

ITEM 6. SELECTED FINANCIAL DATA

The following selected historical consolidated financial and other data are qualified by reference to, and should be read in conjunction with, the consolidated financial statements and notes thereto included elsewhere in this report. The Company's consolidated financial statements are prepared in accordance with United States generally accepted accounting principles. All amounts are in United States dollars.

	Fiscal year ended January 31,				
	2009	2008	2007	2006	2005
Sales from continuing operations	4,824,906	5,734,858	6,499,287	5,265,209	6,372,359
Net income (loss) from continuing operations	(1,591,470)	(885,211)	(260,623)	(1,489,053)	1,139,911
Net income (loss) per common share	(0.52)	(0.29)	(0.09)	(0.49)	0.38
Total assets	6,333,916	9,763,270	10,127,298	9,910,445	10,811,873
Long-term borrowings	890,523	1,033,843	1,058,835	691,178	833,631

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's fiscal year ends on January 31st of each year. In this report, fiscal year 2009 refers to the Company's fiscal year ended January 31, 2009. The following discussion should be read in conjunction with the financial statements and notes thereto included elsewhere in this report. The Company's financial statements are prepared in accordance with United States generally accepted accounting principles. All amounts are in United States dollars, unless otherwise denoted. This discussion contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. For a discussion of risks, uncertainties and other factors that could cause actual results to differ materially from those expressed in, or implied by the forward-looking statements, see the discussion of Risk Factors and "Cautionary Note Regarding Forward-Looking Statements" above.

Overview

The Company is engaged in the, manufacture and marketing of Dextran-based products for the veterinary and human pharmaceutical market. The Company conducts its business operations through its wholly-owned subsidiaries: Dextran Products and Chemdex, Inc.

Dextran Products Business

The manufacture and sale of bulk quantities of Dextran and derivative products for sale to large pharmaceutical companies throughout the world is conducted through a Canadian subsidiary, Dextran Products. Such products are used in the production of veterinary and human products such as vaccines and ophthalmic products.

For the past two fiscal years the Company has been extremely challenged by large fluctuations in exchange rates, especially the increase in the value of the Canadian dollar as compared to the United States dollar. The Company's sales are largely denominated in United States dollars, while its costs are largely in Canadian dollars. As a Canadian based manufacturer of pharmaceutical based compounds exporting internationally, the increase in value of the Canadian dollar by approximately 18% compared to the United States dollar from January 2007 until late in the third quarter of fiscal year 2009 severely reduced the profitability of the Canadian operations, and negatively impacted the Company's cash flows. In addition, the world wide increase in the price of commodities has resulted in lowered hog production, especially in Canada, Europe and the United States, where the Company has traditionally derived a substantial portion of its sales.

After the cancellation of the Phase III clinical trials for UsherCell due to inconclusive results, the Company's share price declined, eventually resulting in the Company's shares being suspended from trading on the NASDAQ Capital Market on September 12th, 2008 and delisted in December 2008. It is important to note that this did not have an impact on the core operations or source of funds for the core operations.

Results from ongoing research aimed at characterizing the impact of UsherCell on mucosal safety with new endpoints is expected in the second half of fiscal 2010. At that point the Company will review further opportunities to develop the compound into a commercial product.

Throughout this period, the Company has been investing its significant cash reserves in refurbishing the Toronto plant, in order to capitalize on the higher margins available for its powdered products line, primarily Dextran and Dextran derivatives.

Chemdex

Chemdex is the US based subsidiary that purchases raw materials from Dextran Products for the production of Iron Dextran 10% for the American market. Chemdex then sells the bulk material to Sparhawk Labs who produce the final dosage form for distribution in the US.

Chemdex, Veterinary Laboratories and the Joint Venture Business

During approximately one month of the 2005 fiscal year, the Company also engaged in the finished product veterinary pharmaceutical business through its United States subsidiary Chemdex, which, in turn, conducted its operations through its subsidiary, Veterinary Laboratories. On December 1, 1992, Veterinary Laboratories and Sparhawk Laboratories Inc. entered into a joint venture for the purpose of manufacturing and selling veterinary pharmaceutical products (the "Joint Venture") On January 13, 2004, the Company, Chemdex and Veterinary Laboratories entered into an Asset Purchase Agreement with Sparhawk pursuant to which the Company agreed to sell its finished product veterinary pharmaceutical business, including substantially all of the assets of Veterinary Laboratories and its ownership interest in the Joint Venture, to Sparhawk for \$5,500,000 in cash. The sale was completed on March 4, 2004. Simultaneously with the closing, Chemdex advanced \$350,000 to Sparhawk in exchange for an unsecured subordinated promissory note bearing interest at 13% per annum and a warrant to purchase 4% of the equity of Sparhawk. The promissory note was payable in full on March 4, 2009. Interest was payable annually, but could be deferred and added to the principal balance of the promissory note each year at Sparhawk's discretion. On May 31, 2006, payment in full for principal and interest was received. The warrant expired at the earlier of payment in full of the promissory note or March 4, 2014, and therefore expired before it could be exercised. Chemdex also entered into a supply agreement with Sparhawk to supply ferric hydroxide and hydrogenated dextran solution to Sparhawk on an exclusive basis in the United States for 10 years.

Results of Operations

Fiscal Year ended January 31, 2009 compared to Fiscal Year ended January 31, 2008 compared to Fiscal Year ended January 31, 2007

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				(% increase (decrease))	
Loss before taxes	\$(1,644,430)	\$(967,155)	\$(375,818)	(70)%	(157)%
Net Loss	(1,591,470)	(885,211)	(260,623)	(80)%	(240)%
Loss per share	(0.52)	(0.29)	(0.09)		

The increase in net loss for the fiscal year 2009 as compared to fiscal year 2008 is attributable to two principal causes. First, there was an impairment charge of \$550,956 against the long-lived assets of the Company, which was determined on the basis of the Company's expected future cash flows compared to the current value of the Company's property and equipment. Second, from an operations aspect, the increase in net loss was impacted by the continued decrease in sales and gross margins, and the strength of the Canadian dollar as compared to the United States dollar encountered during the first three quarters of the fiscal year. Because the majority of the Company's revenue is denominated in United States dollars while the majority of its cost of sales is denominated in Canadian dollars, at its Dextran Products subsidiary, when the value of the Canadian dollar increases in relation to the United States dollar, margins decrease and expenses increase. The average exchange rate used for fiscal 2009 was only slightly better than that encountered in fiscal 2008 (3.5%), though significant improvement did occur in the fourth quarter.

The increase in net loss for the fiscal year 2008 as compared to fiscal year 2007 was due primarily to the rise of the Canadian dollar relative to the United States dollar and the significant portion of Company expenses that are denominated in Canadian dollars. Exchange rate fluctuations resulted in a 13% decrease in margins at Dextran

Products in fiscal year 2008 compared to the previous fiscal year (4% decrease in fiscal year 2007). The results for fiscal year 2007 also included the recognition of the deferred gain on the promissory note related to the sale of the veterinary products assets to Sparhawk (Note 13).

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Sales	\$4,824,906	\$5,734,858	\$6,499,287	(16)%	(12)%

Sales decreased in fiscal year 2009 compared to fiscal year 2008 as a result of decreased demand from existing customers, primarily in the fourth quarter of fiscal year 2009. This decline in demand was caused by the general global economic decline which included the decline in the hog markets, especially in Europe. When the decline in sales orders severely escalated early in the fourth quarter, management determined that as a cost-saving measure, it was prudent to close the production plant for approximately 8 weeks. This resulted in a sales decline of \$714,175 for the fourth quarter of fiscal year 2009 compared to the same quarter of fiscal year 2008, Year to date sales for the third quarter had already been impacted by the general turmoil in the world economy and combined with the reduced sales from the fourth quarter, resulted in an overall sales decline of 16% for fiscal year 2009 compared to the prior fiscal year.

Sales decreased in fiscal year 2008 compared to fiscal year 2007 as a result of decreased demand from existing customers and production problems which primarily affected our powdered products. Lower customer demand, primarily related to our lower margin products, resulted from overall selling price increases, which in turn were necessitated by the increase in value of the Canadian dollar relative to the United States dollar. Total production volume in fiscal year 2008 decreased by 31% compared to fiscal year 2007.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Gross profit	\$31,903	\$375,064	\$832,443	(91)%	(55)%
Percentage of sales	0.7%	6.5%	13%		

The decrease in gross profit in fiscal year 2009 resulted from decreased sales, especially during the fourth quarter as noted above, production problems incurred in the third quarter, and the plant closure that took place during the fourth quarter. Though significant savings resulted from the plant closure in production related areas such as plant labor, utilities and raw materials, ongoing costs such as realty taxes, depreciation and some utility costs were still incurred.

The decrease in gross profit in fiscal year 2008 was a result of the decrease in sales noted above, combined with increased direct costs resulting from the increase in value of the Canadian dollar. Significant cost savings were realized in almost all direct costs, including payroll reductions of more than 10%, but these savings were not sufficient to offset the effect of the exchange rate increase of the Canadian dollar.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>08 v 07</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Selling, promotion, general and administrative expenses	\$1,071,734	\$1,211,172	\$1,376,960	(11)%	(12)%

As in fiscal year 2008, management continued its efforts to reduce overall selling, promotion and general and administrative expenses. The most significant reductions occurred in administrative wages, insurance, options expense, and selling and promotion costs. Reporting costs were also reduced as a result of being suspended from listing in September 2008.

In fiscal year 2008, management continued its efforts to reduce overall selling, promotion and general and administrative expenses. The most significant reductions occurred in professional and reporting fees, insurance,

legal fees, and options expense. The Company also eliminated travel to various conferences that had been attended in previous years that related to the Usher cell project.

<u>Research and development</u>	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Research and development Expenditures	\$35,102	\$135,821	\$214,865	(74)%	(37)%

In fiscal year 2009, virtually all of the Company's research into Usher cell was halted, with only some patent expenses being incurred and paid. Further patent fees are also being curtailed. Results from ongoing research aimed at characterizing the impact of Usher cell on mucosal safety with new endpoints is expected in the second half of fiscal 2010. At this point, the Company will assess the potential commercial viability of the compound before investing in further research or development. Since the cessation of the clinical trials for Usher cell, the Company has been reviewing the other projects in its portfolio and actively pursuing their potential for creating new market opportunities.

In fiscal year 2008, the Company continued to reduce its research and development expenditures. Final payments were made with respect to clinical studies related to the Usher cell project, and a small amount was expended on process improvement projects related to the Company's ongoing product lines. Patent fees were reduced to the minimum necessary to maintain only certain existing patent rights.

Funding for the Company's primary development products has been provided directly by third party public and/or private sector groups to the entities carrying out such research. The Company did not take possession or control over these funds. The Company benefits from the results of research projects through the ownership of patents and/or licenses with respect to the products involved. The Company has no commitments to repay the funding or to purchase the results of the research.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Depreciation and amortization expense	\$549,376	\$559,866	\$547,297	(2)%	2%

The small decrease in depreciation and amortization for fiscal year 2009 is due primarily to the small decrease in average value of the Canadian dollar for the year, compared to fiscal 2008. Included in depreciation and amortization expense are allocations to cost of goods sold in the amount of \$514,899 for fiscal year 2009 (2008 — \$519,787; 2007 — \$505,211).

The increase in depreciation and amortization in fiscal years 2008 and 2007 was due primarily to the increased investments in capital equipment during the year, and the increase in the value of the Canadian dollar relative to the United States dollar.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Interest expense	\$66,714	\$96,818	\$94,790	(31)%	2%

The decrease in interest expense in fiscal year 2009 is primarily due to the decrease in interest rates compared to fiscal year 2008, as well as the continued decrease in other long-term debt and capital obligations.

The increase in interest expense in fiscal year 2008 was primarily attributable to the rise in the Canadian dollar relative to the United States dollar. This is partially offset by the decrease in other long-term debt and capital lease obligations.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Foreign exchange loss (gain)	\$(77,818)	\$43,256	\$(22,857)	280%	(289)%

In fiscal year 2009, the Company experienced an overall foreign exchange gain due to Dextran Products' exposure to the United States dollar, especially with the decline in value of the Canadian dollar relative to the United

States dollar in the latter part of the fiscal year. Throughout most of fiscal year 2008, Dextran Products generally had a net asset exposure to the United States dollar because accounts receivable balances denominated in United States dollars normally exceeded its United States dollar denominated intercompany payables. While the exchange rate was relatively consistent during the earlier part of the fiscal year, the significant decline of the Canadian dollar in the latter part of fiscal year 2009 was a major factor contributing to the overall gain for the fiscal year.

In fiscal year 2008, the Company experienced a foreign exchange loss due to Dextran Products' exposure to the United States dollar, combined with the continued increase in value of the Canadian dollar relative to the United States dollar. Throughout fiscal year 2008, Dextran Products generally had a net asset exposure to the United States dollar because accounts receivable balances denominated in United States dollars normally exceeded its United States dollar denominated intercompany payables.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Impairment of property and equipment	\$550,956	—	—	100%	—

As discussed above, the Company has determined that a charge of \$550,956 is appropriate to align the value of the Company's plant and equipment with the value of future cash flows that are expected to be earned by those capital assets.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Interest and other income	\$10,359	\$184,821	\$497,663	(94)%	(63)%

Interest and other income declined significantly in fiscal year 2009 due to the loss realized on disposal of shares included in the investments available for sale. This loss is partially offset by the gain shown in comprehensive income. The decrease is also due to the lower interest rates experienced during fiscal 2008 applicable to the due from shareholder amount.

The decrease in interest and other income in fiscal year 2008 compared to fiscal year 2007 was due primarily to the recognition of the deferred gain of \$350,000 on the promissory note from Sparhawk in fiscal year 2007, as explained above. Investment income decreased in fiscal year 2008 as a result of the decrease in investments available for sale and amounts included in cash equivalents, partially offset by the cash surrender of a life insurance policy on a departed Company officer.

	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Fiscal Years</u>	
				<u>09 v 08</u>	<u>08 v 07</u>
				<u>(% increase (decrease))</u>	
Recovery of income taxes	\$(52,960)	\$(81,944)	\$(115,195)	(35)%	(29)%

The fiscal year 2009 decrease in tax provision is due to a decrease in deferred tax liabilities. This deferred tax liability was no longer considered necessary as the Company has loss carryforwards available that should result in there being no income taxes payable for the foreseeable future.

The fiscal year 2008 decrease in tax provision is due to a decrease in deferred tax liabilities of \$83,317, combined with an increase in current tax expense of \$1,373. The decrease in the deferred tax liability is due to the decrease in the timing difference related to the excess of carrying value of depreciable assets over tax value, which in turn reduces future income tax liabilities.

Liquidity and Capital Resources

As of January 31, 2009, the Company had cash of \$327,857, compared to cash and cash equivalents of \$468,570 at January 31, 2008. In fiscal year 2009, the Company expended cash of \$251,128 in its operating activities, compared to expending \$297,899 for fiscal year 2008 and generating \$661,607 for fiscal year 2007. The cash expended in operations in fiscal year 2008 as compared to the cash generated in fiscal year 2007 is due to the decrease in earnings. Depreciation and amortization continues to be a large non-cash expense of the Company, which is

expected to increase in fiscal year 2009 as result of assets acquired as part of the refurbishment become operational. The impairment of property and equipment is also a large non-cash item which is not considered to be reoccurring.

Working capital decreased to \$1,359,946, and the current ratio decreased to 3.19 to 1 as of January 31, 2009, compared to \$2,403,042 and 3.43 to 1 as of January 31, 2008.

As at January 31, 2009, the Company had no commitments for capital expenditures related to the plant refurbishment at Dextran Products in Toronto as compared to \$20,024 at January 31, 2008.

At January 31, 2009, the Company had accounts receivable of \$161,858 and inventory of \$1,003,623, compared to \$611,975 and \$1,350,490, respectively, at January 31, 2008. The decrease in accounts receivable and inventory at January 31, 2009 is due to the plant closure and related lower volume of sales in the fourth quarter compared to the same period in fiscal year 2008. At January 31, 2009, the Company had accounts payable of \$150,965, compared to \$399,820 at January 31, 2008. The decrease as at January 31, 2009 was due primarily to the lowered production costs as a result of the plant closure and related lower sales in the fourth quarter. In addition, accrued liabilities at January 31, 2008 included costs related to the plant refurbishment of \$129,500 compared to nil at January 31, 2009. During fiscal year 2009, capital expenditures totaled \$56,401, as compared to \$1,486,866 in fiscal year 2008.

As at January 31, 2009, the Company's investments consisted of a short-term fixed income fund and a global fixed income bond fund, both denominated in Canadian dollars. Unrealized gains and losses will occur as the market interest rates and investment valuations vary. Management does not expect significant gains or losses in the future due to the relatively short term to maturity of the nature of these funds. Management plans to convert a portion of these investments to cash as needed for working capital or other cash needs such as plant refurbishments and equipment.

The change in accumulated other comprehensive income of the Company is almost entirely attributable to the currency translation adjustment of Dextran Products. Dextran Products' functional currency is the Canadian dollar. This currency translation adjustment arises from the translation of Dextran Products' financial statements to United States dollars.

Dextran Products had a Cdn. \$250,000 (U.S. \$203,000) (2008–Cdn. \$750,000; U.S. \$636,000) line of credit, none of which was utilized at January 31, 2009 and 2008. This line of credit bears interest at the Canadian banks' prime lending rate plus 1.00% (2009–3.40%; 2008–6.50%) and is repayable on demand. This indebtedness is collateralized by a general security agreement over the Company's assets and a collateral mortgage of Cdn. \$500,000 on the Dextran Products building in Toronto. In March of 2006, the Company secured an additional Cdn \$500,000 fixed rate term loan primarily to fund capital purchases, with interest at 0.75% over Canadian banks' prime lending rate (2009–6.95%).

The bank indebtedness agreement contains two covenants related to the operations at the Dextran Products facility in Toronto, Canada. First, there is a Debt to Tangible Net Worth ratio, which requires a maximum of 125%. As at January 31, 2009, the Company met this requirement with a ratio of 16% (2008–17%). Second, there is a Debt Service Coverage Ratio, which requires a minimum ratio of 120%. Due to the operating loss incurred in fiscal year 2009, the Company did not meet this ratio test, as the loss created a significant negative ratio of 990% (2008–negative 82%) As a result of this covenant failure, the Company's line of credit was reduced to Cdn \$250,000 (USD \$203,000) during the first quarter of fiscal year 2009, and a waiver was granted by the bank which noted that the Company was expected to meet this ratio in the future. Management has planned to improve the results of its operations as noted below.

The increase in capital lease obligations during fiscal year 2009 was due to the acquisition of printer/fax equipment and a forklift truck, less repayments on capital leases.

No changes in accounting principles or their application have been implemented in the reporting period that would have a material effect on reported income.

Changes in the relative values of the Canadian dollar and the United States dollar occur from time to time and may, in certain instances, materially affect the Company's results of operations. See Item 7A.

The Company does not believe that the impact of inflation and changing prices has had a material effect on its operations or financial results at any time in the last three fiscal years.

Management's Plan to Improve the Results of Operations.

As at January 31, 2009, there were certain negative financial indicators reflected in our financial statements. These include an accumulated deficit of \$19,370,714, a loss of \$ 1,591,470 for the year, cash used in operations of \$251,128, and the inability of its subsidiary, Dextran Products Limited, to meet its bank's lending covenants as noted above. The Company has also determined that an impairment charge was necessary to align the carrying value of its property and equipment with the value of expected future cash flows.

These negative results are due to extreme fluctuations in the value of the Canadian dollar versus the US Dollar as previously discussed, the relatively low margin of the main product base, Iron Dextran, and the decreased sales due primarily to the general economic slowdown, especially related to the hog markets worldwide.

To offset these poor results the Company continues to focus on its active program to improve results with the following activities:

As a result of the dramatic impact of exchange rates during the year, the Company has been aggressively seeking cost reductions in all areas of its operations. Cost reductions have been achieved in most areas including raw material pricing, plant repairs, as well as insurance, legal, consulting and reporting costs. Payroll reductions have been implemented, with reductions in management compensation and the implementation of shorter plant hours of work when appropriate. The plant was also shutdown for approximately 8 weeks in the third quarter, resulting in significant cash savings. These cost control initiatives are ongoing and will continue to be of benefit to the Company.

The Company's operating division, Dextran Products, also conducts weekly meetings with Production and Quality Control to monitor all production processes and batch yields to ensure they are maximized.

In fiscal year 2010, management intends to continue its focus on the core business of Dextran Products that have historically been the backbone of the company. It has come to the attention of the Company that some other producers of Dextran and Dextran derivatives in the world have refocused their attention on other products and are no longer producing Dextran and Dextran derivatives. This has led to an increase in interest in the Company as a potential supplier of this type of product, and the Company is actively responding to these enquiries. These are powdered products and as such present the possibility of increased sales of higher margin product if they result in confirmed orders. At this time it is not possible to confirm this interest will lead to an increase in sales.

The Company is well positioned to take advantage of increased interest in these powdered products as a result of having invested, over the past several years, in state of the art drying equipment. This new drying equipment is now installed and is presently being qualified. This last step requires the preparation of manuals and documents to ensure consistent operation and therefore production of the highest quality product. This will in turn ensure that the Company is capable of supplying product to large pharmaceutical companies who have expressed such an interest. This work is expected to be completed in the first half of fiscal 2010.

Overall, management believes that a number of factors will lead to more profitable operations. First, the Company provides unique, high quality products. This is confirmed by the interest shown from various customers, some of whom have not only researched and tested alternative sources to the products provided by the Company, but have also visited our Toronto operations to confirm their desire to continue or expand their relationship with Polydex Pharmaceuticals. Second, the economic turmoil experienced primarily over the past two years has lessened the number of available producers of comparable products. In addition, our customers have informed us that some of our competitors have had difficulty achieving the high quality standards that are the Company's norm. Third, though inconclusive at this time, the international hog markets appear to have stabilized. This is hopefully a precursor to improved market conditions overall, especially for our core Dextran and Dextran related products. Fourth, recent strong interest in our various product lines has occurred from new and existing customers, as evidenced by the high level of enquiries and requests for samples being regularly received, and the Company's recent return to full production levels. Fifth, the lowered carrying cost of the capital assets will more accurately reflect the lower income charge that is more appropriate to the contribution to be made by these assets. Lastly, the recent

strength of the United States dollar provides increased profitability, liquidity and cash flow to our Canadian subsidiary in Toronto, which is the engine that drives our Company's operations.

All of the foregoing expectations are subject to the risks and uncertainties discussed above under "Risk Factors" and "Cautionary Note Regarding Forward Looking Statements". Should the above expectations fail to occur or do not achieve the levels required to meet the Company's profitability and liquidity requirements, management may seek other sources of investment or liquidity from new or existing investors, creditors and customers.

Related Party Transactions

In August 1997, the Company loaned Thomas C. Usher, formerly its Vice-Chairman, Director of Research and Development, a member of its Board of Directors and the beneficial owner of greater than 5% of the outstanding common shares of the Company, \$691,500 at an interest rate equal to the United States' bank prime rate plus 1.50% (the "Loan"). The Loan was used to partially fund a \$1,000,000 payment to the State of Florida in order to allow Thomas C. Usher to regain possession of 430,000 Common Shares of the Company then held by the State as collateral security relating to the liquidation of insurance companies formerly owned by Thomas C. Usher. Repayment of the Loan is accomplished by periodic payments and through offsets by the Company against royalty payments due Thomas C. Usher pursuant to intellectual property license agreements and, in the past, bonus payments, if any, granted to Thomas C. Usher as an employee of the Company. The amount outstanding under the Loan as of January 31, 2009 was \$299,716, as compared to \$297,321 at January 31, 2008, including accrued interest. The Company has taken a cumulative provision of \$323,490 against this loan and other amounts described below as at January 31, 2009 (2008 -\$323,490). Thomas C. Usher passed away on February 26, 2005. Obligations with respect to the Loan transferred to the estate of Thomas C. Usher. The Company continues to be obligated to make royalty payments pursuant to the license agreements, and intends to continue to offset such payments against the Loan.

In August 1999, Thomas C. Usher personally assumed all of the assets and liabilities of Novadex Corp., including the balance of receivables (the "Receivables") due to the Company from Novadex Corp. The Receivables have no specific repayment terms. The total outstanding amount of the Receivables as of January 31, 2009 was \$31,244, as compared to \$60,339 at January 31, 2008. Thomas C. Usher also owed \$250,000 to a subsidiary of the Company, Novadex International Limited, as of January 31, 2009, pursuant to a non-interest bearing loan with no specific repayment terms. The outstanding amount of this loan has not changed from January 31, 2008. The amounts continue to remain owing from the estate of Thomas C. Usher.

As of January 31, 2009, Thomas C. Usher, now through his estate, has pledged 243,263 common shares of the Company as security for these amounts owing to the Company. These common shares had a market value of \$92,440 at January 31, 2009, based on the closing price of the Company's common shares on the Pink Sheets quotation service on January 31, 2009. During the third quarter of fiscal year 2009, George Usher, Chief Executive Officer of the Company, purchased 27,500 shares of the Company from the estate for a cost of \$16,500, based on the share market price at the time of purchase. Proceeds were used to reduce the shareholder loan owing to the Company. The Company intends to continue to hold the pledged assets as collateral until the amounts owing discussed above are repaid.

The Company had a commitment to pay an amount equal to one year's salary, \$110,000, to Thomas C. Usher's estate. The amount owing on this commitment as at January 31, 2009 is \$36,297 (2008 — \$36,908).

The Company also has an outstanding loan payable to the estate of Ruth Usher, a former director and widow of Thomas C. Usher, who passed away in July 2008. The amount due from the Company pursuant to this loan decreased to \$608,316 at January 31, 2009 from \$658,569 at January 31, 2008 due to monthly payments by the Company exceeding interest charges. The Company is required to make blended monthly payments of \$5,000 (2007 — \$8,000).

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, applied on a consistent basis. The critical accounting policies include the use of estimates of allowance for doubtful accounts, the useful lives of assets and the realizability of deferred tax assets. The Company's accounting policies with respect to the Joint Venture and its disposition are also discussed below.

Management is required to make estimates and assumptions, in preparing the consolidated financial statements that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the periods. The actual results could differ from these estimates. Significant estimates made by management include the calculation of reserves for uncollectible accounts, inventory allowances, useful lives of long-lived assets and the realizability of deferred tax assets.

Revenue Recognition

All revenue is from sales of bulk and finished dosage manufactured products and is recognized when title and risk of ownership of products pass to the customer. Title and risk of ownership pass to the customer pursuant to the applicable sales contract, either upon shipment of product or upon receipt by the customer. Since returns are rare and generally not accepted, management has not made provision for returns. In addition, product sold in bulk quantities is tested, prior to release for shipment, to ensure that it meets customer specifications, and in many cases, customers receive samples for their own testing. Approval is obtained from the customer prior to shipping.

Allowance for Doubtful Accounts

Accounts receivable is stated net of allowances for doubtful accounts. Allowances for doubtful accounts are determined by each reporting unit on a specific item basis. Management reviews the credit worthiness of individual customers and past payment history to determine the allowance for doubtful accounts. Since the majority of sales at Dextran Products are export, Dextran Products maintains credit insurance through a crown corporation, which is supported by the Canadian government, for the majority of its customers' receivables. There has been no allowance for doubtful accounts during the past three fiscal years.

Long-Lived Assets

Long-lived assets are stated at cost, less accumulated depreciation or amortization computed using the straight-line method based on their estimated useful lives ranging from three to fifteen years. Useful life is the period over which the asset is expected to contribute to the Company's cash flows. A significant change in estimated useful lives could have a material impact on the results of operations. The Company reviews the recoverability of its long-lived assets, including buildings, equipment and other intangible assets, when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to make estimates of these cash flows related to long-lived assets as well as other fair value determinations.

Deferred Tax Assets

The Company has recorded a valuation allowance on deferred tax assets where there is uncertainty as to the ultimate realization of the future tax deduction. Dextran Products has incurred capital losses, which are only deductible against capital gains. It is not certain that Dextran Products will realize capital gains in the future to use these Canadian capital loss deductions.

Changes in Accounting Policies

No changes in accounting principles or their application have been implemented in the reporting period that would have a material adverse effect on reported income.

Recent Accounting Pronouncements

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets-an amendment of FASB Statement No. 140*. SFAS No. 156 amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective at the beginning of the first fiscal year that begins after September 15, 2006. The Company does not anticipate that the application of SFAS 156 will have an impact on the consolidated financial statements of the Company.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (“GAAP”), and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ending December 31, 2008. The Company is currently evaluating the impact of SFAS No. 157 on its financial statements.

In June 2006, the FASB issued FASB Interpretation (“FIN”) No. 48 “Accounting for Uncertainty in Income Taxes.” FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109 “Accounting for Income Taxes.” FIN No. 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Earlier application is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period of adoption. The adoption of FIN No. 48 will not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS No. 158 improves financial reporting by requiring an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Management does not expect that SFAS No. 158 will have an impact on the consolidated financial statements of the Company.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (“SAB 108”), “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.” SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires companies to quantify misstatements using both a balance sheet and an income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is material, companies will record the effect as a cumulative effect adjustment to beginning of year retained earnings. The adoption of SAB 108 does not have an impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The adoption of SFAS 159 does not have an impact on our consolidated financial statements.

In December 2007, the FASB revised SFAS No. 141, *Business Combinations*. SFAS No. 141 (revised 2007) improves the relevance, representational faithfulness, and comparability of the information that a reporting entity

provides in its financial reports about a business combination and its effects. SFAS No. 141 (revised 2007) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is not permitted before that date. As such, the Company is required to adopt these provisions during the fiscal year ending January 31, 2010. The Company is currently evaluating the impact of SFAS No. 141 (revised 2007) on its financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51*. SFAS 160 improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, earlier adoption is prohibited. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ending January 31, 2010. The Company is currently evaluating the impact of SFAS No. 160 on its financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standard No. 161, *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. SFAS No. 161 is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008, with early adoption encouraged. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended January 31, 2010. The Company is currently evaluating the impact of SFAS No. 161 on its financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Exchange Rate Sensitivity

The Company's operations consist of manufacturing activities in Canada. The Company's products are sold in North America, Europe and the Pacific Rim. While the majority of the sales of Dextran Products, the Company's Canadian operation, are denominated in United States dollars, the majority of its expenses are incurred in Canadian dollars. The majority of the assets and liabilities of Dextran Products are denominated in Canadian dollars prior to the currency translation adjustment necessary for preparation of the financial statements of the Company contained in this report. When the Canadian dollar rises in value relative to the United States dollar, the carrying value of the assets and liabilities of Dextran Products as stated in United States dollars increases. A rise in the Canadian dollar relative to the United States dollar also results in a decrease in gross margins and net income of Dextran Products. Dextran Products also experiences a foreign exchange gain when the Canadian dollar rises in relation to the United States dollar because it has a net liability exposure to the United States dollar resulting from a United States dollar denominated intercompany loan. Similarly, a decline in the Canadian dollar relative to the United States dollar results in a foreign exchange loss and increased gross margins and net income at Dextran Products. Management monitors currency fluctuations to ensure that an acceptable margin level at Dextran Products is maintained. Management has the ability, to some extent, to adjust sales prices to maintain an acceptable margin level.

The following table presents information about the Company's financial instruments other than accounts receivable that are sensitive to changes in foreign currency exchange rates. All financial instruments are held for other than trading purposes. The table presents principal cash flows and related weighted average interest rates by expected maturity dates.

	<u>Expected Maturity Date</u>						<u>Total</u>	<u>Fair Value</u>
	<u>1/31/10</u>	<u>1/31/11</u>	<u>1/31/12</u>	<u>1/31/13</u>	<u>1/31/14</u>	<u>Thereafter</u>		
	(US\$ Equivalent)							
Assets:								
Short-term investments:								
Fixed rate (\$Cdn.)	383,940	—	—	—	—	—	383,940	378,973
Average interest rate	3.23%	—	—	—	—	—	3.23%	
Marketable securities:								
Fixed rate (\$Cdn.)	—	—	—	—	—	—	—	—
Average interest rate	—	—	—	—	—	—	—	—
Liabilities:								
Long-term debt:								
Fixed rate (\$Cdn.)	50,790	42,423	45,560	49,199	52,998	121,749	362,719	443,341
Average interest rate	8.80%	9.16%	9.16%	9.17%	9.18%	9.00%	9.08%	

Interest Rate Sensitivity

The Company has interest earning assets consisting of investment grade or higher short-term commercial paper and medium-term fixed income instruments. A significant portion of the Company's debt is at fixed rates. The variable rate debt represents the shareholder loan payable, which is partially offset with the shareholder loan receivable. Both of these financial instruments carry the same interest rate. As such, the Company has no significant risk exposure to changes in interest rates. The following table presents information about the Company's financial instruments that are sensitive to changes in interest rates. All financial instruments are held for other than trading purposes. The table presents principal cash flows and related weighted average interest rates by expected maturity dates.

	<u>Expected Maturity Date</u>						<u>Total</u>	<u>Fair Value</u>
	<u>1/31/10</u>	<u>1/31/11</u>	<u>1/31/12</u>	<u>1/31/13</u>	<u>1/31/14</u>	<u>Thereafter</u>		
	(US\$ Equivalent)							
Assets:								
Short-term investments:								
Fixed rate (\$Cdn.)	383,940	—	—	—	—	—	383,940	378,973
Average interest rate	3.23%	—	—	—	—	—	3.23%	
Marketable securities:								
Fixed rate (\$Cdn.)	—	—	—	—	—	—	—	—
Average interest rate	—	—	—	—	—	—	—	—
Notes receivable:								
Variable rate (\$US)	21,763	22,797	23,880	25,014	26,203	180,058	299,716	299,716
Average interest rate	4.78%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	
Liabilities:								
Long-term debt:								
Fixed rate (\$Cdn.)	50,790	42,423	45,560	49,199	52,998	121,749	362,719	443,341
Average interest rate	8.80%	9.16%	9.16%	9.17%	9.18%	9.00%	9.08%	
Variable rate (\$US)	31,106	32,584	34,131	35,753	37,451	445,916	616,942	616,942
Average interest rate	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	4.75%	

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**Polydex Pharmaceuticals Limited**
Quarterly Financial Highlights
January 31, 2009
(Expressed in United States dollars)

	<u>Fourth Quarter</u> <u>Fiscal Year</u>		<u>Third Quarter</u> <u>Fiscal Year</u>		<u>Second Quarter</u> <u>Fiscal Year</u>		<u>First Quarter</u> <u>Fiscal Year</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Sales from continuing operations	934,454	1,525,679	1,373,963	1,357,681	1,296,704	1,504,365	1,219,785	1,347,133
Gross profit (Loss)	(223,286)	(70,947)	(200,713)	137,947	191,906	99,103	263,996	208,961
Net loss from continuing operations	(1,030,593)	(285,076)	(418,680)	(237,544)	(169,535)	(228,353)	(25,622)	(134,238)
Net loss per common share	(0.34)	(0.10)	(0.014)	(0.08)	(0.04)	(0.07)	(0.01)	(0.04)