

1. GENERAL

Polydex Pharmaceuticals Limited, the (“Company”), is incorporated in the Commonwealth of the Bahamas and carries on business in Canada and the United States. Its principal business activities, carried on through subsidiaries, include the manufacture and sale of veterinary pharmaceutical products and specialty chemicals. These consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles.

GOING CONCERN

These consolidated financial statements have been prepared on going concern basis which assumes that the Company will be able to realize assets and discharge liabilities in the normal course of business for the foreseeable future. For the fiscal year ended January 31, 2009, the Company has generated a consolidated net loss of \$1,591,470 (2008-\$885,211) and realized a negative cash flow from operating activities of \$251,128 (2008 – \$297,899). There is an accumulated deficit of \$19,370,714 (2008 – \$17,779,244) The Company, through its wholly-owned subsidiary Dextran Products Limited, is also in violation of its debt service loan covenant related to the bank term loan of \$324,893 (Cdn\$398,481), on which the Company subsequently received a waiver from its bank. The Company has positive working capital of \$1,359,946 as at January 31, 2009 (2008 – \$2,403,042).

As referred to in Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operation*, management has undertaken the following initiatives that it believes will be instrumental in leading to more profitable operations:

- Cost reductions relating to direct cost areas, including raw material pricing, and tighter control of plant hours of work (including the plant shutdown in the fourth quarter).
- Restructuring of the supervisory hierarchy over production personnel, to ensure more efficient communication especially as related to problem identification and scheduling.
- Improved control of operational processes, including increased frequency of production and quality control meetings to address production issues on a more timely basis.
- Cost reductions relating to administrative and overhead expenses, including administrative wages, insurance, and reporting costs.
- Increased interaction with larger new and potential customers, including site visits, in order to address their opportunities and concerns, and strengthen our relationship with them.

The Company’s ability to continue as a going concern is in doubt as it is dependent on the ability of the Company to attain profitable operations, and enabling it to meet the Company’s liabilities as they become due and the realization of its business plans. The outcome of these matters is dependent on factors outside the Company’s control and cannot be predicted at this time. Should the above expectations fail to occur or not achieve the levels required to meet the Company’s profitability and liquidity requirements, management will seek other sources of investment from new or existing investors, creditors and customers.

The accompanying consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize assets and discharge liabilities in the normal course of business for the foreseeable future. These financial statements do not include any adjustments relating to the recoverability or classification of assets or the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are 100% owned. The subsidiaries are: Dextran Products Limited; Chemdex, Inc.; Polydex Chemicals (Canada) Limited; and Novadex International Limited. All inter-company accounts and transactions have been eliminated on consolidation.

Cash and cash equivalents

These consist of cash and short-term deposits having maturities of less than three months.

Use of estimates

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant accounting estimates relate to the allowance for unrecoverable amounts, depreciation and amortization rates, and asset impairment charges.

Inventories

Inventories of raw materials are stated at the lower of cost and net realizable value, cost being determined on a first-in, first-out basis. Work-in-process and finished goods are valued at the lower of cost and net realizable value, and include the cost of raw materials, direct labor and fixed and variable overhead expenses.

Investments available for sale

Investments available for sale consist of medium-term fixed income investments and mutual funds and are stated at fair value based on quoted market prices. Interest income is included in other income in the consolidated statements of operations as it is earned. Changes in fair values during the holding period are reported as unrealized gain (loss) on investments available for sale and are included in other comprehensive income (loss). Realized gains (losses) are reclassified from accumulated other comprehensive income (loss) on a specific item basis when the security is sold or matured.

Property, plant and equipment and patents and intangible assets

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings	15 years
Machinery and equipment	3 to 10 years

Patents and intangible assets are recorded at cost and are amortized on a straight-line basis over their estimated useful lives of ten years. Intangible assets consist of intellectual property, government licenses and government license applications.

Useful life is the period over which the asset is expected to contribute to the Company's future cash flows. The Company reviews the recoverability of its long-lived 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 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.

Costs related to plant refurbishments and equipment upgrades that represent improvements to existing facilities are capitalized. Costs related to repair and maintenance of buildings and equipment are expensed. The Company has no major planned maintenance activity.

Revenue recognition

All revenue is from sales of bulk 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 of product by the customer.

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. Further purchases by a customer of a bulk product with the same specifications do not require approvals. Returns of bulk product are rare and generally are not accepted.

Comprehensive income

The Company has adopted SFAS No. 130 Reporting Comprehensive Income. This standard requires companies to disclose comprehensive income in their financial statements. In addition to items included in net income, comprehensive income includes items currently charged or credited directly to shareholders' equity, such as foreign currency translation adjustments.

Shipping and handling costs

Shipping and handling costs incurred by the Company for shipment of products to customers are classified as cost of goods sold.

Research and development

Research and development costs are expensed as incurred and are stated net of investment tax credits earned.

Foreign currency translation

The functional currency of the Company's Canadian operations has been determined to be the Canadian dollar. All asset and liability accounts of these companies have been translated into United States dollars using the current exchange rates at the consolidated balance sheet dates. Capital stock is recorded at historical rates. Revenue and expense items are translated using the average exchange rates for the year. The resulting gains and losses have been reported separately as other comprehensive income (loss) within shareholders' equity.

Derivative financial instruments

The Company's Canadian subsidiary enters into foreign exchange contracts from time to time, to manage exposure to currency rate fluctuations related to expected future cash flows. The Company does not engage in speculative trading of derivative financial instruments. The foreign exchange contracts are not designated as hedging instruments, and as a result all foreign exchange contracts are marked to market and the resulting gains and losses are recorded in the consolidated statements of operations in each reporting period. Unrealized gains and losses are included in accrued liabilities in the consolidated balance sheets and in net change in non-cash working capital balances related to operations in the consolidated statements of cash flows.

Income taxes

The Company accounts for income tax under the provision of Statement of Financial Accounting Standards No. 109, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statement or tax returns. Deferred income taxes are provided using the liability method. Under the liability method, deferred income taxes are recognized for all significant temporary differences between the tax and financial statement bases of assets and liabilities.

Effects of changes in enacted tax laws on deferred tax assets and liabilities are reflected as adjustments to tax expense in the period of enactment. Deferred tax assets may be reduced if deemed necessary based on a judgmental assessment of available evidence, by a valuation allowance for the amount of any tax benefits which are more likely, based on current circumstances, not expected to be realized.

Stock options

The Company uses the fair value accounting method provided for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") to apply recognition provisions to its employee stock options granted, modified or settled. Compensation expense is recorded at the date stock options are granted. The amount of compensation expense is determined by estimating the fair value of the options granted using the Black-Scholes option pricing model.

Loss per common share

Basic loss per common share is computed using the weighted average number of shares outstanding of 3,072,846 for the year ended January 31, 2009 (2008 — 3,072,846; 2007 — 3,063,884). Diluted loss per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares, using the treasury stock method, attributed to outstanding options to purchase common stock. No incremental shares in 2009, 2008 or 2007, were used in the calculation of diluted loss per common share. Options to purchase of 138,761, 63,699, and 37,725 common shares in 2009, 2008 and 2007, respectively, were not included in the computation of diluted loss per common share because their effect was anti-dilutive.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	2009	2008
	\$	\$
Cash	327,857	171,625
Short-term deposit	—	296,945
	327,857	468,570

4. INVENTORIES

Inventories consist of the following:

	2009	2008
	\$	\$
Finished goods	626,058	790,822
Work-in-process	135,966	380,855
Raw materials	241,599	178,813
	1,003,623	1,350,490

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2009			2008		
	Cost	Accumulated Appreciation	Net book value	Cost	Accumulated Appreciation	Net book value
	\$	\$	\$	\$	\$	\$
Land and buildings	4,314,500	976,493	3,338,007	5,242,002	1,079,827	4,162,175
Machinery and equipment	8,173,744	6,964,595	1,209,149	9,908,157	8,028,984	1,879,173
	12,488,244	7,941,088	4,547,156	15,150,159	9,108,811	6,041,348
Less: Impairment adjustment	(489,197)		(489,197)			
	11,999,047	7,941,088	4,057,959	15,150,159	9,108,811	6,041,348

As stated in the Going Concern note above, the Company's operations resulted in several negative financial indicators, including recurring net losses, negative cash flows, violation of a covenant related to its bank term loan, and the plant shutdown in the fourth quarter. The Company then compared the carrying values of its building and production equipment, which are located in Toronto, Canada, and including the nearly completed plant refurbishments, to the value of estimated future cash flows to be expected from the utilization of these assets over their lifetime. This resulted in an impairment adjustment of \$489,197, which reduces the carrying value of its assets and the amounts for depreciation to be charged in future financial statements, thereby better reflecting the expected contribution of these assets to the Company's future operations.

Included in machinery and equipment are assets under capital lease with a total cost of \$928,064 (2008 — \$1,204,935) and accumulated depreciation of \$836,237 (2008 — \$919,651). Depreciation of assets under capital lease is included in cost of goods sold. Depreciation of \$514,899 was charged to cost of sales in fiscal 2009 (2008 — \$519,893). Assets not available for use amounted to \$2,861,449 (2008 — \$3,496,281).

6. PATENTS AND INTANGIBLE ASSETS

Patents and intangible assets consist of the following:

	2009 \$	2008 \$
Cost	80,341	80,341
Less accumulated amortization	42,870	34,830
	37,471	45,511

These patents and intangible assets will be amortized at approximately \$8,040 per year over the next 5 years.

7. INVESTMENTS AVAILABLE FOR SALE

Investments available for sale, at fair value, consist of the following:

	2009 \$	2008 \$
22,685 units (2008 — 44,458) of DFA Fixed Income Fund yielding 3.27%	175,523	418,094
TD short term bond fund consisting of Canadian government and corporate bonds maturing in the next 1–5 years, yielding 3.19%	205,934	346,845
4,000 preferred shares of Diversified 6% preferred share trust units	—	80,095
	381,457	845,034

Investments available for sale are stated at fair market value, based on quoted market prices. The Company expects that the investments available for sale will be used for working capital for fiscal 2009 and onwards. Accordingly the investments available for sale were classified as part of current assets as at January 31, 2008.

8. RELATED PARTY TRANSACTIONS

Amounts due from (to) shareholder consist of the following:

	2009 \$	2008 \$
Amounts due from estate of former shareholder [i]	257,470	284,170
Amounts due to shareholder [ii]	(608,316)	(658,569)

[i] Amounts due from estate of former shareholder (the “Estate”) bear interest at the United States banks prime lending rate plus 1.5% (2009 — 6.28%; 2008 — 8.48%), except for an amount of \$281,244 (2008 — \$310,339) which is non-interest bearing. Interest income on this loan is recognized monthly. These amounts have no fixed terms of repayment. The Estate has pledged 243,263 shares of the Company and has pledged future license fee payments from the Iron Dextran process license agreement [note 14] as collateral for this loan. During 2009, \$32,769 (2008 — \$70,280; 2006 — \$76,978) of license fee payments were made. The Company will continue to hold the pledged assets as collateral until the loan is repaid. The Company had a commitment to pay a death benefit of \$110,000 to the Estate. At January 31, 2009, a balance of \$36,297 is still to be paid to the Estate. See also “Iron Dextran Process” under Note 14.

[ii] Amounts due to shareholder are unsecured and bear interest at the United States banks prime lending rate plus 1.5% (2009 — 6.28%; 2008 — 8.48%). The Company is required to make monthly payments, inclusive of accrued interest, of \$5,000. Based on the current rate of interest, the principal repayment on this loan for fiscal 2010 would be approximately \$30,000. This loan may not be called.

Interest expense recorded with respect to amounts due to shareholder is as follows:

	2009	2008	2007
	\$	\$	\$
Interest expense	39,752	63,256	64,390

9. BANK INDEBTEDNESS

The Company had a Canadian operating line of credit of Cdn. \$250,000 (U.S. \$203,830; 2008 — U.S. \$747,160), none of which was utilized at January 31, 2009 (2008 — Nil). The Canadian line of credit bears interest at the Canadian banks' prime lending rate plus 1.00% (2009 — 3.40%; 2008 — 6.50%). During March 2006, a term loan of Cdn \$500,000 (U.S. \$498,100) was obtained for the purchase of equipment, bearing interest of 6.95% (note 10[a]). Bank 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 Limited ("Dextran Products") building.

Subsequent to the end of fiscal years 2009 and 2008, the Company received notice from its Canadian bank that it was in default of one of its covenants, and that this covenant is to be met on a going forward basis. Subsequent to the year end the bank has waived this default.

10. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

[a] Long-term debt consists of the following:

	2009	2008
	\$	\$
Note payable in blended quarterly payments of Cdn. \$141 (U.S. \$115), bearing interest at a fixed rate of 11%, maturing November 13, 2013	1,748	2,980
Bank term loan (note 9) payable in monthly installments of Cdn. \$5,792 (U.S. \$4,722) principal and interest at the Canadian banks' prime lending rate plus 0.75% (2009 — 6.95%), maturing May 2016	324,893	437,104
	326,641	440,084
Less current portion	35,336	41,544
	291,305	398,540

Interest expense for the year for long-term debt was \$ 23,430 (2008 — \$31,984)

Principal repayments on the long-term debt are as follows:

	\$
2010	35,336
2011	38,036
2012	40,779
2013	43,721
2014	49,332
Thereafter	84,101
	291,305

[b] Capital lease obligations consist of the following:

	2009	2008
	\$	\$
Obligation (Cdn. \$30,436) under a capital lease, repayable in quarterly installments, bearing interest at 11.15% and maturing in 2014.	24,815	—
Obligation (Cdn \$13,965) under a capital lease, repayable in monthly installments, bearing interest at Nil, and maturing in 2009.	11,386	—
Obligation (Cdn. \$12,854) under a capital lease, repayable in quarterly installments, bearing interest at 10.43% and matured December 2008.	—	12,805
	36,201	12,805
Less current portion	15,299	6,071
	20,902	6,734

Future minimum annual lease payments on the capital lease obligations including interest are as follows:

	\$
2010	17,943
2011	6,557
2012	6,557
2013	6,557
2014	6,557
Total minimum lease payments	44,171
Less amount representing imputed interest	7,970
	36,201

Interest expense for the year for capital lease obligations was \$3,433 (2008 — \$1,711)

11. ACCRUED LIABILITIES

	2009	2008
	\$	\$
Payroll and related taxes payable	132,495	98,736
Professional fees payable	71,221	66,248
Death benefit payable	36,297	36,908
Utilities and taxes	34,489	39,466
Others	22,036	47,966
Plant refurbishment costs	—	129,508
	296,538	418,832

12. CAPITAL STOCK

[a] Share capital issued and outstanding

[i] Class A preferred shares

The Class A preferred shares will carry dividends, will be convertible into common shares of the Company and will be redeemable, at rates as shall be determined by resolution of the Board of Directors. No Class A preferred shares have been issued to date.

[ii] Class B preferred shares

The Class B preferred shares carry no dividends, are non-convertible and entitle the holder to two votes per share. 899,400 of the Class B preferred shares have been issued and are outstanding.

[iii] Common shares

During the year ended January 31, 2009, no common share options were exercised, and no common shares were issued.

During the year ended January 31, 2008, no common share options were exercised, and no common shares were issued.

During the year ended January 31, 2007, 13,950 common share options were exercised for \$39,111 resulting in the issuance 13,950 common shares.

[b] Share option plan

The Company maintains an incentive share option plan for management personnel for 1,000,000 options to purchase common shares. The Company also issues options to certain consultants for services provided to the Company.

All options granted have a term of five years and vest immediately. At January 31, 2009, the Company had 138,761 options outstanding at exercise prices ranging from \$0.38 to \$10.01 and a weighted average exercise price of \$1.53. The options, which are immediately exercisable and expire on dates between January 31, 2010 and January 31, 2014, entitle the holder of an option to acquire one common share of the Company.

On January 31, 2009, 78,947 common share options were issued to the independent directors of the Company. These options were valued at \$28,422 and were included in general and administrative expense, in accordance with SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 2.50%; dividend yield of nil; volatility factor of the expected market price of the Company's common stock of 1.776, and an expected life of five years.

On January 31, 2008, 37,974 common share options were issued to the independent directors of the Company. These options were valued at \$15,495 and were included in general and administrative expense, in accordance with SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 5.25%; dividend yield of nil; volatility factor of the expected market price of the Company's common stock of 0.745, and an expected life of five years.

On July 8, 2006, 7,500 common share options were granted to employees and non-employees of the Company. These options were valued at \$35,160 and were included in general and administrative expense, in accordance with SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 5.04%; dividend yield of nil; volatility factor of the expected market price of the Company's common stock of 0.644, and an expected life of five years. On January 31, 2007, 6,000 common share options were issued to the independent directors of the Company. These options were valued at \$9,361 and were included in general and administrative expense, in accordance with SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 5.25%; dividend yield of nil; volatility factor of the expected market price of the Company's common stock of 0.754, and an expected life of five years.

Details of the outstanding options, which are all currently exercisable, are as follows:

	Share options			Weighted average exercise price per share		
	2009 #	2008 #	2007 #	2009 \$	2008 \$	2007 \$
Options outstanding, beginning of year	63,699	37,725	42,175	3.34	5.64	4.24
Granted	78,947	37,974	13,500	0.38	0.79	6.89
Exercised	—	—	(13,950)	—	—	2.80
Expired	(3,885)	(12,000)	(4,000)	7.72	2.50	5.00
Options outstanding, end of year	138,761	63,699	37,725	1.53	3.34	5.64
Weighted average fair value of options granted during the year				\$0.38	\$0.51	\$4.12

The following table summarizes information relating to the options outstanding at January 31, 2009:

Exercise price \$	Number outstanding	Weighted average remaining contractual life [months]
0.38	78,947	60
0.79	37,974	48
3.00	6,000	36
6.86	4,365	12
7.52	3,975	24
10.01	7,500	30
	138,761	52

13. VETERINARY LABORATORIES, INC.

Sparhawk Laboratories, Inc.

In 1992, Veterinary Laboratories, Inc., a subsidiary of Chemdex, Inc. and Sparhawk Laboratories, Inc. entered into a Joint Venture for the manufacture and sale of veterinary pharmaceutical products. Veterinary Laboratories and Sparhawk each owned 50% of the Joint Venture during its operation.

On January 13, 2004, the Company, Chemdex, Inc. and Sparhawk entered into an Asset Purchase Agreement with Sparhawk. Pursuant to this Asset Purchase Agreement, the Company agreed to sell substantially all of the assets of Veterinary Laboratories, including its interest in the Joint Venture, to Sparhawk for \$5,500,000 in cash. Effective March 4, 2004, this sale was completed and a gain of \$1,859,471 was recognized. Simultaneously with the closing, Chemdex, Inc. advanced \$350,000 to Sparhawk in exchange for a promissory note bearing interest at 13% per annum and a warrant to purchase 4% of the equity of Sparhawk. On May 31, 2006, payment in full for principal and interest of the promissory note 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.

Since Sparhawk was thinly capitalized and highly leveraged, the Company had deferred \$350,000 of the gain relating to the promissory note receivable from Sparhawk. Since payment in full on the promissory note was received on May 31, 2006, the deferred gain of \$350,000 was recognized at April 30, 2006 and included in other income on the consolidated statement of operations.

14. LICENSE AGREEMENTS AND RESEARCH AND DEVELOPMENT

The Company has made claims for investment tax credits on research and development activities. Research and development expenditures have been reduced by investment tax credits as follows:

	2009	2008	2007
	\$	\$	\$
Research and development expenditures	35,102	135,821	214,865
Investment tax credits	—	—	—
Research and development expense	35,102	135,821	214,865

Iron Dextran process

The Company has an agreement with the Estate which grants the Company the exclusive worldwide license to use a certain process for producing Iron Dextran. This license agreement expires in 2014. The Company pays a license fee based on production volumes. The total license fee incurred during the year was \$32,769 [2008 — \$70,280; 2007 — \$76,978]. These payments are applied to the balance owing by the Estate [note 8[i]].

15. INCOME TAXES

[a] Substantially all of the Company's activities are carried out through operating subsidiaries in Canada and the United States. The Company's effective income tax rate is dependent on the tax legislation in each country and the operating results of each subsidiary and the parent company.

The components of loss before income taxes are as follows:

	2009	2008	2007
	\$	\$	\$
Bahamas	(23,716)	(111,208)	(244,022)
Canada	(1,650,590)	(878,468)	(510,970)
United States	29,876	22,521	379,174
	(1,644,430)	(967,155)	(375,818)

During fiscal 2006, the tax residency of the parent company, Polydex Pharmaceuticals Limited, was determined to be Canada, for the years 1999 to the present. Due to the losses incurred in the Company during that period, no income taxes payable were incurred. The provision for (recovery of) income taxes consists of the following:

	2009	2008	2007
	\$	\$	\$
Provision for (recovery of) income taxes based on Canadian statutory income tax rates	(511,683)	(280,466)	(189,059)
Decrease in tax reserve	—	—	(46,055)
Increase in valuation allowance	496,470	216,216	81,833
Tax and exchange rate changes on deferred tax items	(37,205)	22,823	(3,554)
Items not deductible for tax	(542)	(40,517)	41,640
	(52,960)	(81,944)	(115,195)
Provision for (recovery of) income taxes based on United States income tax rates	11,054	8,333	140,294
Utilization of previously unrecognized tax losses	(11,054)	(8,333)	(140,294)
	—	—	—
Recovery of income taxes	(52,960)	(81,944)	(115,195)

Significant components of the provision for (recovery of) income taxes attributable to continuing operations are as follows:

	2009	2008	2007
	\$	\$	\$
Canadian deferred tax recovery	(52,960)	(83,317)	(69,140)
Canadian current tax expense (recovery)	—	1,373	(46,055)
	<u>(52,960)</u>	<u>(81,944)</u>	<u>(115,195)</u>

[b] Deferred tax assets and liabilities have been provided on temporary differences that consist of the following:

	2009	2008	2007
	\$	\$	\$
Deferred tax assets			
Canadian			
Non-capital losses	1,082,241	1,053,398	1,120,327
Unclaimed research and development expenses	304,083	315,905	285,444
Excess of tax value over carrying value of depreciable assets	184,476		
Net capital losses <i>[note 15[c]]</i>	154,541	200,055	164,976
Other items	20,846	14,414	15,160
United States			
Net operating loss carryforwards	29,378	29,378	42,981
	<u>1,775,565</u>	<u>1,613,150</u>	<u>1,628,888</u>
Less valuation allowance	<u>1,775,565</u>	<u>1,613,150</u>	<u>1,628,888</u>
	—	—	—

Deferred tax liabilities

Excess of carrying value over tax value of depreciable assets	—	(47,120)	(119,097)
Investment tax credits and other items	—	(8,842)	(2,670)
Net deferred tax liabilities	<u>—</u>	<u>(55,962)</u>	<u>(121,767)</u>

[c] The Canadian subsidiaries have non-capital loss carryforwards available to reduce future years' income for tax purposes totaling approximately \$3,862,000. These non-capital losses expire from 2010 to 2029 and are stated below.

Year of expiry	\$
2010	123,000
2011	217,000
2015	491,000
2026	767,000
2027	347,000
2028	1,150,000
2029	767,000
<u>Total</u>	<u>3,862,000</u>

The Canadian subsidiaries also have deductions relating to scientific research and experimental development credits amounting to approximately \$1,600,000. Certain Canadian subsidiaries also have net capital losses available for carryforward of approximately \$499,000 available to offset future taxable capital gains. These potential deductions and net capital losses have an indefinite carryforward period.

[d] The Company has not recorded a deferred tax liability related to its investment in foreign subsidiaries. The Company has determined that its investment in these subsidiaries is permanent in nature and it does not intend to dispose of or realize dividends from these investments in the foreseeable future. However, if either of these events were to occur, the Company will be liable for withholding taxes. The amount of the deferred tax liability related to the Company's investment in foreign subsidiaries is not readily determinable.

16. CONSOLIDATED STATEMENTS OF CASH FLOWS

The net change in non-cash working capital balances related to operations consists of the following:

	2009 \$	2008 \$	2007 \$
Decrease (increase) in current assets			
Trade accounts receivable	381,994	691,495	(436,313)
Interest receivable	—	—	41,511
Inventories	114,488	212,075	164,193
Prepaid expenses and other current assets	(5,132)	(3,566)	26,287
	491,350	900,004	(204,322)
Increase (decrease) in current liabilities			
Accounts payable	(198,510)	(978,507)	685,309
Accrued liabilities	(66,697)	147,783	(117,143)
Customer deposits	19,004	(15,294)	3,113
Income taxes payable	—	—	(44,833)
	245,147	53,986	322,124

Cash paid during the year for interest was \$66,714 (2008 — \$96,818; 2007 — \$89,365). Cash paid during the year for income taxes was Nil (2008 — Nil; 2007 — Nil).

During the fiscal year ended January 31, 2009, the Company acquired a forklift truck for an amount of \$19,518 and photocopier/printing equipment for an amount of \$18,710 under capital lease arrangements. There were no capital equipment acquisitions under capital leases for the years ended January 31, 2008 and 2007.

17. SEGMENTED INFORMATION

All manufacturing, sales and administrative operations are carried out through Dextran Products Limited (“Dextran”) in Canada, while Chemdex in the United States only sells bulk quantities of a specific dextran derivative to Sparhawk under the Supply Agreement, as described in *note 13*.

Below is a breakdown of our sales revenue among significant customers and by geographic region:

	2009 \$	2008 \$	2007 \$
Total revenue by significant customer:			
Customer A	1,095,647	1,106,972	1,296,702
Customer B	917,704	655,107	618,878
Customer C	767,878	427,206	668,001
Customer D	376,027	291,983	178,538
Customer E	220,160	578,120	275,200
Customer F	53,960	10,115	780,039
Customer G	—	538,033	155,420
	3,431,376	3,607,536	3,972,778
	2009 \$	2008 \$	2007 \$
Sales by geographic destination:			
United States	\$1,810,342	\$1,475,295	\$1,283,251
Europe	1,410,803	1,928,278	2,796,710
Canada	824,358	1,035,040	893,977
Other	405,132	452,028	943,768
Pacific Rim	374,271	844,217	581,581
	\$4,824,906	\$5,734,858	\$6,499,287

18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of financial instruments information and appropriate valuation methodologies. has been determined based on available market.

The carrying values of cash and cash equivalents, trade accounts receivable, interest receivable and accounts payable approximate their fair values as at January 31, 2009 because of the short period to maturity of these financial instruments.

The estimated fair values of the bank indebtedness, due to shareholder, long-term debt and capital lease obligations are not materially different from the carrying values for financial statement purposes as at January 31, 2009 and 2008. The estimated fair value of the amount due from shareholder is not determinable because the amount has no fixed terms of repayment.

19. OTHER DISCLOSURES

[a] Concentration of accounts receivable

As at January 31, 2009, two (2008 — three) customers of the Company comprised 73% (2008 — 74%) of the trade accounts receivable balance. No other customers had trade accounts receivable outstanding at year end that represented more than 10% of the Company's trade accounts receivable balance.

[b] Foreign currency risk

The Company is exposed to foreign currency risk through its net investment in its Canadian operations. The Company has not entered into hedging arrangements related to the foreign currency risk exposure.

20. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of other accumulated comprehensive income are as follows:

	2009	2008
	\$	\$
Unrealized gains (losses) on investments available for sale	17,301	(9,968)
Currency translation	581,965	1,908,129
Accumulated other comprehensive income	599,266	1,898,161

21. COMMITMENTS AND CONTINGENCIES

As at January 31, 2009, the Company had no commitments for capital expenditures related to the plant refurbishment (2008 — \$20,024) at Dextran Products in Toronto, and no additional other commitments (2008 — \$NIL).

22. RECENT ACCOUNTING PRONOUNCEMENTS

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.

In May 2008, the FASB issued Financial Accounting Standard No. 162, *"The Hierarchy of Generally Accepted Accounting Principles"* ("SFAS No. 162"). The statement is intended to improve financial reporting by identifying a consistent hierarchy for selecting accounting principles to be used in preparing financial statements that are prepared in conformance with GAAP. Unlike SAS No. 69, "The Meaning of Present in Conformity With GAAP," SFAS No. 162 is directed to the entity rather than the auditor. The statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with GAAP." The Company is currently assessing the impact of this statement, but believes it will not have a material impact on its financial position, results of operations, or cash flows upon adoption.

In May 2008, the FASB issued SFAS No. 163, *"Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60."* Diversity exists in practice in accounting for financial guarantee insurance contracts by insurance enterprises under FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises. This results in inconsistencies in the recognition and measurement of claim liabilities. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement requires expanded disclosures about financial guarantee insurance contracts. The accounting and disclosure requirements of the Statement will improve the quality of information provided to users of financial statements. The adoption of FASB 163 is not expected to have a material impact on the Company's financial position.

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") APB 14-1, *Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon either mandatory or optional conversion (including Partial Cash Settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants. Additionally, FSP

APB14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company has adopted FSP APB14-1 beginning February 1, 2009, and this standard must be applied on a retrospective basis. The Company is evaluating the impact the adoption of FSP APB14-1 will have on its consolidated financial position and results of operations.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. EITF Issue No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The Company is currently evaluating the impact of adopting EITF Issue No. 07-05 on its consolidated financial statements.

On June 16, 2008, the FASB issued final Staff Position (FSP) No. EITF03-6-1, *"Determining Whether Instruments Granted in Share-Based Payment Transaction Are Participating Securities,"* to address the question of whether instrument granted in share-based payment transaction are participating securities prior to vesting. The FSP determines that unvested share-based payment awards that contain rights to dividend payments should be included in earnings per share calculations. The guidance will be effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the requirement of (FSP) No. EITF03-6-1 as well as the impact of the adoption on its consolidated financial statements.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, *"Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities"* ("FSP FAS 140-4 and FIN 46 (R)-8"). FSP FAS140-4 and FIN 46(R)-8 amends FAS140 and FIN 46(R) to require additional disclosures regarding transfers of financial assets and interest in variable interest entities. FSP FAS 140-4 and FIN 46 (R)-8 is effective for interim or annual reporting periods ending after December 15, 2008. The Company is currently evaluating the impact of the adoption of FSP FAS140-4 and FIN 46(R)-8 will have on its consolidated financial position and results of operations.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as amended. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures cannot be relied upon to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required or to ensure that information is accumulated and communicated to our management to allow timely decisions regarding required disclosure. Therefore controls and procedures were not effective for fiscal year ended January 31, 2009.

Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. We have assessed the effectiveness of those internal controls as of January 31, 2009.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

A material weakness in internal controls is a deficiency in internal control, or combination of control deficiencies, that adversely affects the Company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a material misstatement of the Company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

In the course of making our assessment of the effectiveness of internal controls over financial reporting, we identified a material weakness in our internal control over financial reporting. This material weakness consisted of inadequate staffing within the accounting operations of our company. The small number of employees who are responsible for accounting functions prevents us from segregating duties within our internal control system. The inadequate segregation of duties is a weakness because it could lead to the untimely identification and resolution of accounting and disclosure matters or could lead to a failure to perform timely and effective reviews. Due to this material weakness, management concluded that its internal control over financial reporting was not effective as of January 31, 2009.

Our review also revealed that although a number of controls appeared to exist, and indeed were observed to have been in operation, documentary evidence that such controls were operating throughout the period was found to be lacking. Such evidence as signatures indicating that a certain procedure had been carried out and affixing responsibility were lacking in the internal control system.

Our review also indicated the existence of certain high level procedures that might or might not serve to provide compensating control over these weaknesses. These procedures consisted of analytical review of key operating results by senior management of the Company, including preparation and review of monthly operating results, comparison of such results to budgets and to historical amounts, and comprehensive gross profit analysis. In addition, the Board of Directors received monthly updates on operations, and on a quarterly basis, reviews, investigates and discusses apparent inconsistencies and concerns with senior operating management.

Management has reacted to the Company's profitability and liquidity issues in various ways, one of which is the reduction of administrative personnel. Inherent in remedying the internal control weaknesses noted above is increased division of duties, which would require the addition of administrative personnel. The Company fully intends to address this need once more profitable operating results have been achieved.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

There was no change in internal control over financial reporting during our fourth fiscal quarter ended January 31, 2009 that has materially affected, or is likely to materially affect, our internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION

As of September 12, 2008, the Company's common shares were delisted from the NASDAQ Capital Market. Subsequent to that date, the shares have been listed and traded on the NASDAQ Bulletin Board and the Pinksheets listings. The Company's common shares trade under the symbol "POLXF."

PART III

ITEMS 10-14.

Pursuant to General Instruction G (3) of Form 10-K, Items 10 through 14, inclusive, have not been restated or answered in this annual report on Form 10-K because the Company intends to file within 120 days after the close of its fiscal year with the Securities and Exchange Commission a definitive proxy statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, which proxy statement involves the election of directors. The information required in these Items 10 through 14, inclusive is incorporated by reference to that proxy statement.