Footmaxx Holdings Inc. C

2004 annual report

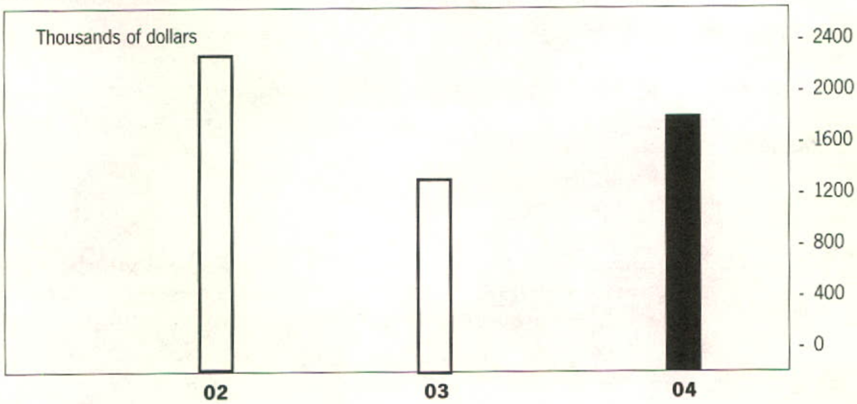
footmaxx™

www. footmaxx.com

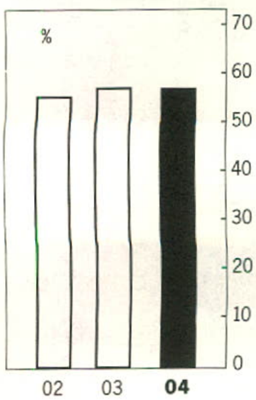
Financial Highlights

For the years ended December 31	Results of Operation 2004	2003	2002
Sales	$ 13,045,751	$ 14,038,427	$ 15,397,253
Gross Profit	7,319,192	7,863,704	8,658,515
Gross Profit %	56.10%	56.01%	56.20%
EBITDA*	1,661,048	1,218,794	2,158,146
Earnings (Loss) Before Income Taxes	(423,333)	(964,744)	35,844
Income (Loss) For Year	(462,354)	(1,006,927)	(56,322)
Income (Loss) Per Share	$ (0.01)	$ (0.06)	$ 0.00
1.00 USD to $CAN Average Exchange Rate	1.30	1.41	1.57

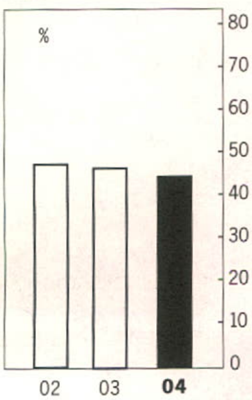
EBITDA 2002, 2003 & 2004



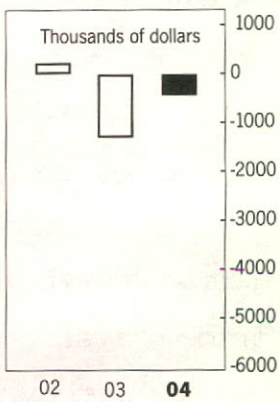
Gross Profit Ratio



Expenses to Revenue Ratio



Earnings Before Income Taxes



*EBITDA is calculated by taking Net Loss and adding back interest, taxes, depreciation and amortization. Amortization includes inventory allowance on revenue generating systems.

Footmaxx Holdings Inc. is a leading provider of high quality medical products targeting the orthopedic, rehabilitation and chiropractic markets. The Company sells its products primarily in the U.S. and Canada and in 10 other countries directly to healthcare professionals and through distributors.

Footmaxx celebrated its 10-year Anniversary in October of 2004. The Company was founded on a proprietary medical computerized technology that helped to diagnose foot function and order orthotics from Footmaxx.

Since that time the Company has grown to 125 employees with operations in the US and Canada. Footmaxx continues to develop its proprietary diagnostic and ordering technology and has expanded its product lines and services to include complete orthotic laboratory services, detailed diagnostic reports, non-prescription products and customized footwear.

As one of the world's leading foot health companies, Footmaxx is dedicated to the highest standard of care possible to provide patient relief from foot related and biomechanical difficulties.

TO OUR SHAREHOLDERS

In 2004 Footmaxx continued to improve its operational efficiency, which resulted in a year over year increase of EBITDA of 36%, to $1,661,048. Our gross profit ratio improved to 56.1% and our expense to revenue ratio was reduced significantly to 42.8%.

We have also continued our strategy to expand and diversify our customer base of healthcare professionals that include podiatrists, orthopedic surgeons, chiropractors, orthotists and prosthetists, physical therapists and athletic trainers.

For the third consecutive year the decline in the value of the US dollar has cost the company in top line revenue. With the majority of our revenue transacted in US dollars the decline in value reduced revenues by 4.4% versus 2003. Changes in reimbursement of corporate health plans for our primary products reduced order volumes, along with strong price competition, resulted in an additional reduction in revenue of 2.7%. Order volume which rebounded nicely in the second half of the year, was not great enough to overcome the soft demand that occurred early in the year.

In spite of these challenges, Footmaxx grew operating EBITDA by 36% to $1,166,048. The company also continues to reduce its outstanding debt load and maintain the confidence of its investors. During 2004 we continued to make changes in our operation, to improve efficiency and customer service. Several new product lines were introduced or evaluated which will expand our customer offering in 2005 and beyond.

LOOKING FORWARD TO 2005, We have been significantly impacted by exchange fluctuation and market changes. We are encouraged by the pick up in volume in the later part of 2004 and believe the impact of unfavorable foreign exchange will be minimal during 2005.

The company continues to focus on gaining new customers in our targeted market and introduce products that will drive growth.

Lenny Simak

President and Chief Executive Officer

for the Twelve Months Ended December 31, 2004 Management Discussion and Analysis

OVERALL PERFORMANCE

During 2004 the company continued to face the challenges of a strengthening Canadian dollar and changes in the reimbursement policies of corporate health plans in Canada and the United States. The decline in the value of the US dollar, the currency in which Footmaxx transacts the majority of its business, reduced revenues by $623,500 or 4.4% of 2003 revenues. Changes to the reimbursement policies also reduced orthotic demand and volumes. As a result, revenues in 2004 were $13,045,751, a decrease of $992,676 or 7.1% from $14,038,427 in 2003. In order to deal with these challenges the company initiated cost reduction programs in late 2003 and early in 2004. This resulted in the company being able to more than offset the negative impact of decreased revenues such that EBITDA increased $442,254 to $1,661,048. The net loss in 2004 was $462,354, an improvement of $544,573.

RESULTS OF OPERATIONS

NON-GAAP MEASURES

In the Management Discussion and Analysis, and elsewhere, measures such as earnings before interest, taxes, depreciation and amortization (EBITDA) and other terms that are used are not defined by generally accepted accounting principles ("GAAP"). The use of these terms may not be consistent with the way these terms are used by others. Where possible, in particular for EBITDA, tables and other information are provided that enables readers to reconcile between such non-GAAP measures and standard GAAP measures. While these measures are not defined by or required by GAAP, this information is provided to readers to help them better understand significant measures.

REVENUES

Revenues for 2003 decreased during the year by $992,676 or 7.1%, to $13,045,751 from $14,038,427. The strengthening Canadian dollar versus the US dollar, accounted for $623,500 of this decrease as approximately 60% of the Company's revenues are in US dollars. Orthotic volume decreased by 3.5%, further decreasing revenues for the year by approximately $400,000. Approximately 75% of the decline was in Canada where changes in corporate and government health plan coverage for orthotics was the primary reason for the decrease.

Revenues generated from system placements decreased during 2004 due to a shift in marketing direction from system sales to system rentals, which resulted in the placement of systems remaining strong in 2004. During 2004 the company expanded our product base to include more non-prescription orhotics as well as a full line of shoes that are sold with orthotics. Revenues generated from these products more than offset the decrease in revenues caused by the change in marketing of systems.

REVENUES BY GEOGRAPHIC AREA

$CDN (000's)	Revenues by Geographic Area			
	2004	% Total Sales	2003	% Total Sales
Canada	$5,547	42.5%	$5,802	41.3%
International (mainly USA)	$7,499	57.5%	$8,236	58.7%
Total Sales	$13,046	100.0%	$14,038	100.0%

The revenues in Canada for 2004 were 2.3% below revenues in Canada for 2003 mainly due to orthotic volume decrease and shift to rentals from system sales. There was a 8.9% decrease in revenues from the International business of which 80% was due to the unfavorable foreign exchange situation.

GROSS PROFIT

Gross Profit for 2004 decreased $544,512 or 6.9% from $7,863,704 in 2003, to $7,319,192 in 2004. The unfavourable net impact of the strengthening Canadian dollar on gross profit was approximately $453,000. Foreign exchange reduced costs at our US manufacturing plant and for certain raw materials and computer hardware purchased from the US. The decrease in gross profit due to the decrease in volume of custom orthotics was approximately $200,000. However this was partially offset by gross profits earned from the sale of new products such as footwear and expanded non-prescription orhotics.

	Gross Profit by Geographic Area			
$CDN (000's)	**2004**	**% Gross Profit**	**2003**	**% Gross Profit**
Canada	$3,308	45.2%	$3,280	41.7%
International (mainly USA)	$4,011	54.8%	$4,584	58.3%
Total Sales	$7,319	100.0%	$7,864	100.0%

Canadian gross profits remained fairly level with 2003 due to cost reduction programs. Gross profit in the International business was mainly impacted by unfavorable foreign exchange rates.

OPERATING EXPENSES

SALES & ADMINISTRATIVE expenses decreased $770,753 or 14.2% during 2004. This is the second straight year of fixed expense reduction over 14%. The favourable effect of the stronger Canadian dollar reduced expenses by approximately $157,000; $145,000 in US Selling and $12,000 in finance and administrative for those expenses paid in US dollars. The balance of the $550,967 cost reduction in Field Sales was the result of the cost reduction program implemented late in 2003. Marketing expense reduction of $96,277 was also the result of a cost reduction program implemented early in 2004. Finance and administration reduction was $45,461, the result of various expense reductions realized during the year.

Selling and Administration	2004	2003	Decr (Incr)	%
Field Sales Force	$2,611,617	$3,162,584	$550,967	17.4%
Marketing Expense	$214,225	$ 310,502	$96,277	31.0%
Finance and administration	$1,826,935	$ 1,950,444	$45,461	2.3%
	$4,652,777	$5,423,530	$770,753	14.2%

Information Technology expenses decreased by $40,324 from $967,643 in 2003 to $927,319 in 2004. This is the result of effective cost control during 2004.

NET LOSS

Net Loss for 2004 is $462,354, which is $544,573 less than the $1,006,927 recorded for 2003. The $ 544,573 decrease in net loss is the result of the $544,512 decrease in gross profit being more than offset by the $770,753 decrease in Selling and Administrative expenses as well as a $175,689 decrease in unfavourable balance sheet foreign exchange variance.

Summary of quarterly results

(000's) $CDN	2004				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue	$3,088	$3,519	$3,415	$3,024	$3,788	$3,745	$3,461	$3,044
Net Income (Loss)	(126.7)	20.0	(165.7)	(190.0)	(181.2)	(285.5)	(166.5)	(373.7)
Earnings (Loss) per share	($0.00)	$0.00	($0.00)	($0.01)	($0.01)	($0.01)	$0.00	($0.01)

In spite of the continuing negative impact of foreign exchange the company reduced net loss in all four quarters of 2004 compared to the four quarters of 2003 with the second quarter showing a net income.

EBITDA

Earnings before interest, taxes, depreciation and amortization (EBITDA) for 2004 increased by $442,254 from $1,218,794 in 2003 to $1,661,048. The $ 544,512 decrease in gross profit was more than offset by the $770,753 reduction in Selling and Administrative expenses, the $175,689 decrease in unfavourable balance sheet foreign exchange and the $ 40,324 decrease in Information Technology expenses. EBITDA has been used by the Company historically to measure the cash flow profit generated by operations. EBITDA is also used in calculating some of the company's debt covenants for the Royal Bank line of credit and the Penfund long term debt.

	2004	2003
Net Loss	($ 462,354)	($1,006,927)
Add Back:		
Accrued Interest on convertible debentures	$927,076	$766,073
Interest on long term debt	$610,018	$847,883
Other interest	$22,751	$26,794
Amortization capital assets	$431,549	$449,801
Amortization financing costs	$92,987	$92,987
Income taxes	$39,021	$42,183
EBITDA	$1,661,048	$1,218,794

LIQUIDITY

CASH FLOW

During 2004 the Company managed to pay $888,889 in principal and $468,007 in interest on its long tem debt. The Company, further made over $260,000 worth of investments in capital assets, to benefit future revenues and expenses. Cash flow for the year was negative $74,457 after paying $350,615 on its bank line of credit. The company continues to manage cash effectively and is meeting financial commitments, both short term and long term, in a timely manner. The company continues to manage accounts receivable closely, keeping the average aging of receivables in the 40 to 42 days outstanding range. The company also implemented programs to increase inventory turnover.

CAPITAL EXPENDITURES

During 2004 the Company made investments in capital assets in the amount of $261,837, as compared with the $212,186 invested during 2003. The largest investment was in the orthotic ordering system pool to meet the demand for trial and rental systems from customers. In addition investments were made in software and hardware upgrades, to deal with the increased need to protect the company's network from computer viruses.

DEBT COVENANTS

During 2004 the company was in violation of certain of its financial covenants. Penfund and The Royal Bank have provided the company with letters of waiver and tolerance respectively.

2004 FOURTH QUARTER RESULTS

Fourth quarter revenues for 2004 decreased $20,390, from $3,044,140 in 2003 to $3,023,750 in 2004. An unfavorable exchange rate year over year accounted for a decrease of $139,000. However, orthotic volumes increase year over year by 655 pairs offsetting the decrease caused by foreign exchange by $72,000. Increases in footwear and non-prescription orthotics further reduced the decrease in revenues to $20,501. EBITDA increased $77,579 in the fourth quarter of 2004 to $252,856 from the $175,277 achieved for the fourth quarter of 2003. Fixed cost reduction was the main contributing factor. Net loss for the fourth quarter of $190,036 is $183,735 less than the $373,771 loss the company incurred for the same quarter of 2003. Fixed cost reduction and a year to date depreciation adjustment of $100,000 re leasehold improvements were the main contributors to the improvement.

2005 FINANCIAL OUTLOOK

Management believes that the impact of unfavourable foreign exchange should be minimal during 2005. The company has tried to minimize the effect of fluctuating foreign exchange rates by committing to hedging contracts for the balance of the year. Taking these factors into account and projecting moderate growth for 2005, management believes that profitability will be in the same range in 2005 as experienced during 2004. However, there are several potential upsides in the expansion of distribution orthotic products and new developments of the company's orthotic ordering system.

TRANSACTIONS WITH RELATED PARTIES

The company has had no related party transactions during 2004.

OVERSIGHT ROLE OF THE AUDIT COMMITTEE

The Audit Committee reviews, with management, the Company's quarterly MD&A and related consolidated financial statements and approves the release to shareholders. Management also periodically presents to the Audit Committee a report of their assessment of the Company's internal controls and procedures for financial reporting.

FORWARD-LOOKING STATEMENTS

The foregoing may contain forward-looking statements. These statements are based on current expectations that are subject to risks and uncertainties, and the Company can give no assurance that these expectations are correct. Various factors could cause actual results to differ materially from those projected in such statements, including financial considerations and those predicting the timing and market acceptance of future products. The Company disclaims any intention or obligation to revise forward-looking statements whether as a result of new information, future developments or otherwise. All forward-looking statements are expressly qualified in their entirety by this Cautionary Statement.

TO THE SHAREHOLDERS OF
FOOTMAXX HOLDINGS INC.

We have audited the consolidated balance sheet of Footmaxx Holdings Inc. as at December 31, 2004 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2003 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 19, 2004.

BDO Dunwoody LLP

Chartered Accountants

Markham, Ontario

March 7, 2005

Consolidated Balance Sheets

December 31, 2004 and 2003	2004	2003
Assets		
Current assets:		
Cash	$ 27,878	$ 99,335
Accounts receivable, net	1,419,710	1,289,960
Inventory (note 2)	454,258	488,205
Other assets	102,015	92,033
	2,003,861	1,969,533
Capital assets (note 3)	906,910	1,076,623
Deferred financing costs	224,718	317,704
	$ 3,135,489	**$ 3,363,860**
Liabilities and Shareholders' Deficiency		
Current liabilities:		
Bank indebtedness (note 4)	$ 260,000	$ 610,615
Accounts payable and accrued liabilities	1,057,528	653,128
Current portion of long-term debt (note 5)	2,775,479	3,522,357
	4,093,007	4,786,100
Long-term debt (note 5)	–	–
Convertible debentures (note 6)	13,182,298	12,255,222
Redeemable and retractable preferred shares (note 8)	2,103,924	2,103,924
	19,379,229	19,145,246
Shareholders' deficiency:		
Capital stock (note 8)	20,212,315	20,212,315
Deficit	(36,456,055)	(35,993,701)
	(16,243,740)	(15,781,386)
	$ 3,135,489	**$ 3,363,860**

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Director ______________

Director ______________

Consolidated Statements of Operations and Deficit

Years ended December 31, 2004 and 2003	2004	2003
Sales	$ 13,045,751	$ 14,038,427
Cost of goods sold	5,726,559	6,174,723
Gross profit	7,319,192	7,863,704
Expenses:		
Selling and administration	4,652,777	5,423,530
Information technology	927,319	967,643
Accrued interest on convertible debentures	927,076	766,073
Interest on long-term debt	610,018	847,883
Other interest	22,751	26,794
Foreign exchange loss	78,048	253,737
Amortization of capital assets	431,549	449,801
Amortization of deferred financing costs	92,987	92,987
	7,742,525	8,828,448
Earnings (loss) before income taxes	(423,333)	(964,744)
Income taxes (note 10)	39,021	42,183
Loss for the year	(462,354)	(1,006,927)
Deficit, beginning of year	(35,993,701)	(34,986,774)
Deficit, end of year	**$ (36,456,055)**	**$ (35,993,701)**
Basic and diluted loss per common share (note 11)	$ (0.01)	$ (0.03)

See accompanying notes to consolidated financial statements.

Footmaxx Holdings Inc.

Consolidated Statements of Cash Flows

Years ended December 31, 2004 and 2003	2004	2003
Cash flows from (used in) operating activities:		
Loss for the year	$ (462,354)	$ (1,006,927)
Items not involving cash:		
Amortization of capital assets	431,549	449,801
Amortization of deferred financing costs	92,987	92,987
Interest on convertible debentures	927,076	766,073
Imputed interest on long-term loan (note 5)	142,011	334,727
	1,131,269	636,661
Change in non-cash operating working capital:		
Decrease (increase) in accounts receivable	(129,750)	371,296
Decrease (increase) in inventory	33,947	171,768
Decrease (increase) in other assets	(9,982)	81,102
Increase (decrease) in accounts payable and accrued liabilities	404,400	(513,305)
	1,429,884	747,522
Cash flows from (used in) financing activities:		
Increase (decrease) in bank indebtedness	(350,615)	358,615
Repayments on long-term debt	(888,889)	(888,888)
	(1,239,504)	(530,273)
Cash flows used in investing activities:		
Purchase of capital assets	(261,837)	(212,186)
Increase (decrease) in cash	(71,457)	5,063
Cash, beginning of year	99,335	94,272
Cash, end of year	**$ 27,878**	**$ 99,335**
Supplemental cash flow information:		
Interest paid on short-term debt	$ 22,751	$ 26,784
Interest paid on long-term debt	468,007	542,323

See accompanying notes to consolidated financial statements

The Company is in the business of manufacturing, distributing and selling foot orthotics and associated computer systems for specifying custom foot orthotics in Canada and internationally.

1. Significant accounting policies:

(a) Basis of presentation:

The accompanying consolidated financial statements include the accounts of Footmaxx Holdings Inc. and its wholly owned subsidiaries, Footmaxx International Inc., Footmaxx Limited and Footmaxx Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern. The Company's ability to continue as a going concern is dependent upon the Company being able to meet its financial covenant tests for the Royal Bank and Penfund Mezzanine Fund, and its ability to improve profitability of the business to permit it to realize its assets and discharge its liabilities in the normal course of operations. During fiscal 2004, the Company was in violation of certain financial covenants imposed by the Royal Bank (note 4) and Penfund Mezzanine Fund (note 5). If the going concern assumption is not appropriate for these consolidated financial statements, adjustments would be necessary to the carrying value of assets and liabilities and the reported revenue and expenses.

(b) Inventory:

Inventory is valued at the lower of cost and net realizable value, with cost being determined on a first-in, first-out basis.

Computer footmats and the associated computer hardware (revenue-generating systems) that are intended for resale are included in inventory.

(c) Capital assets:

Capital assets are recorded at cost less accumulated amortization. Terms of amortization applied by the Company to amortize the cost of the capital assets over their estimated useful lives, on a straight-line basis, are as follows:

Leasehold improvements	10 years
Furniture, fixtures and equipment	10 years
Computer hardware	2 - 5 years
Computer software	2 - 5 years
Dies and moulds	20 years

(d) Impairment of long-lived assets:

On January 1, 2004, the company adopted CICA Handbook Section 3063, "Impairment of Long-Lived Assets", which requires the Company to test for impairment loss of long-lived assets to be held and used when events or changes in circumstances occur which may cause their carrying value to exceed the total undiscounted cash flows expected from their use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value.

(e) Deferred financing costs:

Costs incurred to obtain long-term financing are deferred and amortized over the term of such debt.

(f) Income taxes:

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. In addition, the effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the enactment or substantive enactment date. Future income tax assets are recognized and if realization is not considered, more likely than not, a valuation allowance is provided.

(g) Stock options:

The Company has a stock-based compensation plan, which is described in note 9.

Effective January 1, 2003, the Company adopted the new recommendations of the CICA with respect to the accounting for stock-based compensation and other stock-based payments, using the fair value-based method. The new recommendations were applied to all stock-based payments granted on or after January 1, 2003. The adoption of this new recommendation did not impact the Company's financial position.

In 2002, the Company applied settlement accounting as permitted under CICA Handbook Section 3870.

(h) Revenue recognition:

The Company recognizes revenue from sales of orthotics and proprietary computer equipment when shipment occurs and title is transferred to customers. Revenue is recorded at the invoice price for each product net of estimated returns and incentives provided to customers.

(i) Research and development:

Research costs are expensed in the year in which they are incurred. Development costs are expensed in the year incurred unless such costs meet the criteria for deferral and amortization under generally accepted accounting principles. To date, there have been no deferred development costs.

(j) Translation of foreign currency:

The results of foreign operations which are financially and operationally integrated with the Company are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the rates of exchange prevailing at year end. Capital assets have been translated at the rates prevailing at the dates of acquisition. Amortization is translated at the rates prevailing when the related assets were acquired. Revenue and expense items, other than amortization, are translated at the average rates of exchange for the year. Any exchange gains or losses are recorded in income.

(k) Measurement uncertainty

The preparation of financial statements 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 financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

2. Inventory:

		2004		2003
Computer footmats and hardware	$	44,840	$	202,548
Orthotic raw materials and components		276,331		190,773
Resale products, non-prescription insoles and sandal chassis		133,087		94,884
	$	**454,258**	**$**	**488,205**

3. Capital assets:

						2004
		Cost		Accumulated amortization		Net book value
Leasehold improvements	$	480,451	$	360,732	$	119,719
Furniture, fixtures and equipment		1,012,380		738,134		274,246
Computer hardware		1,836,976		1,576,363		260,613
Computer software		1,219,321		1,190,089		29,232
Dies and moulds		510,432		287,332		223,100
	$	**5,059,560**	**$**	**4,152,650**	**$**	**906,910**

						2003
		Cost		Accumulated amortization		Net book value
Leasehold improvements	$	480,451	$	312,517	$	167,934
Furniture, fixtures and equipment		1,012,380		641,796		370,584
Computer hardware		1,575,140		1,343,466		231,674
Computer software		1,219,320		1,154,628		64,692
Dies and moulds		510,432		268,693		241,739
	$	**4,797,723**	**$**	**3,721,100**	**$**	**1,076,623**

Years ended December 31, 2004 and 2003

4. Bank indebtedness:

The bank indebtedness consists of an operating line of credit at the Royal Bank (maximum credit facility of $750,000), which bears interest at prime plus 1.5% and is repayable on demand. The bank credit facility is secured by a general security agreement covering all assets. In addition, the line of credit has financial covenants related to tangible net worth and quarterly earnings before interest, taxes, depreciation and amortization ("EBITDA") targets. The Company was in violation of the tangible net worth covenant for the fourth quarter of the year and also in violation of the EBITDA covenant for the third quarter of 2004. The Company has obtained a letter of tolerance and non-waivers from the bank for each quarter in which a violation occurred.

5. Long-term debt:

On May 31, 2002, the Company secured a loan for $4,000,000 from Penfund Mezzanine Fund to facilitate the redemption of the majority of the Series II debentures. This loan matures on May 31, 2007 and bears annual interest at a rate of 14% paid monthly. In addition, there are bonus interest payments to be paid on the yearly anniversary of the loan. These payments are $50,000 for 2003, $100,000 for 2004, $150,000 for 2005, $300,000 for 2006 and $425,000 for 2007. Factoring these bonus interest payments into account, the effective interest rate is approximately 23.2%. The imputed bonus interest accrued to long-term debt for the year is $142,011 (2003 - $334,727).

The total outstanding loan plus accrued interest using the effective yield method of interest is $2,775,479, which is comprised of $2,148,148 principal and $627,331 in accrued interest. The Company will make $888,889 in principal payments and $150,000 of bonus interest during 2005, as well as monthly interest payments based on the annual interest rate of 14%.

The Penfund Mezzanine Fund loan has two financial covenants as part of the agreement. The first is the ratio of concentration debt to EBITDA. Concentration debt is defined as the total of the outstanding Penfund Mezzanine Fund loan plus the outstanding Royal Bank line of credit at the end of each quarter. The covenant requires that the Company maintain a ratio of not more than 3.0 to 1.0.

The second covenant refers to the ratio of earnings before interest and taxes ("EBIT") to concentration interest with concentration interest defined as the interest on the Penfund Mezzanine Fund loan and the Royal Bank line of credit. The covenant requires that the Company achieve an EBIT to concentration interest ratio of not less than 2.0 to 1.0.

The Company was in violation of these covenants for the first, second and third quarters of 2004 but achieved all of these covenants at December 31, 2004. Penfund Mezzanine Fund has waived the covenant default for the three quarters but not for any other dates or periods where there is a subsequent default, and as such, the debt has been classified as a current liability.

Future principal payments on the Penfund Mezzanine Fund loan are due as follows:

2005	$	888,889
2006		888,889
2007		370,370
	$	2,148,148

6. Convertible debentures:

The convertible debentures consist of Series I debentures with a face value of $6,556,530, Series II debentures with a face value of $1,233,149 (after repayment as disclosed in note 5), Series III debentures with a face value of $1,116,480 and Series IV debentures with a face value of $1,000,000. These convertible debentures mature on June 30, 2007. Series I became non-interest bearing as of March 31, 2002. Series II bear interest at 24%, Series III at 12% and Series IV at 14%. All interest is compounded quarterly in arrears. As at December 31, 2004, interest of $3,276,139 has accrued on these convertible debentures and is included in the balance of convertible debentures. The interest accrued is split between the debentures as follows:

	2004	2003
Series I debentures	$ 822,903	$ 822,903
Series II debentures	1,403,446	853,770
Series III debentures	622,959	428,990
Series IV debentures	426,831	243,400
	$ 3,276,139	$ 2,349,063

The principal and accrued interest are convertible into common shares. The Series I debentures are convertible into 73,794,329 common shares of the Company at a price equal to $0.10 per common share, at any time, in whole or in part, at the sole option of the holder. The Series II debentures are convertible into 26,365,953 common shares of the Company at a price equal to $0.10 per common share, at any time, in whole or in part, at the sole option of the holder. The Series III debentures are convertible into 17,394,389 common shares at a conversion price of $0.10 per common share, at any time, in whole or in part, at the sole option of the holder. The Series IV debentures are convertible into 14,268,303 common shares at a price equal to $0.10 per common share, at any time, in whole or in part, at the sole option of the holder. The Series IV debentures rank senior to all other debentures but junior to the Penfund Mezzanine Fund loan. Series II and Series III debentures rank pari passu and rank senior in repayment to the Series I debentures. The convertible debentures are secured by a floating charge with respect to all of the Company's undertaking and business and all of its property, assets and rights.

No amount has been assigned to the equity component of these financial instruments as the conversion option, at the time of issuance, had a nominal value.

The convertible debentures are held by two significant shareholders and two other shareholders of the Company.

7. Redeemable and retractable preferred shares:

The following preferred shares meet the definition of a financial liability in accordance with Canadian generally accepted accounting principles and as such are presented as liabilities in the financial statements:

	2004	2003
Authorized:		
Unlimited Class A preferred shares, voting, cumulative dividends, if declared, at prime less 1%, non-participating, redeemable and retractable at amount paid thereon plus dividends due, with retraction based upon a retained income formula		
Issued:		
4,207,847 Class A preferred shares	$ 2,103,924	$ 2,103,924

8. Capital stock:

	2004	2003
Authorized:		
Unlimited Class B preferred shares, issuable in series with rights, privileges, restrictions and conditions to be determined by the directors on issue		
Unlimited common shares		
Issued:		
37,554,535 common shares	$ 20,212,315	$ 20,212,315

9. Stock option plan:

	2004			2003		
	Number of shares		Weighted average exercise price	Number of shares		Weighted average exercise price
Outstanding, beginning of year	2,271,121	$	0.20	2,829,121	$	0.25
Retired	793,000		0.39	558,000		0.44
Outstanding, end of year	1,478,121		0.10	2,271,121		0.20
Stock options exercisable, end of year	1,423,121	$	0.10	2,034,559	$	0.21
Weighted average remaining contractual life	1.42 years			1.73 years		

The Company grants stock options to employees, directors and members of the advisory board of the Company. The stock options vest over varying time periods from the date of grant to four years and expire approximately five years from the date of grant.

In November 2002, the Board of Directors granted an additional 1,726,932 options to the President of the Company at an exercise price of $0.10. Simultaneously, the Board approved a loan of $178,831 to the President to allow him to exercise 1,788,311 options. These options vested immediately. These options were exercised on December 30, 2002. On the date of exercise, the fair value of the options was $71,533 and was accounted for as a direct award of stock as a charge to selling and administration expense in the consolidated statements of operations and deficit. The loan has no fixed terms of repayment, is non-interest bearing and is secured by the value of the shares. For accounting purposes, the net amount of the loan of $107,298 has been deducted from capital stock.

Years ended December 31, 2004 and 2003

10. Income taxes:

The Company has available non-capital losses carryforward for income tax purposes, the benefit of which has not been recorded, of $18,438,723 (2003 - $20,475,075) to be applied against future years' taxable income. The losses expire as follows:

2005	$ 1,263,554
2006	2,267,304
2007	210,393
2008	–
2009	1,647,465
2010	4,685,161
2011	–
2012	–
2013	–
2014 and thereafter	8,364,846
	$ 18,438,723

A summary of the principal components of future tax assets at December 31 are as follows:

	2004	2003
Future tax assets:		
Non-capital loss carryforwards	$ 6,660,067	$ 7,050,677
Capital assets	757,706	583,748
Inventory	895,129	895,129
General reserves and goodwill	29,079	100,439
Interest	1,231,418	1,532,039
Unrealized foreign exchange loss	372,922	510,217
	9,946,321	10,672,249
Less valuation allowance	9,766,837	10,477,830
	179,484	194,419
Future tax liabilities:		
Unrealized foreign exchange gain	87,532	110,521
Capital assets	91,952	83,898
	179,484	194,419
Net future tax assets	**$ –**	**$ –**

10. Income taxes (continued):

The average statutory Canadian income tax for the year ended December 31, 2004 was 36.12% (2003 - 36.12%). A comparison of nominal provisions at these rates, with the amounts provided in the consolidated statements of operations and deficit, is as follows:

		2004		2003
Earnings (loss) before income taxes	**$**	**(423,333)**	**$**	**(964,744)**
Nominal tax charge (recovery) at average statutory Canadian income tax rate	$	(152,900)	$	(348,500)
Increase (decrease) in income taxes due to valuation allowance		152,900		348,500
US State income taxes		39,021		42,183
Income Taxes	**$**	**39,021**	**$**	**42,183**

11. Loss per common share:

		2004		2003
Loss for the year	**$**	**(462,354)**	**$**	**(1,006,927)**
Weighted average common shares		37,554,535		37,554,535
Basic and diluted loss per common share	$	(0.01)	$	(0.03)

The exercise of stock options which would result in the issuance of 1,478,121 (2003 - 2,271,121) common shares and the conversion of debentures which would result in the issuance of 131,822,974 (2003 - 122,552,211) common shares have not been considered in the calculation of diluted loss per share since they would be anti-dilutive.

12. Related party transactions:

The Company had no other related party transactions for the year ended December 31, 2004, except those related to the debenture holders outlined in note 6.

13. Commitments:

Minimum lease payments, excluding property taxes and other costs, are approximately as follows:

2005	$ 200,697
2006	157,670
2007	93,037
2008	4,838
	$ 456,242

Years ended December 31, 2004 and 2003

14. Financial instruments:

Interest rate and credit risk:

Interest rates, maturities and security affecting the interest and credit risk of the Company's financial assets and liabilities have been disclosed in notes 4, 5 and 6.

The carrying values of cash, accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments.

Due to the Company's circumstances, the fair value of the debt cannot be reliably determined.

15. Segmented information:

The Company operates in Canada and internationally in one dominant industry segment (foot orthotics and associated computer systems). Revenue is attributed to geographic areas based on location of customer. International sales are predominantly sales to the United States.

		2004		**2003**
Revenue:				
Canada	$	5,547,054	$	5,802,801
International		7,498,697		8,235,626
	$	**13,045,751**	**$**	**14,038,427**
Gross profit:				
Canada	$	3,308,518	$	3,279,554
International		4,010,674		4,584,150
	$	**7,319,192**	**$**	**7,863,704**
Capital assets:				
Canada	$	635,148	$	751,830
International		271,762		324,793
	$	**906,910**	**$**	**1,076,623**

16. Comparative information:

The comparative amounts presented in the financial statements have been reclassified to conform to the current year's presentation.

Footmaxx Board of Directors

David Banks – Chairman
Lawrence & Co.
Toronto, ON

Lenny Simak
Footmaxx Holdings Inc.
Toronto, ON

Grant McCutcheon
Lawrence & Co.
Toronto, ON

Michael Cohen
VenGrowth Private Equity
Partners Inc.
Toronto, ON

Michael A. Kehoe
Innova LifeSciences
Corporation
Toronto, ON

John R. Kennedy
Toronto, ON

Footmaxx Officers

Lenny Simak
President & CEO

Jon Kelly
Director Finance & IT

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STOCK INFORMATION
FMX (TSX Venture Exchange)

STOCK CERTIFICATE CUSIP NUMBER:
344910 20 3

PROVINCE OF INCORPORATION:
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STATE OF INCORPORATION
Footmaxx Inc. Delaware, USA (1996)

REGISTRAR AND TRANSFER AGENT:
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Toronto, ON M5H 4C3

INVESTOR INFORMATION

To request complete Footmaxx financial reports and other financial-related news releases electronically, please email the webmaster at webmaster@footmaxx.com