$4.2 million (13.0%). As a percentage of net product sales, the gross margin percentage decreased 0.9% from 68.8% to 67.9%. This reduction would be as anticipated with a reduction in recognized revenue.

	Previous	Restated	Change
Gross margin	32,311,611	28,100,288	(4,211,323)

- Advertising and marketing expenses increased \$55 thousand (0.7%). This increase resulted from reclassifications of marketing displays and packaging shipped with product but subject to a right of return. These materials are likely not recoverable in the event of return. This increase also includes non-refundable sales discounts and allowances to advertising and marketing under operating expenses. This reclassification results from sales allowances that would have created negative sales revenue for certain customers.

	Previous	Restated	Change
Advertising and marketing	8,084,658	8,140,050	55,392

- A foreign currency translation adjustment was reclassified to the statement of earnings, increasing expenses by \$83 thousand. With the parent company now funding the day-to-day operations of the foreign subsidiaries, those operations are considered integrated with the parent company. In the prior financial statements, these foreign subsidiaries were considered self-sustaining. The change in foreign operations from self-sustaining to integrated status resulted in the foreign currency translation gains and losses being reclassified from equity to the statement



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of earnings. The translation of these subsidiaries, which operate in U.S. dollars, has been updated from the current rate method to temporal method. The change in method resulted in application of different foreign exchange rates in translation of the financial statements for various accounts.

	Previous	Restated	Change
Foreign currency translation adjustment	0	83	83

- Earnings before income taxes decreased by \$4.3 million (50.8%) as result of the above corrections to revenue and expenses.

	Previous	Restated	Change
Earnings before income taxes	8,406,536	4,139,904	(4,266,632)

- Income taxes decreased by \$0.8 million (18.0%) because of a decrease in net earnings from a reversal in revenue recognition.

	Previous	Restated	Change
Current income taxes	3,159,825	3,301,238	141,413
Future income taxes	1,109,401	199,650	(909,751)
Income taxes	4,269,226	3,500,888	(768,338)

- Earnings (after income taxes) decreased by \$3.5 million (84.6%) as result of the above corrections to revenue and expenses.

	Previous	Restated	Change
Earnings	4,137,310	639,016	(3,498,294)

## Consolidated Balance Sheets

- Accounts receivable decreased by \$3.8 million with the reversal of U.S. product sales until consumer sell-through takes place or the risk of returns is substantially eliminated.

	Previous	Restated	Change
Accounts receivable	10,474,732	6,707,356	(3,767,376)

- Inventories increased by \$1.7 million with the reversal of revenue recognition on shipments. This inventory is described in the consolidated financial statements as "product shipped with right of return".

	Previous	Restated	Change
Inventory	16,771,353	18,425,505	1,654,152

- Future income taxes (current asset) were adjusted to reflect the correction to net earnings before tax. The increase is the result of timing differences between product sales to third parties and intercompany sales.

	Previous	Restated	Change
Current future income taxes asset	91,841	1,001,590	909,749

- Total assets decreased by \$1.2 million based on the above asset restatements.

	Previous	Restated	Change
Total assets	44,335,343	43,131,868	(1,203,475)



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- Accounts payable and accruals increased by \$0.3 million. This adjustment reflects an increased liability related to higher levels of inventory from slower than anticipated sales.

	Previous	Restated	Change
Accounts payable and accruals	11,280,235	11,600,073	319,838

- Customer deposits on products shipped with right of return increased by \$1.8 million. This liability represents payments received from customers for product shipped that have an implicit or explicit right to return. This payment will result in a monetary refund a customer requests to return product.

	Previous	Restated	Change
Customer deposits on products shipped with right of return	0	1,773,559	1,773,559

- Current income taxes payable increased by \$142 thousand.

	Previous	Restated	Change
Current incomes taxes payable	5,091,744	5,233,698	141,954

- Total liabilities increased by \$2.2 million based on the above restatements to liabilities.

	Previous	Restated	Change
Total liabilities	17,371,905	19,607,256	2,235,351

- The deficit increased by \$3.5 million based on the decrease in net earnings resulting from a reversal of recognition of U.S. product sales.

	Previous	Restated	Change
Deficit	(1,880,085)	(5,378,379)	(3,498,294)

- The foreign currency translation adjustment increased by \$59 thousand based on the above restatements. With the parent company funding the day-to-day operations of the foreign subsidiaries, those operations are considered integrated with the parent. In the prior statements, these foreign subsidiaries were considered self-sustaining. The change in foreign operations from self-sustaining to integrated status resulted in the foreign currency translation being reclassified from equity to the income statement.

	Previous	Restated	Change
Foreign currency translation adjustment	(59,468)	0	59,468

- Total shareholders' equity decreased by \$3.4 million based on the above restatements to the deficit and foreign currency translation adjustment.

	Prior	Restated	Change
Shareholders' equity	26,963,438	23,524,612	(3,438,826)

The appropriate application of the revenue recognition policy did not have an effect on the operating, financing and investing categories within the consolidated statement of cash flow; therefore, the effect on the restated cash flow statement has not been presented.



## Internal Controls over Financial Reporting

The Enterprise Risk Management Committee (a subcommittee of the Audit Committee) oversees risk assessment and review processes of the Company's internal controls over financial reporting to meet the requirements under MI 52-109. The Committee provides regular updates to the Audit Committee and Board. At the end of fiscal year 2006, the design and documentation of internal controls over financial reporting were completed, with the exception of the design and documentation of entity level controls (control environment) which was completed in February 2007. Certain non-material control gaps and remediation of those deficiencies are expected to carry through the 2007 fiscal year. The Company is in a period of rapid growth and will continue, as required, to modify the design, and implement controls over financial reporting during 2007.

In March 2007, the Company initiated a review of its revenue recognition policy and practices following awareness of the potential for significant product returns from U.S. customers. The potential for U.S. returns was significantly greater than estimated that the Company had made for the initial shipments. In this evaluation, management concluded the following material weaknesses existed in its internal controls over financial reporting:

- Instances of non-compliance with policies and procedures related to reviewing and communicating material arrangements entered into on behalf of the Company in a timely manner, including the identification and analysis of sales arrangements containing a right of return, adequate records of customer and vendor files, and documentation of the application of GAAP to such transactions;
- Non-compliance with policies and procedures related to processing and shipping of sales orders to new customers, including shipments without internal release of the sales order, confirmation of customer sales arrangements, credit review, and sufficient customer documentation; and
- Failure to appropriately apply GAAP to the initial recording of product sales when entering into a new market where a reasonable estimate for product returns was not possible; and insufficient internal cross-functional and external communication and coordination, including compliance with internal control processes, management override, and insufficient segregation of duties and training in certain areas, all of which affected the appropriate application of the revenue recognition policy.

These control deficiencies resulted in the restatement of the Company's consolidated financial statements for the year ended September 30, 2006 and interim financial statements for the three month period ended December 31, 2006 and materially affected revenue, cost of goods sold, income taxes, accounts receivable, inventory, liabilities, net earnings and retained earnings.

As part of the measures to correct the above weaknesses in internal controls over financial reporting, the Company has improved its contract review process and communicated the revised process within the Company. The Company has created a team, comprised of representatives from operations, finance and, if required, external legal counsel to analyze, review and document customer and vendor arrangements for their effects on the business, financial reporting and disclosures.

Intensive efforts will be initiated to expedite employee training and to complete the implementation of designed controls and procedures, with priority in the sales and purchasing cycles.

These efforts include the restructuring of management, including the hiring of Ross Montagano as Chief Operating Officer, the splitting of the sales and marketing responsibilities between two executive roles, and



improving the environment of accountability, workloads, training, communication, and information flow between functional areas. Management and the Audit Committee also review performance and variance reporting to improve risk management, monitoring and accountability.

In certifying the previous financial statements for fiscal year ended September 30, 2006 and the three month period ended December 31, 2006, the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) acknowledged responsibility for establishing and maintaining the Company's disclosure controls and procedures, and had evaluated, tested, and certified their design and effectiveness, according to MI 52-109, based on the information available at the time.

In that evaluation of disclosure controls, the following deficiencies were identified:

- Education of employees, and
- Control of website updates were non-current and obsolete information was not removed and information was not reviewed for material content.

Although employees have read the Disclosure and Insider Trading Policies, Core Values and Code of Conduct, and Employee and Business Protection Guide, the Company believes that educational sessions for new employees will provide additional assurance that there will be compliance with these policies. This educational process has commenced. A committee was formed and is comprised of representatives of Investor Relations, Communications, Scientific and Regulatory Affairs, Human Resources and Financial departments with the purpose to review, on a regular basis, website updates to mitigate risks of errors or omissions.

Awareness of significant returns subsequent to the original certification of disclosure controls caused the CEO and CFO to reconsider their conclusions on the effectiveness of disclosure controls and procedures. The Chief Executive Officer and Chief Financial Officer proceeded to retest and re-evaluate the disclosure controls and procedures to determine if their conclusions were correct.

In re-evaluating disclosure controls, the following deficiency was identified:

- Non-compliance with policies and procedures in the sub-certification process of the filing of the Company's disclosures, in that material information on the conditions of business contracts and arrangements were not communicated in a timely manner

This deficiency contributed to a weakness in the Company's disclosure controls and procedures, which has now been corrected. Management believes a lack of understanding of the need to properly communicate material agreements appeared to have resulted in incomplete information being provided on the risk of product returns and consumer acceptance, and on sales and vendor agreements, which contributed to the accounting errors in revenue recognition. As discussed under Internal Controls over Financial Reporting, a review process was established to evaluate business arrangements and it is believed that this issue is resolved.

Management is committed to implementing the improvements to the disclosure processes and controls. Management will foster a culture of open communication and accountability in compliance with policies and procedures on a proactive basis. The Disclosure Committee has emphasized to Executive



Management the importance of the communication of material information and changes in control systems in a timely manner to the CEO and CFO.

The CEO and CFO have concluded that the Company's disclosure controls and procedures do provide management with a reasonable level of assurance that the information required to disclose continuously in its annual and interim filings and other reports, is recorded, processed, summarized and reported or disclosed on a timely basis. This process continues to be frequently reviewed and refined. The Board of Directors and management are concerned with the above control deficiencies, take these matters very seriously and are determined to ensure correction of these deficiencies that contributed to the need for restatement of the financial statements.

The Enterprise Risk Management Committee and Management continue to monitor the progress and improvements in the design, efficiency and implementation of controls over financial reporting and disclosures, with particular attention to the above internal control deficiencies and weakness. Notwithstanding the foregoing, no assurance can be made that the Company's disclosure controls and procedures will detect or prevent all failures of people within the Company to disclose material information otherwise required to be set forth in the Company's reports.



## Risks and Uncertainties

The Company is in the growth stage with its lead natural health products, COLD-fx<sup>®</sup>, REMEMBER-fx<sup>®</sup> and CELL-fx<sup>®</sup>. In order to gain a successful market share, the Company will be required to incur expenditures for marketing, advertising and public awareness programs. Future success is dependent on these activities, together with the effectiveness and safety of the Company's products, regulatory review and approval for its products, the degree of patent protection afforded to particular products and seasonality of demand for its products. The Company has Quality Control and Quality Assurance programs to monitor product quality. The Company also maintains product liability insurance; however, it is possible that this coverage will not provide full protection against all risks.

The Company currently has operations in North America and Europe. The Company is economically dependent, to varying extents, on certain customers and vendors in each of these regions. Political and regulatory environments, economic conditions and other factors may affect product sales and operations. However, these risks may be mitigated by geographic diversification of sales and supply. Entry into new markets will subject the Company to additional risk as supply chains and customer relationships are developed, and consumer acceptance is sought. Risks include, but are not limited to, initial product sales to fill pipeline, replenishment rates, consumer purchases, product returns, inventory levels, and consumer preferences and adoption rates. In entering new markets, retailers may rebalance inventories and request to return stock depending on consumer demand and sell-through rates. There can be no assurance that the Company will be able to cost-effectively operate, generate product sales, generate adequate funds or maintain relationships with such customers, vendors, employees, collaborators and other third parties. The Company mitigates these risks with monitoring of activities, developing and implementing action plans and diversification of vendors and customers.

Expectations about the Company's financial and scientific results could have a significant effect on the trading price of the Company's shares. Certain risks exist in the timing of scientific and regulatory reviews, filings and approvals, and the Company's ability to commercialize products in its pipeline. During fiscal year 2006, four (2005 – four) major customers accounted for \$27.1 million or 65.4% (2005 - \$20.5 million or 64.5%) of Canadian net product sales. As at year-end, two customers represented 42.4% and 29.7% (2005 – 37.3% and 26.1%), respectively of total Canadian accounts receivable.

Prospects for the Company's new technologies and products are uncertain and should be regarded as highly speculative. It is not possible to predict the results of studies or regulatory approvals. If products are approved for sale, there can be no assurance that they will result in significant sales.

Except for historical information, certain matters discussed in this report are by their nature forward-looking statements that involve risks and uncertainties, which may cause actual results to differ materially from the statements made.

## Financial risks and risk management

The risks and uncertainties described below are those that the Company currently believes may materially affect its operations. This is not an exhaustive list and can change as the Company develops. Additional risks and uncertainties that the Company is unaware of or currently deems immaterial may become important factors that may materially affect the business. A more comprehensive discussion is available in the Company's Annual Information Form available on SEDAR.



## Liquidity risk

Liquidity risk is the risk arising from the inability to meet obligations when they come due in a timely manner. The Company's liquidity strategy is to maintain the capacity to fund assets and repay liabilities in a timely and cost-effective manner under adverse market conditions. This capacity primarily arises from the Company's earnings, issuance ability in the debt and equity markets as well as its ability to generate liquidity from its balance sheet.

The Company's strategy is to diversify its sources of funding, and may choose to allocate its funding activities depending upon market conditions, relative costs, and other factors. The Company believes that debt and securitization funding, combined with operating and investing activities, will provide sufficient liquidity to meet future funding requirements.

As the Company's operations are seasonal in nature, sales and incoming cash flows are lowest in the third quarter. The Company's short-term cash requirements may exceed cash balances for the last six months of the fiscal year ending September 30, 2007. The availability of cash is dependent upon the earnings, availability of existing or alternate financing facilities, and the timing and extent of product returns and repayment terms. The outcomes of these events are difficult to predict.

## Inventory valuation, obsolescence and spoilage risk

The Company's inventories have a finite shelf life (up to five years). Raw materials, work in process and finished goods have expiry dates and are subject to competitive pricing, obsolescence and spoilage. All inventory items are reviewed with the sales and operations groups for obsolescence including products that are discontinued or may not be saleable, or materials that are no longer used in production. These revaluations and allowances are charged to the cost of goods sold as identified or required.

## Foreign exchange risk

The Company is exposed to market risk related to operations in foreign countries, and transactions and changes in foreign currencies. These changes could adversely affect the value of the Company's current assets and liabilities, as well as impact revenues and earnings. In Canada, the Company's expenditures on goods and services and revenues are primarily in Canadian dollars. In the United States, the Company's expenditures on goods and services and revenues are primarily in U.S. dollars. In Switzerland, the Company's expenditures on goods and services and revenues are primarily in U.S. dollars and to lesser degree Swiss francs. As of September 30, 2006, the Company has not entered into any forward currency contracts (forwards, futures or options) or other financial derivatives to hedge foreign exchange risk, and therefore is subject to foreign currency transaction and translation gains and losses.

## Credit risk

Credit risk arises from the possibility that the entities to which the Company sells products may experience financial difficulty and be unable to fulfill contractual obligations. This risk is mitigated by credit management practices that include monitoring of the debtor's payment history and performance. The customer base is comprised of well established, reliable retailers and wholesalers.

## Interest rate risk



The Company is exposed to interest rate fluctuations. The Company's investment strategy of cash surpluses is protection of principal as such investments are made on high quality short-term deposits at Schedule "A" banks in the form of term deposits and bankers acceptances. With respect to borrowings, the Company would be exposed to Canadian dollar prime rate fluctuations. The Company currently does not utilize hedging instruments to manage interest rate risk.

### Regulatory environment

The Company is subject to extensive laws and regulations in respect of securities, commercial activities, taxation, product quality, processing, labeling, and testing of its products. Changes to these laws and regulations could have a significant impact and can vary by country. There can be no assurance that the Company will be able to comply cost-effectively with future laws and regulations. The Company complies with the guidelines set by regulatory agencies and "Good Manufacturing Practices". The Company also has established and reviews policies and procedures to mitigate risk of non-compliance.

### Market risk

In order to gain successful market share, the Company may be required to increase investments in marketing, advertising and public awareness programs. Future success depends on these activities, together with the effectiveness and safety of the Company's products, regulatory review and approval of its products, the degree of patent protection afforded to particular products and seasonality of demand for its products.

Consumer acceptance of the Company's products will depend upon a number of factors, including demonstration of clinical efficacy and safety; scientific and marketing advantages of its products over competitors' offerings; availability of acceptable pricing and adequate third-party reimbursement; and effectiveness of marketing and distribution methods for the products.

The Company may not have all the required clinical data and results to market its product pipeline in any jurisdiction. Current and future clinical or preclinical results may be negative, inconclusive or insufficient to allow the Company to market any of its product candidates. Obtaining data and results may also take longer than planned, or may not be obtained at all.



## Critical Accounting Policies and Estimates

Critical accounting policies and estimates are those policies, assumptions and estimates most important in the preparation of the Company's consolidated financial statements. Selection of policies requires Management's subjective and complex judgment from many alternatives and estimates involving matters that are inherently uncertain. Management believes that those policies, assumptions and estimates are reasonable, based on the information available. Those policies, assumptions and estimates affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the period represented.

The preparation of the Company's financial statements requires estimates and judgments that affect the reported amounts of assets, liabilities, equity, and revenues and expenses, and related disclosure of contingencies. Management evaluates the assumptions and estimates, including those related to product sales, bad debts, inventories, deferred costs, investments, intangible assets, accrued liabilities and legal issues. Management bases its estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. The results of those estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The actual results might differ materially from these estimates under different assumptions or conditions. The methodologies used and assumptions selected by management in making these estimates, as well as the related disclosures, have been reviewed by and discussed with the Audit Committee of the Board of Directors. Management believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements.

Critical accounting policies and estimates relate to the following:

- Revenue recognition;
- Useful lives and impairment of intangible assets and deferred development costs;
- Contingencies;
- Income taxes;
- Inventory valuation;
- Stock-based compensation; and
- Capitalized interest.

Because of the identified correction in application of revenue recognition policy, the Company has updated its recognition policy in conjunction with the restatements of fiscal year 2006 and the first quarter of fiscal year 2007.

### Revenue recognition

The Company recognizes revenue in accordance with the CICA handbook Section 3400 Revenue and Emerging Issues Committee (EIC) Abstract 141 Revenue Recognition. EIC-141 states that revenue recognition should take place when realized or realizable and earned. Revenue recognition occurs upon meeting all of the following criteria:

- evidence of an arrangement exists;
- upon delivery of the product or rendering of services;
- the seller's price to the buyer is fixed and determinable; and
- collection is reasonably assured.



EIC-141 also states that revenue recognition occurs at the time of the sales transactions where the buyer has the right to return the product only if:

- (1) the seller's price to the buyer is substantially fixed or determinable at the date of sale;
- (2) the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product;
- (3) the buyer's obligation to the seller would not be changed in the event of physical destruction, loss or damage of the product;
- (4) the buyer acquiring the product for resale has economic substance apart from that provided by the seller;
- (5) the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer; and
- (6) the amount of future returns can be reasonably estimated.

The Company recognizes revenues for product sales when the title and risk of ownership transfers to the customer, and the criteria of EIC-141 are satisfied, which is generally at the time of delivery of products to customers. Product sales represent total gross revenues less allowances for customer credits, including estimates of discounts and allowances, rebates, charge-backs, and product returns.

The Company establishes allowances for estimated rebates, charge-backs and product returns based on numerous qualitative and quantitative factors, which include:

- the number of and specific terms of arrangements with customers;
- estimated levels of inventory in the distribution channel;
- historical rebates, coupon redemption rates, charge-backs and returns of products;
- direct communication with customers;
- anticipated introduction of competitive products;
- anticipated pricing strategy changes by the Company and/or its competitors;
- analysis of sales data gathered by a third-party data provider;
- the effect of regulatory changes; and
- the estimated remaining shelf life of products.

The Company uses internal forecasts, historical sales data, information gathered from customers and external data providers and judgment, to determine the estimated amount of product sold to customers, product in the sales channel or customer inventories, and to assess risk of returns. This forecast is based on input from members of the sales, marketing and operations groups. The adjusted forecasts take into account numerous factors including, but not limited to, new product introductions, promotional programs, direct communication with customers and potential product expiry issues. Consistent with industry practice, we periodically offer promotional discounts or allowances to the existing customer base. Where product is sold into new markets, the Company recognizes revenue when the risk of return is substantially eliminated which is based on estimates of sell-through to the end consumer.

Customer discounts and allowances are typically a percentage of the current published list price or may be a fixed amount, and treated as off-invoice allowances. Accordingly, discounts reduce revenue in the period of offering the program. Shipments resulting from these programs generally are not in excess of ordinary levels, therefore, the Company recognizes the related revenue upon delivery and include the shipments in estimating various product related allowances. In the event the Company determines these shipments represent purchases of inventory in excess of ordinary levels for a given wholesaler, an evaluation of the potential effect of exposure of product returns and a reduction in revenue (and increase to inventory) occurs. Discounts and allowances vary by customer, marketing program and time of the



year. Discounts in excess of recognized revenue are charged to advertising and marketing expense following a customer specific analysis.

Recognition of licensing revenues, which are comprised of initial up-front fees and milestone payments from licensing arrangements, is in accordance with EIC-141, Revenue Recognition and EIC-142, Revenue Arrangements with Multiple Deliverables. Recognition of fees at the inception of the agreement for prior research and technology rights occur when the Company has no further involvement or obligation to perform under the arrangement. Initial up-front and milestone payments, that require the Company's continuing involvement, are deferred and amortized into income over the estimated period of the Company's participation. The Company's commitment varies by each arrangement based on the ratio of costs expended to total estimated costs required to complete the Company's obligations. Recognition of revenue from performance milestone payments occurs upon achievement of the milestones as specified in the arrangement, provided payment is proportionate to the effort expended as measured by the portion of costs expended to total estimated development costs. Review of the estimates of the period and development costs take place on a regular basis.

#### Intangible assets and deferred development costs

Intangible assets are presented at cost less accumulated amortization, generally computed using the straight-line method based on estimated useful lives ranging from five to twenty years. The Company amortizes intangible assets on a systematic basis to reflect the pattern in which the economic benefits of the asset are consumed, if that basis can be reliably determined. The expected useful life is the period over which the intangible asset contributes directly or indirectly to future cash flows. Management determines the useful lives of intangible assets based on a number of factors, which include legal, regulatory or contractual limitations; known technological advances; anticipated demand; and the presence of competition. A significant change in these factors may require a revision of the expected remaining useful life of an intangible asset, which could have a material effect on results of operations.

Deferred research and development costs consist of direct and indirect expenditures related to the Company's research and development programs. Expensing of research and development costs takes place in the current period unless they meet generally accepted accounting criteria for deferral and amortization. The Company assesses whether these costs have met the relevant criteria for deferral and amortization at each reporting date. Development costs related to Parathyroid Hypertensive Factor have been deferred and are being amortized over a period of five years. Deferred development costs are subject to the same impairment testing as intangibles.

Typically, the original carrying value of intangible assets and deferred costs is cost less amortization. The recording of those intangible assets acquired through asset acquisitions or business combinations is at fair value based on an allocation of the purchase price.

The Company evaluates intangible assets annually for impairment, or more frequently if events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable. Impairment testing is an assessment of fair value based on potential indicators of impairment, such as obsolescence, plans to discontinue use or restructure, and poor financial performance compared with original plans. Impairment exists when the carrying amount of an asset is not recoverable and its carrying amount exceeds its estimated fair value.

For intangible assets, impairment testing uses an income approach. This approach involves a forecast of the estimated future cash flows, adjusted to present value by applying an appropriate discount rate that



reflects the risk factors associated with the cash flow streams. Some of the more significant estimates and assumptions inherent in the income approach include the amount and timing of the future cash flows, and the discount rate used to reflect the risks inherent in the future cash flows. A change in any of these estimates and assumptions could produce a different fair value, which could have a material impact on results of operations. In cases of impairment, management will re-evaluate the remaining useful life of the intangible asset and modify it, as appropriate. This evaluation may include an immediate adjustment to the carrying value and materially effect the results of operations.

## Accrued liabilities

The Company engages a significant number of third party service providers, contract manufacturing and logistic organizations. The basis of accruals is estimated expenses and/or inventory production. Where possible, detective controls, such as confirmations, are used to verify significant accruals. For example, the Company requests and verifies the accruals with statements from known, significant vendors and reconciles invoices received subsequent to the period end against those accruals. This accrual depends on the issuance and accuracy of estimates in purchase orders and contracts, and the accuracy of estimates on the percentage of completion and costs incurred to the end of the reporting period.

## Contingencies

In the normal course of business, the Company may be subject to loss contingencies, such as claims and assessments arising from litigation and other legal proceedings, contractual commitments and indemnities, product liabilities, and tax matters. The Company is required to accrue for such loss contingencies or expense if it is probable that the outcome will be unfavourable or take place, and if there is a reasonable estimate of the amount of the loss or expense. Evaluation of the Company's exposure to a loss takes into consideration various factors, including the progress of each contingency, experience with similar contingencies, and consultation with specialists and external legal counsel. The Company re-evaluates contingencies as additional information becomes available. Given the uncertainties inherent in complex litigation, regulatory processes and other contingencies, these evaluations can involve significant judgment about future events. The ultimate outcome of any litigation or other contingency may be material to the results of operations, financial position and cash flows.

## Income taxes

The Company has operations in various countries that have differing tax laws and rates. Income tax reporting is subject to audit by both domestic and foreign tax authorities.

The provision for income taxes involves a number of estimates and assumptions made by management. The amount of income earned in the various operating jurisdictions and the rate of taxes payable in respect of that income has an effect on the Company's consolidated income tax rate. The Company also enters into many transactions and arrangements in the ordinary course of business in which the tax treatment is not entirely certain and involves many taxation jurisdictions. As a result, management must make estimates and judgments based on knowledge and understanding of domestic and international tax rules in determining the consolidated tax provision. For example, certain countries in which we operate could seek to tax a greater share of income than has been provided for by the Company. The outcome of any audits by taxation authorities may differ from the estimates and assumptions used in determining our consolidated income tax provisions and accruals. These assessments could have a material effect on the Company's consolidated income tax provision and results of operations, financial position and cash flows for the period in which the tax authorities make such a determination. The Company may make a



valuation allowance on deferred tax assets primarily relating to operating losses, future tax depreciation and tax credit carry forwards. Management assumes that these deferred tax assets are more likely than not, to remain unrealized. Management must exercise significant judgment to determine the appropriate amount of valuation allowance to record. Changes in the valuation allowance required could materially increase or decrease the provision for income taxes in a period and affect the results of operations.

## Inventory valuation

Inventories of finished goods and product shipped with right-of return are presented at the lower of cost or net realizable value. The cost of inventory includes direct materials and labour costs, on a weighted average basis for the production lot. The net realizable value of inventory is determined by the estimated selling price of the products in the normal course of business less the cost of the inventory and estimated costs necessary to complete a sale. Determination of net realizable value is also based on, but not limited to, internal forecasts, historical sales data, input from members of the sales, marketing and operations groups, expiry dates and planned promotional programs. If the costs exceeds estimated net realizable value, the Company records allowances and continues to assess these allowances on a quarterly basis. All inventory items are also reviewed with members of the operations group for obsolescence including products that are no longer sold or saleable, or materials that are no longer used in production. These products and materials are expensed as identified or required.

The Company utilizes information gathered from customers and external data providers, sales estimates and judgment to determine the volume of product shipped with right-of-return. This product is within the customer's possession but is included in the Company's inventory as the related revenue has not been recognized and the customer has the ability to return the product. Management estimates that display and packaging materials will not be recoverable in the event of a return and expenses these materials when the product is shipped.

## Stock-based compensation

The Company has adopted the fair value-based method for recognizing stock-based compensation. The Company uses the Black-Scholes option-pricing model to calculate stock option values, which requires certain assumptions related to the expected life of the option, forfeiture rate, future stock-price volatility, risk-free interest rate, and dividend yield. The expected life of an option is based on the maximum 5 year vesting period of the stock option plan. The basis of future stock-price volatility is historical volatility of the Company's common shares over the expected life of the option. The basis of the risk-free interest rate is the zero-coupon Canadian government bonds rate at the time of the grant, with a term equal to the expected life of the option. The basis of the dividend yield is on the option's exercise price and expected annual dividend rate at the time of grant. The Company has not paid dividends in the past three years, nor has any plans to pay dividends. Changes to any of these estimates or assumptions, or the use of a different option-pricing model could produce a different fair value for stock-based compensation expense, which could have a material effect on the results of operations.

## Capitalized interest

The Company has modified its capitalization policy to include interest incurred on the construction of the related asset. Interest costs were capitalized on the land lease in fiscal year 2006.



## Recent Accounting Pronouncements

### Financial instruments

On October 1, 2006, the Company will adopt the following Canadian Institute of Chartered Accountants (CICA) accounting recommendations for the recognition, presentation and disclosure of financial instruments:

- CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement"
- CICA Handbook Section 3862 "Financial Instruments – Disclosures"
- CICA Handbook Section 3863 "Financial Instruments – Presentation"
- CICA Handbook Section 1530 "Comprehensive Income"
- CICA Handbook Section 3251 "Equity"

Under the new standards, all financial assets on acquisition must be classified as held-to-maturity, loans and receivables, held-for-trading or available-for-sale, and all financial liabilities at inception, must be classified as held-for-trading or other. All financial instruments are initially recorded on the balance sheet at fair value and if classified as loans and receivables, or held for trading, changes in fair value are included in earnings. For those instruments classified as available-for-sale and for derivative financial instruments designated as hedges, changes in fair value will be included in other comprehensive income. Other comprehensive income and its components are presented in a separate financial statement that is displayed with the same prominence as other financial statements.



## Glossary

<b>Term</b>	<b>Definition</b>
ASC	Alberta Securities Commission
BCSC	British Columbia Securities Commission
CBP	See ChemBioPrint
ChemBioPrint	A discovery and standardization platform used by the Company's scientists to identify the chemical profile and biological activity of natural products
CICA	Canadian Institute of Chartered Accountants
Company	CV Technologies Inc. which is the reporting issuer
CTO	Cease Trade Order
CVT-E002	Active ingredient in COLD-fx <sup>®</sup>
CVQ	Trading symbol for CV Technologies Inc. which is the reporting issuer
DIN	Drug Identification Number
FDA	U.S. Food and Drug Administration; the U.S. government body responsible for food (Dietary Supplements) drugs, medical devices, biologics, animal feed and drugs, cosmetics, radiation-emitting products, and combination products. CDER, the Center for Drug Evaluation and Research, is the division of the FDA responsible for drug approvals and the clinical trials on drugs. CFSAN, Center for Food Safety and Applied Nutrition, is the division of the FDA responsible for dietary supplements.
HT1001	Active ingredient in REMEMBER-fx <sup>®</sup>
HUMC	Hackensack University Medical Centre, New Jersey
ICTO	Interim Cease Trade Order
MD&A	Management's Discussion and Analysis
NHPD	Natural Health Products Directorate
NIH	National Institutes of Health: The National Institutes of Health (NIH), a part of the U.S. Department of Health and Human Services, is the primary Federal agency for conducting and supporting medical research.
NK	Natural Killer (cells)



NPN	Natural Product Number
OSC	Ontario Securities Commission
OTC	OTC drug/product: Over-The-Counter drug; a drug approved for sale by the FDA or Health Canada that does not require a Doctor's prescription to be purchased. It is available for self-care.
Phase I	Phase I of Clinical Development (as defined by the U.S. FDA for use in drug development): Phase I starts with the initial administration of an investigational new drug into humans. Studies in this phase of development usually have nontherapeutic objectives (no efficacy endpoints for the trial) and may be conducted in healthy volunteer subjects. Studies conducted in Phase I typically involve one or a combination of the following aspects: (a) safety and tolerability (b) pharmacokinetics including absorption, distribution, metabolism and excretion (c) early measurement of efficacy if performed in patients.
Phase II	Phase II of Clinical Development (as defined by the U.S. FDA for use in drug development): A therapeutic exploratory phase where efficacy in disease populations is determined. Phase II is usually considered to start with the initiation of studies in which the primary objective is to explore therapeutic efficacy in patients. An important goal for this phase is to determine the dose and regimen for Phase III trials. Additional objectives of clinical trials conducted in Phase II may include evaluation of potential study endpoints, therapeutic regimens (including concomitant medications), and target populations for further study in Phase II or III.
Phase III	Phase III of Clinical Development (as defined by the U.S. FDA for use in drug development): Studies in Phase III are designed to confirm the preliminary evidence accumulated in Phase II that a drug is safe and effective for use in the intended indication and recipient population. These studies are intended to provide an adequate basis for marketing approval in the U.S. for a drug. Studies in Phase III may also further explore the dose-response relationship, or explore the drug's use in wider populations, in different stages of disease, or in combination with another drug.
QA	Quality assurance: All the planned and systematic activities applied within the quality system to provide adequate confidence that the predetermined standards for quality and safety will be met.
QC	Quality control: The testing of the product to ensure it meets the standards established by quality assurance.
Sales	Product sales and revenues include reductions for sales discounts and allowances
SEDAR	System for Electronic Data Access and Retrieval ( <a href="http://www.sedar.com">www.sedar.com</a> )
PHF	Parathyroid Hypertensive Factor



# CV Technologies Inc.

Annual Report for the Twelve Month Period Ended

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POS Point of Sale refers to the retail sale of product to consumers or end user.

RSV Respiratory Syncytial Virus

