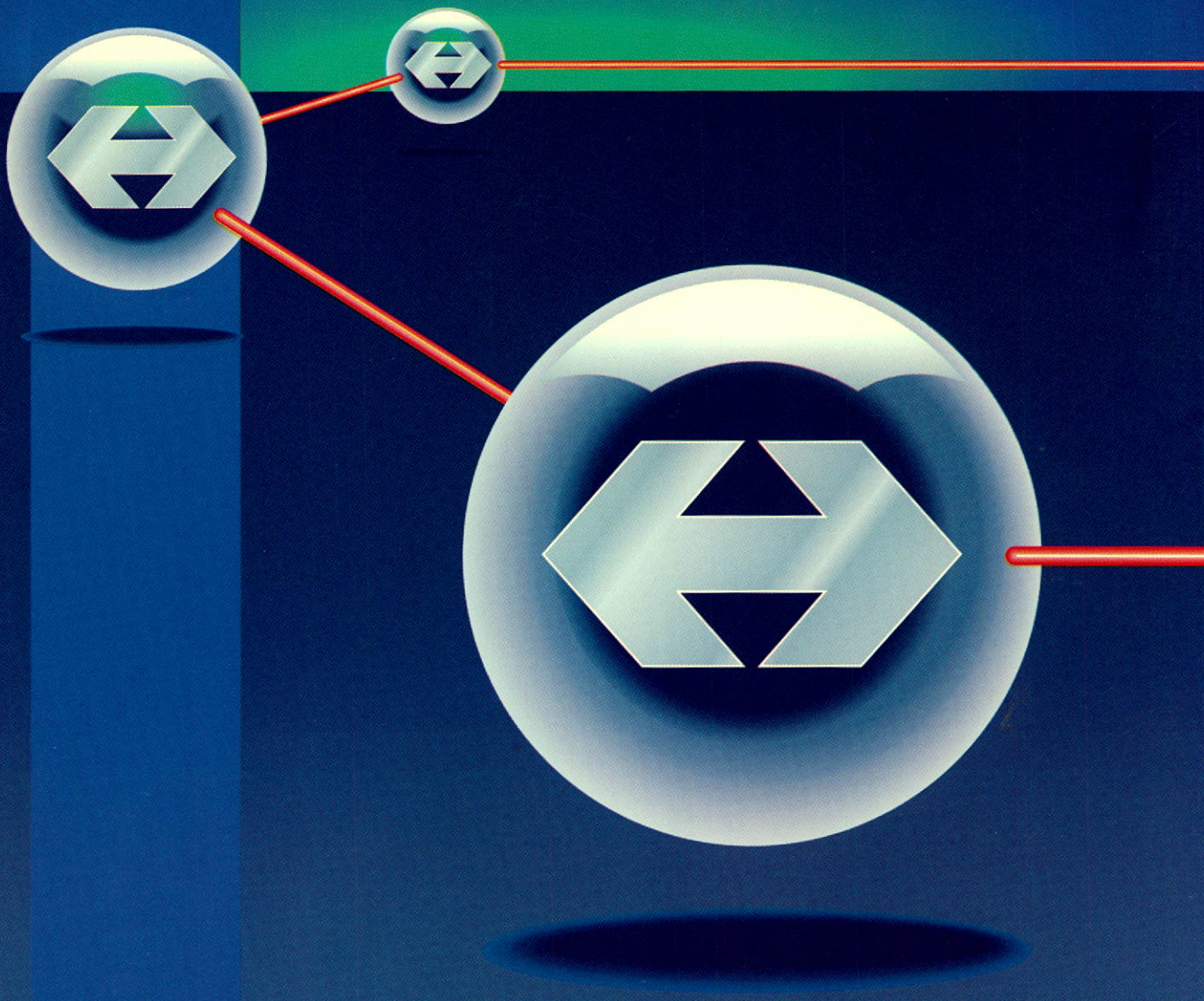
# Annual Report 1991



HPC Hval Pharmaceutical Corporation

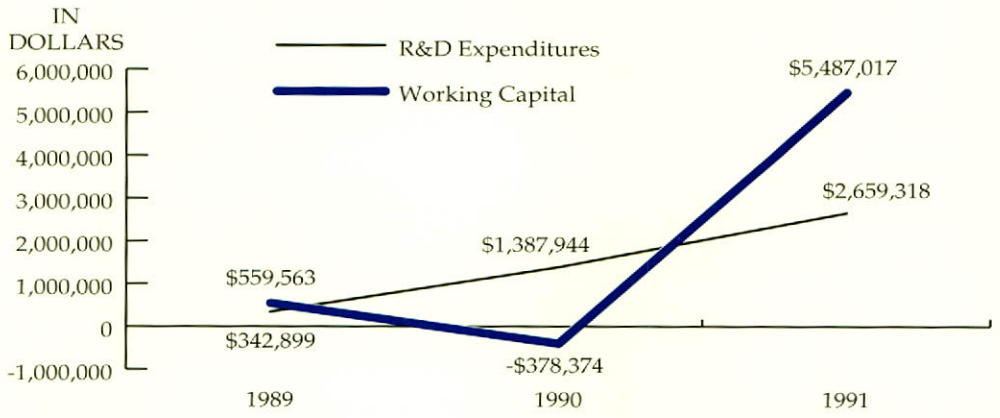
# Hyal Pharmaceutical Corporate Profile

Hyal Pharmaceutical Corporation is a Canadian public company engaged in the development of Hyaluronic Acid (HA) formulations which enhance, improve and control the delivery and utilization of active drug compounds in the human body. These formulations allow drugs to be delivered to their pharmacological site of action with greater efficiency and fewer side effects than if the same drug compounds were given alone.

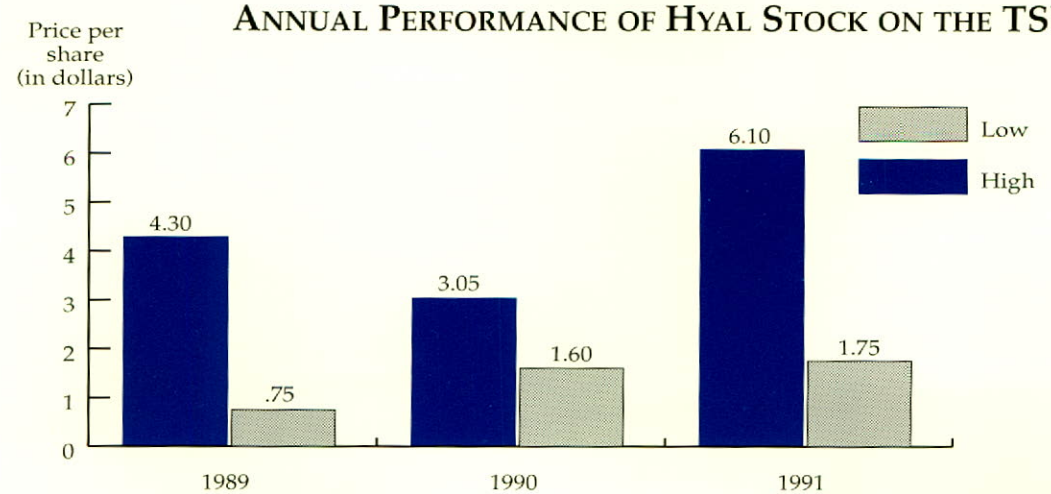
In addition to major therapeutic benefits, Hyal's proprietary formulations provide a method of improving the commercial prospects of existing drugs by extending their patent life and providing new protection to older pharmaceutical products.

Currently Hyal is working in three areas of medical importance: the treatment of pain, particularly pain associated with cancer, the treatment of infectious diseases and the treatment of a number of common types of skin cancer. The Company plans to market its formulations through licensing arrangements in all of the major pharmaceutical markets in the world.

## R&D Expenditures & Working Capital




## Annual Performance of Hyal Stock on the TSE



# Report To Shareholders

This past year has been extremely rewarding for the Company. Significant new discoveries in the control of pain were added to our growing intellectual property base. Important strides were made in the clinical development of Hyaluronic Acid (HA)-based formulations for the treatment of these conditions. Our basic understanding of the mechanisms of action of HA increased substantially, with the resultant expansion of our R and D in certain key areas of development.

Based on the clinical discoveries, the intellectual property and a sound and focused business plan, Hyal was successful in raising the necessary capital to fund appropriate clinical trials which will lead to the eventual marketing of the first of our proprietary HA formulations.

External clinical trials on our HYANALGESE$_{TM}$ analgesic compounds for the relief of pain have been initiated in a number of countries. The trials are being carried out at centres acknowledged for their expertise in the relevant therapeutic area and are being monitored by independent groups qualified to ensure compliance with international standards. These independent trials focus on pain control by means of both intravenous and topical formulations.

At the same time, clinical evaluations of HYANALGESE$_{TM}$ and HA with NSAIDS and chemotherapy combinations are continuing at the Falk Oncology Centre in Toronto with encouraging results. As we previously reported, a number of patients with advanced forms of cancer have responded to treatments and are continuing to respond. As the result of promising findings last summer at the Falk Oncology Centre, which were confirmed at other independent locations, the Company has plans to sponsor large scale randomized clinical trials in Canada, the U.S., Australia and Europe for the topical treatment of various forms of skin cancer using HA formulations. These trials are scheduled to commence in 1992. Your company is very encouraged by the strong recovery rate of patients whose basal cell carcinomas have been treated with our formulations.

Early in 1991, the European Patent Office published the Company's patent application consisting of 274 claims covering the use of HA-based technology in enhancing the penetration and effectiveness of a number of important classes of drugs. As well, in November the United States Patent Office issued a Notice of Allowance to the Company for a patent entitled "Pure, sterile, pyrogen-free Hyaluronic Acid formulations, their methods of preparation and methods of use." The U.S. Patent Office also granted Hyal's patent covering PP-14, an immune system modulator.

Hyal is soundly financed, enabling us to continue and accelerate our program of clinical trials. As a result of a combined common share and rights offering completed in the fall of 1991, the Company's capital base was increased by nearly $10 million. The investors in this offering included a number of Canadian financial institutions indicating confidence in Hyal by the investment community. In March 1992, the Company arranged a private placement equity issue of approximately $12 million dollars which will allow us to broaden the scope of the Company's research and development activities. The Company expects to receive the proceeds of this offering following the filing of a final prospectus.

Operating results for the year showed growth in sales of Hyaluronic Acid for clinical evaluations. Research and development costs, which almost doubled in 1991, reflected the heightened pace of activities towards clinical trials and new product development. Increased interest expense reflects the borrowing cost attributed to the business before the equity issue in September of 1991 and the concentration of the business entirely on continuing operations in 1991. Please see management's discussion and analysis of operating results and the consolidated financial statements for a more detailed analysis of operating results.

We wish to thank our employees and colleagues for their continuing efforts towards realizing our goals and to our old and new shareholders, may I express my appreciation for their support and participation.

Samuel S. Asculai, Ph.D.
President and C.E.O.
May 1, 1992

# The Properties of HA

Hyaluronic Acid (HA) is a naturally occurring substance present in all tissues in humans and other animals. It is found in high concentrations in the fluids within the joints and eye and as part of the cement that holds cells together. The central biological function of HA is believed to be its ability to bind and transport water to various internal sites in the body and therefore functions as a lubricant and moisturizer. Laboratory results, as well as observations in man, suggest that trauma, whether physical (such as surgery) or physiological (such as cancer), leads to a local depletion of HA. External administration of "new" HA leads to a preferential accumulation of this "new" HA at the site of depletion together with any drugs with which it is combined. This is believed to be the basis of the targeting properties of HA.

## The Applications

HA's promising future lies in its ability to enhance the effects of a whole range of drugs, including those used to combat pain, infection and cancer. HA reduces the drugs' toxicity, so larger doses can be used without the often debilitating side effects many patients experience.

## Pain

The class of drugs known as non-steroidal anti-inflammatory drugs (NSAIDS) have been recognized as excellent agents for the relief of inflammation and pain for some time. What has hindered greater clinical application has been their equally significant toxic side effects. This has precluded the use of high doses of these NSAIDS to replace narcotic analgesics such as morphine. When combined with HA, NSAID formulations suitable for intravenous injection are available for the first time. It has been noted that significantly higher doses of NSAIDS may be applied without major untoward side effects and substantial pain relief previously only associated with narcotic analgesics has been consistently observed.

In the area of topical formulations such as creams and gels, pilot studies on humans as well as experimental laboratory work have shown the ability of HA formulations to target to the site of superficial pain and to provide more rapid pain relief than previously observed for other topical analgesic preparations.

## Cancer

Studies carried out at the Falk Oncology Centre in Toronto have shown that chemotherapy administered in combination with HA targeted more directly to pathological tissue in patients suffering advanced forms of cancer. In a group of patients who had not received previous therapy, more effective tumour destruction was produced and when combined with NSAID/HA treatment, 90% of the patients passed their median anticipated survival level after 18 months of treatment and have continued to respond and improve.

In addition to exploring new modalities of cancer treatment, Hyal has developed a formulation containing HA for the treatment of basal cell carcinomas, the most common type of human skin cancer. In a pilot study conducted at the Falk Oncology Centre and two other locations, more than 50 individuals with basal cell skin cancers were treated with a topical formulation containing HA. It was remarkable that non-invasive, non-toxic therapy resulted in the disappearance of all tumors treated. Controlled, randomized trials in Canada, the U.S., Australia and Europe will begin this year.

## Infectious Diseases

Studies involving laboratory animals have shown that HA enhances the effect of antibiotics such as gentamycin and ampicillin in treating acute and chronic infections. The experimental observations have been confirmed in humans where long-term infections were eradicated by the use of formulations of HA with antibiotics. Hyal intends to initiate clinical tests on antibiotic formulations combined with HA for in-hospital use in 1992.

## Visible Youth™

In addition to numerous pharmaceutical applications using HA compounds, the Company is marketing a line of HA-based skin care products under the name Visible Youth™. This line contains three products that are sold primarily in Canada.

The product line is based on a highly purified grade of hyaluronate and the company is looking to establish a niche in the high end market, where quality is a first consideration. The Company has enjoyed substantial repeat business with specialized cosmetic outlets and is continuing to expand its market penetration and product line this year. To this end, Eye Zone Gel was launched in March of 1992.

# Management's Discussion and Analysis of Operating Results

## Fiscal 1991 Compared with Fiscal 1990

Sales increased in 1991 compared with 1990 primarily as a result of increased sales of products for clinical evaluation. Sales of the Visible Youth$_{TM}$ skin care product line for 1991 increased minimally from 1990. The increased sales were volume related and were not due to price changes.

Interest income in 1991 reflects interest earned from the investment of the net proceeds of the common share and the rights offerings which closed on September 19, 1991 and October 8, 1991, respectively. In addition, investment income in the form of imputed interest was earned on notes receivable which had previously been discounted. The discounted notes receivable were a portion of the proceeds from the sale of the veterinary operations in September 1990.

Royalty income reflects ongoing revenues resulting from the exclusive licensing of the rights to the Company's veterinary products Synacid and Synacid 2x to Schering Corporation in March 1991.

Selling, general and administrative expenses increased over 1990 as a result of the concentration of ongoing operations solely on the human business segment in 1991, whereas during the first half of 1990 such expenses related to both the human and the veterinary (discontinued operations) segments.

The comparative twofold increase in research and development expenditures for 1991 reflects the increased levels of research activity toward the development of drug delivery technologies for human health care applications using HA drug combinations.

Increased interest expense in 1991 reflects borrowing costs attributable to the ongoing business for the first three quarters of 1991. During the first nine months of 1990, interest expense was related primarily to the veterinary operations and was included in discontinued operations.

The comparative increase in earnings from discontinued operations for 1991 results primarily from the disposition of the Company's rights to the veterinary products, Synacid and Synacid 2x, for proceeds of $375,000 U.S. in March 1991. A gain on disposal of $346,114 has been included in earnings from discontinued operations for 1991 and is outlined in note 4 to the consolidated financial statements.

## Fiscal 1990 Compared with Fiscal 1989

Sales from ongoing operations increased in 1990 compared with 1989, primarily as a result of increased sales of the Company's human skin care product, Visible Youth$_{TM}$, the expansion of that product's geographic market base and also revenues obtained from the sale of product for clinical evaluation.

The comparative increase in selling, general and administrative expenses reflects concentration of the ongoing operations on the human business segment, whereas in 1989 the concentration was on the veterinary segment. In addition, there were increased marketing and selling costs related to gains in Visible Youth$_{TM}$ sales.

The increase in research and development expenditures reflects the refocusing of the Company's research and development resources as well as the increased research activity necessary to further the development of HA technologies in order to facilitate and control the delivery and utilization of drug compounds for human health care applications. The increase also reflects the costs related to the filing of worldwide patents for the Company's HA technology, as well as the costs associated with the amortization of the licence agreement entered into with Norpharmco in May 1990.

Interest expense reflects costs related to the ongoing business operations. In 1989, interest expense was fully attributed to the veterinary business segment.

The earnings from the discontinued business reflect the results of operations and gain on disposition of a substantial portion of the Company's veterinary operations as outlined in note 4 to the consolidated financial statements.

### Liquidity and Working Capital

In the past, in addition to revenues from operations, the Company has relied on bank borrowings, the private placement of a convertible debenture and advances from one of its principal shareholders, Helix Investments Limited, to fund its working capital requirements. A portion of the proceeds from disposition of the veterinary assets in 1990 and 1991 and the common share and rights offering in 1991 provided working capital to pay down bank indebtedness and amounts owing to Helix. Hyal intends to rely on revenues from operations, ongoing royalties from the veterinary products sold under licence, co-development fees and HA licensing fees and equity financing to meet its long-term capital requirements.

The proceeds from the 1991 common share and rights offering have been invested in debt obligations guaranteed by the federal and provincial governments of Canada and by Canadian chartered banks until such proceeds are required for research and development activities.

Subsequent to December 31, 1991, the Company completed a private placement equity issue for net proceeds of approximately $11,800,000. Proceeds of this offering will allow the Company to broaden the scope of its research and development activities. The Company expects to receive the proceeds of this offering following the filing of a final prospectus. See note 17(a) to the consolidated financial statements.

On March 31, 1992 the Company sold its PP-14 technology for proceeds of $750,000. See note 17(b) to the consolidated financial statements.

# Auditors' Report to the Shareholders of Hyal Pharmaceutical Corporation

We have audited the consolidated balance sheets of Hyal Pharmaceutical Corporation as at December 31, 1991 and 1990 and the consolidated statements of operations, shareholders' equity and changes in financial position for each of the years in the three year period ended December 31, 1991. 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 audits.

We conducted our audits in accordance with 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, 1991 and 1990 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1991 in accordance with generally accepted accounting principles.

Coopers & Lybrand

Chartered Accountants

Mississauga, Ontario
February 21, 1992 (March 9, 1992 with respect to note 17(a)
and March 31, 1992 with respect to notes 17(b) and (c))

# Consolidated Balance Sheets

| | As at December 31, 1991 | 1990 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and short-term investments (note 8) | $ 4,229,022 | $ – |
| Accounts receivable - | | |
| Trade (note 16) | 128,774 | 127,804 |
| Other | 70,740 | 30,246 |
| Inventory (note 3) | 594,429 | 520,639 |
| Notes receivable - current portion | 329,600 | 303,800 |
| Prepaid expenses | 128,539 | – |
| Discontinued operations - net (note 4) | - | 10,950 |
| | 5,481,104 | 993,439 |
| **Notes Receivable** (note 5) | 300,310 | 448,742 |
| **Capital Assets** (note 6) | 153,525 | 185,787 |
| **Licence Agreement** (note 7) | 4,355,556 | 4,682,222 |
| | $ 10,290,495 | $ 6,310,190 |
| **Liabilities** | | |
| **Current Liabilities** | | |
| Bank indebtedness (note 8) | $ – | $ 1,257,995 |
| Accounts payable and accrued liabilities | 787,634 | 678,196 |
| Advances from shareholder (note 9) | – | 500,000 |
| Current portion of long-term debt | 1,000,000 | – |
| | 1,787,634 | 2,436,191 |
| **Long-term Debt** (note 10) | – | 1,000,000 |
| | 1,787,634 | 3,436,191 |
| **Commitments and Contingencies** (notes 11 and 15) | | |
| **Shareholders' Equity** | | |
| **Share Capital** (note 12) | 19,087,853 | 10,490,163 |
| **Contributed Surplus** (note 12) | 457,321 | 457,321 |
| **Deficit** | (11,042,313) | (8,073,485) |
| | 8,502,861 | 2,873,999 |
| | $ 10,290,495 | $ 6,310,190 |

SIGNED ON BEHALF OF THE BOARD

D. C. Webster, Director

Samuel S. Asculai, Director

# Consolidated Statements of Shareholders' Equity

| | Share capital | Contributed surplus | Deficit |
|---|---|---|---|
| **Balance - December 31, 1988** | $5,360,454 | $513,863 | $(5,097,079) |
| Loss for the year ended December 31, 1989 | – | – | (829,898) |
| Net proceeds on issue of common shares | 80,088 | – | – |
| **Balance - December 31, 1989** | 5,440,542 | 513,863 | (5,926,977) |
| Loss for the year ended December 31, 1990 | – | – | (2,146,508) |
| Net proceeds on issue of common shares | 5,119,395 | – | – |
| Redemption of common shares | (69,774) | (56,542) | – |
| **Balance - December 31, 1990** | 10,490,163 | 457,321 | (8,073,485) |
| Loss for the year ended December 31, 1991 | – | – | (2,968,828) |
| Net proceeds on issue of common shares | 8,597,690 | – | – |
| **Balance - December 31, 1991** | **$19,087,853** | **$457,321** | **$(11,042,313)** |

# Consolidated Statements of Operations

| | Years ended December 31, | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| **Sales** (note 16) | **$ 1,163,134** | $ 627,015 | $ 185,644 |
| **Cost of Sales** | **351,612** | 187,772 | 49,331 |
| **Gross Profit** | **811,522** | 439,243 | 136,313 |
| **Interest Income** | **183,387** | 2,850 | – |
| **Royalty Income** | **32,312** | – | – |
| **Expenses** | | | |
| Selling, general and administrative | **1,391,909** | 1,165,662 | 163,521 |
| Research and development | **2,659,318** | 1,387,944 | 342,899 |
| Interest (notes 8, 9 and 10) | **290,936** | 174,142 | 1,753 |
| | **4,342,163** | 2,727,748 | 508,173 |
| **Loss from continuing operations** | **(3,314,942)** | (2,285,655) | (371,860) |
| **Earnings (loss) from discontinued operations** (note 4) | **346,114** | 139,147 | (458,038) |
| **Net Loss for the Year** | **$ (2,968,828)** | $ (2,146,508) | $ (829,898) |
| **Loss Per Share** (note 14) | | | |
| Continuing operations | **$ (0.36)** | $ (0.32) | $ (0.08) |
| Discontinued operations | **0.04** | 0.02 | (0.08) |
| **Net Loss Per Share** | **$ (0.32)** | $ (0.30) | $ (0.16) |

# Consolidated Statements of Changes in Financial Position

| | Years ended December 31, | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| **Cash Provided From (Used In)** | | | |
| **Operating Activities** | | | |
| Loss from continuing operations | **$ (3,314,942)** | $ (2,285,655) | $ (371,860) |
| Items not affecting cash - | | | |
| Amortization | **377,542** | 264,252 | 1,233 |
| Loss (gain) on disposal of capital assets | **1,410** | (2,224) | – |
| Interest on discounted notes receivable | **(96,568)** | – | – |
| | **(3,032,558)** | (2,023,627) | (370,627) |
| Net (increase) decrease in non-cash working capital items affecting operations | **(163,855)** | 117,817 | 37,071 |
| Cash used in continuing operations | **(3,196,413)** | (1,905,810) | (333,556) |
| Cash provided from (used in) discontinued operations | **(49,780)** | 738,689 | (181,865) |
| | **(3,246,193)** | (1,167,121) | (515,421) |
| **Financing Activities** | | | |
| (Payment to) advances from shareholder - net | **(500,000)** | 500,000 | – |
| Proceeds on issue of common shares | **8,597,690** | 5,119,395 | 80,088 |
| Issue of convertible debenture | **–** | – | 1,000,000 |
| Redemption of common shares | **–** | (126,316) | – |
| | **8,097,690** | 5,493,079 | 1,080,088 |
| **Investing Activities** | | | |
| Discontinued operations | **–** | – | 1,939 |
| Proceeds on disposition of business | **436,344** | 785,742 | – |
| Change in notes receivable | **219,200** | (582,542) | – |
| Purchase of capital assets | **(24,824)** | (11,979) | (7,043) |
| Proceeds on sale of capital assets | **4,800** | 4,447 | – |
| Licence agreement acquired for issue of common shares | **–** | (4,900,000) | – |
| | **635,520** | (4,704,332) | (5,104) |
| **Increase (Decrease) in Cash and Short-Term Investments During the Year** | **5,487,017** | (378,374) | 559,563 |
| **Bank Indebtedness - Beginning of Year** | **(1,257,995)** | (879,621) | (1,439,184) |
| **Cash and Short-Term Investments (Bank Indebtedness) - End of Year** | **$ 4,229,022** | $ (1,257,995) | $ (879,621) |

# Notes to Consolidated Financial Statements

## 1. Description of Business

Hyal Pharmaceutical Corporation ("the Company") is a research oriented pharmaceutical company engaged in the identification, development, formulation and sale of pharmaceutical products related to Hyaluronic Acid. In 1991, the Company completed the sale of its veterinary products business (note 4) and now concentrates on human applications of Hyaluronic Acid. In 1990, the Company purchased the remaining 50% equity interest in the joint venture, Hyal Pharmaceutical Inc. (note 15). To reflect the concentration on human applications of its technologies, the Company changed its name in 1990 from Sterivet Laboratories Limited to Hyal Pharmaceutical Corporation.

Prior to 1990, the Company's efforts were focused substantially on the veterinary products business segment, identifying, developing and obtaining regulatory approval for the sale of such drugs, primarily for the performance horse.

The Company's operating plans, sales prospects and profitability are predicated on successful marketing of its human products and development of pharmaceutical technologies for human applications. The Company is in the process of developing and obtaining regulatory approvals, and the initiation of distribution arrangements for its products.

## 2. Significant Accounting Policies

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Sterivet Laboratories Incorporated, a company incorporated in the State of Ohio, U.S.A., and Hyal Pharmaceutical Inc., a company incorporated in the Province of Ontario. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

### Inventory

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

### Capital assets, licence agreement and amortization

Capital assets are recorded at cost less accumulated amortization. Equipment, furniture and fixtures, and research facilities are amortized on a straight-line basis over their estimated useful lives of five to ten years. Leasehold improvements are amortized on a straight-line basis over the remaining term of the lease. The Licence Agreement is carried at cost less accumulated amortization and is amortized on a straight-line basis over fifteen years.

**Foreign currency translation**

Monetary assets and liabilities denominated in U.S. currency have been translated into Canadian dollars at year-end exchange rates. Revenues and expenses denominated in U.S. currency have been translated at exchange rates prevalent at the transaction date. All exchange gains or losses arising on translation are included in the statements of operations.

**Research and development**

Research and development costs are expensed as incurred unless they meet generally accepted accounting criteria for deferral.

Certain qualified research and development expenditures have resulted in investment tax credits being available to the Company. To the extent that the Company has been able to utilize these credits to reduce taxes otherwise payable, they are reflected as a reduction of research and development expense.

## 3. Inventory

| | December 31, | |
|---|---|---|
| | **1991** | 1990 |
| Raw materials | **$ 372,431** | $ 262,636 |
| Packaging materials | **159,017** | 207,369 |
| Finished goods | **62,981** | 50,634 |
| | **$ 594,429** | $ 520,639 |

## 4. Discontinued Operations

The Board of Directors adopted a formal plan for disposal of the veterinary business segment on June 30, 1990. Earnings (loss) from discontinued operations represents the gain on disposition and the results of operations of the veterinary business. The consolidated statements of operations and changes in financial position for 1989 have been restated to reflect the discontinued business. Certain assets previously identified with the veterinary business segment in 1989 have been reclassified to the human business segment in 1990 to recognize their ongoing use.

On September 14, 1990, effective June 30, 1990, the Company sold substantially all of its veterinary products except for products for veterinary applications involving Hyaluronic Acid. The proceeds on disposition on the June 30, 1990 sale comprise $591,000 cash and notes receivable of $200,000 per year for a period of four years. The notes are non-interest bearing and are secured by an irrevocable letter of credit. For financial statement purposes the notes have been discounted to $482,310 (1990 - $585,742). A gain of $223,462 was recognized in 1990 as a result of the disposition.

On March 19, 1991, the Company sold its remaining veterinary products and entered into a licence agreement with Schering Corporation whereby the purchaser received an exclusive worldwide licence to use the trademarks Synacid and Synacid 2X in connection with the manufacture, marketing, and sale of Synacid for veterinary applications. The proceeds on closing amounted to cash of $300,000 U.S. and ongoing royalties of 10% of worldwide sales. The royalty agreement expires in 20 years, after which the worldwide applicable veterinary Synacid licence can be acquired for a nominal amount. Inventories valued at approximately $75,000 U.S. were sold to Schering at cost in April 1991.

The operating results and financial position of the discontinued operations are summarized below:

## Statements of Operations

| | Years ended December 31, | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| **Operations** | | | |
| Sales | **$ –** | $ 1,060,344 | $ 2,377,709 |
| Cost of sales | **–** | 552,805 | 1,244,641 |
| Gross profit | **–** | 507,539 | 1,133,068 |
| Investment income | **–** | – | 4,290 |
| Selling, general and administrative expense | **–** | (387,819) | (1,164,973) |
| Research and development expense | **–** | (116,035) | (221,202) |
| Interest expense | **–** | (88,000) | (209,221) |
| | **–** | (591,854) | (1,595,396) |
| **Loss from discontinued operations** | **–** | (84,315) | (458,038) |
| **Gain on disposition** | **346,114** | 223,462 | – |
| **Earnings (loss) from discontinued operations** | **$ 346,114** | $ 139,147 | $ (458,038) |

## Balance Sheets

The following amounts are included in the consolidated balance sheet:

| | December 31, | |
|---|---|---|
| | **1991** | 1990 |
| **Net Current Assets** | | |
| Accounts receivable | **$ -** | $ 38,188 |
| Inventory | **-** | 89,810 |
| Accounts payable | **-** | (117,048) |
| | **$ -** | $ 10,950 |

## 5. Notes Receivable

| | December 31, | |
|---|---|---|
| | **1991** | 1990 |
| Interest free notes, principal of $200,000 due each year from 1992 to 1994 secured by irrevocable letter of credit (note 4) | **$ 482,310** | $ 585,742 |
| Interest free note due 1992 After 1992 unpaid balance subject to interest at bank prime rate plus 2% from an officer and shareholder | **30,000** | 30,000 |
| Interest free note due 1992 from a Company controlled by officer and shareholder. After 1991 unpaid balance subject to interest at bank prime rate plus 2%. | **77,600** | 96,800 |
| Interest free note due 1992 After 1992 unpaid balance subject to bank prime plus 2% | **40,000** | 40,000 |
| | **629,910** | 752,542 |
| Less: current portion | **329,600** | 303,800 |
| | **$ 300,310** | $ 448,742 |

## 6. Capital Assets

| | December 31, 1991 | | |
|---|---|---|---|
| | Cost | Accumulated amortization | Net |
| Data processing equipment | **$ 35,219** | **$ 16,608** | **$ 18,611** |
| Machinery and equipment | **172,914** | **104,968** | **67,946** |
| Office furniture and fixtures | **53,711** | **50,833** | **2,878** |
| Leasehold improvements | **235,126** | **172,853** | **62,273** |
| Research facilities | **45,171** | **43,354** | **1,817** |
| | **$ 542,141** | **$ 388,616** | **$ 153,525** |

| | December 31, 1990 | | |
|---|---|---|---|
| | Cost | Accumulated amortization | Net |
| Data processing equipment | $ 23,295 | $ 8,530 | $ 14,765 |
| Machinery and equipment | 180,087 | 99,846 | 80,241 |
| Office furniture and fixtures | 53,276 | 47,913 | 5,363 |
| Leasehold improvements | 234,566 | 151,302 | 83,264 |
| Research facilities | 45,171 | 43,017 | 2,154 |
| | $ 536,395 | $ 350,608 | $ 185,787 |

## 7. Licence Agreement

| | December 31, | |
|---|---|---|
| | **1991** | 1990 |
| Licence agreement | **$ 4,900,000** | $ 4,900,000 |
| Less: Accumulated amortization | **(544,444)** | (217,778) |
| | **$ 4,355,556** | $ 4,682,222 |

The Licence Agreement was acquired as a result of the Company purchasing the remaining 50% interest in the joint venture (note 15).

Amortization expense on the licence agreement amounted to $326,666 (1990 - $217,778; 1989 -$ Nil).

## 8. Bank Credit Facilities

The Company has a revolving bank credit facility providing a maximum amount of credit of $500,000. Borrowings under the credit facility bear interest at the bank's prime lending rate.

A term deposit of $500,000 has been pledged as collateral for the bank credit facilities.

## 9. Advances from Shareholder

During 1990, a significant shareholder advanced $500,000 to the Company. A further $1,205,000 was advanced in the first nine months of 1991. These advances were due on demand and bore interest at 1.75% above bank prime, payable monthly. During 1991, interest on the advances amounted to $105,200 (1990 - $44,500; 1989 - $Nil). The advances and related interest were repaid in 1991.

## 10. Long-term Debt

Long-term debt originated in 1989 and comprises a subordinated convertible debenture in the amount of $1,000,000 which bears interest at 8% payable quarterly. The principal is due December 14, 1992. Interest expense for the year amounted to $80,000 (1990 - $80,000, 1989 - $1,753). The debenture is convertible into common shares at a rate of $3.33 per share. Attached to the debenture are warrants to purchase 250,000 common shares at $3.33 per common share which are exercisable until December 14, 1994. The debenture and warrants are held by a significant shareholder of the Company.

## 11. Commitments and Contingent Liabilities

(a) At December 31, 1991, the Company was committed to future payments under certain operating leases for equipment and premises as follows:

| | |
|---|---|
| 1992 | $ 83,057 |
| 1993 | 64,433 |
| 1994 | 54,678 |
| 1995 | 27,685 |
| | $ 229,853 |

(b) During 1988, a claim was filed against the Company and three other parties in the amount of $10,000,000 for breach of contract. The plaintiff has not taken any further action against the Company since filing its original claim in 1988. The Company believes this action to be unfounded and filed a counterclaim in 1988. The outcome of these actions is indeterminable and accordingly, no provision has been made in the financial statements for the years ended December 31, 1991, 1990 and 1989.

## 12. Share Capital

Authorized -

Unlimited number of preferred shares, without par value, issuable in series
Unlimited number of common shares, without par value
187,500 9% cumulative, convertible, redeemable, non-voting Series A preferred shares

| Issued - | December 31, | |
|---|---|---|
| | **1991** | 1990 |
| 12,631,362 (1990 - 8,372,375) Common Shares | **$ 18,489,434** | $ 9,709,735 |
| 93,750 (1990 - 125,000) Series A Preferred Shares | **598,419** | 780,428 |
| | **$ 19,087,853** | $ 10,490,163 |

The Series A preferred shares are entitled to a cumulative dividend of $0.72 per share per annum payable quarterly. Subsequent to December 31, 1991, the Company may redeem all or any part of the outstanding Series A preferred shares for $8.00 per share plus accrued unpaid dividends per share. The shares are convertible into 2.82 common shares for each Series A preferred share.

In the first quarter of 1989, the Company suspended dividends on the Series A preferred shares. Cumulative dividends in arrears at December 31, 1991 amount to $202,500 (1990 - $180,000, 1989 - $90,000). In accordance with the articles of amendment, four quarterly dividend payments in arrears entitle the Series A preferred shareholders to voting rights for the period in which the dividends remain in arrears. In addition, during this period, these shareholders are entitled to elect two members of the board of directors of the Company.

The Company is restricted from paying dividends on the common shares if such dividends would reduce common shareholders' equity to less than $4,000,000 or if the payment of the dividend would result in dividends paid subsequent to December 31, 1985 exceeding net earnings subsequent to December 31, 1985 less $1,000,000. The Company has incurred cumulative net losses for the period subsequent to December 31, 1985.

Warrants to purchase common shares outstanding as at December 31, 1991, provide the following entitlement:

| Number of common shares under warrant | Price per share $ | Date of expiry |
|---|---|---|
| 250,000 | 3.33 | December 14, 1994 |
| 150,000 | 2.20 | May 11, 1995 |
| 300,000 | 2.40 | May 11, 1995 |
| 700,000 | | |

The following share transactions took place in 1991:

(a) On September 4, 1991, the Company filed a prospectus with the Ontario Securities Commission for the public issue of 9,725,172 rights to subscribe for 1,620,862 common shares and a concurrent additional offering of 2,550,000 common shares. Each holder of common shares of record at the close of business on September 17, 1991 received one right for each common share held. Six rights entitled the holder to subscribe for one common share at a price of $2.25 per common share. All rights were exercised. The share issue costs of $786,750 were charged to capital stock.

On September 19, 1991, 2,550,000 common shares were issued at $2.25 for net proceeds of $5,373,337 pursuant to the offering noted above. On October 8, 1991, a further 1,620,862 common shares were issued at $2.25 for net proceeds of $3,224,353 pursuant to the rights offering noted above.

(b) On October 22, 1991, 31,250 preferred shares with a book value of $182,009 were converted to 88,125 common shares.

The following share transactions took place in 1990:

(a) On January 22, 1990, 2,500,000 common shares were issued to Norpharmco Inc. in exchange for the remaining 50% equity portion in the joint venture (note 15).

(b) On October 22, 1990 options were exercised resulting in the issuance of 141,775 common shares for proceeds of $219,395. As part of the consideration for the exercise of these options under the terms of the 1983 Executive Stock Option Plan, the Company redeemed and cancelled 60,150 common shares with a net book value of $69,774 for $126,316. The amounts paid in excess of book value have been charged to contributed surplus.

Options to purchase common shares are as follows:

| Expiry Date | Option Price | Balance 12/31/89 | Issued 1990 | Exercised 1990 | Expired 1990 | Balance 12/31/90 | Issued 1991 | Exercised 1991 | Expired 1991 | Balance 12/31/91 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Employee Share Option Plan** | | | | | | | | | | |
| 10/30/90 | $1.330 U.S. | 150,000 | | 141,775 | 8,225 | | | | | |
| 09/19/91 | $3.170 | 69,900 | | | 6,000 | 63,900 | | | 63,900 | |
| 06/18/95 | $2.210 | | 200,000 | | | 200,000 | | | | 200,000 |
| 07/31/96 | $2.250 | | | | | | 75,000 | | | 75,000 |
| 08/01/96 | $2.250 | | | | | | 25,000 | | | 25,000 |
| | | 219,900 | 200,000 | 141,775 | 14,225 | 263,900 | 100,000 | 0 | 63,900 | 300,000 |
| **Granted to Consultants** | | | | | | | | | | |
| 12/16/96 | $4.610 | | | | | | 120,000 | | | 120,000 |
| | | 219,900 | 200,000 | 141,775 | 14,225 | 263,900 | 220,000 | 0 | 63,900 | 420,000 |

## 13. Income Taxes

The Company has accumulated losses for income tax purposes at December 31, 1991 which are available to reduce taxable income in future years and for which no future tax benefit has been recognized in the accounts. In addition, for federal purposes, at December 31, 1991 the Company has investment tax credits ("ITCs") available to reduce future years' taxes payable which may be claimed in varying amounts up to 2001. For federal purposes these losses and ITCs expire as follows:

| | | Losses | | |
|---|---|---|---|---|
| | | ITC | Canada | United States |
| Years ending | | | | |
| December 31, | 1993 | $ | $ 175,000 | $ |
| | 1994 | 24,000 | 478,000 | |
| | 1995 | | 741,000 | |
| | 1996 | 19,000 | 415,000 | |
| | 1997 | 69,000 | 877,000 | |
| | 1998 | 86,000 | 1,270,000 | |
| | 1999 | 47,000 | | 505,000 |
| | 2000 | 191,000 | | 23,000 |
| | 2001 | 309,000 | | 34,000 |
| | 2002 | | | 10,000 |
| | 2003 | | | 115,000 |
| | 2004 | | | 123,000 |
| | 2005 | | | 43,000 |
| | 2006 | | | 16,000 |
| | | $ 745,000 | $ 3,956,000 | $ 869,000 |

The Company also has research and development expenditures amounting to approximately $4,500,000 which may be used to reduce future years' taxable income. For Canadian provincial purposes, the Company has accumulated losses for income tax purposes at December 31, 1991 amounting to approximately $8,900,000 that expire in varying amounts up to 1998.

## 14. Loss Per Share

The loss per share amounts have been calculated using the weighted average outstanding number of common shares of 9,490,957 (1990 - 7,415,864; 1989 - 5,651,796).

At December 31, 1991, preferred share dividends in arrears of $67,500 (1990 and 1989 - $90,000) have been deducted in determining income available to common shareholders.

## 15. Joint Venture and Licence Agreement

In October 1989, the Company entered into a joint venture agreement ("Agreement") with Norpharmco Inc. ("Norpharmco"). In exchange for 50% equity interests, the Company and Norpharmco granted to the joint venture, Hyal Pharmaceutical Inc., exclusive unlimited life worldwide royalty-free licences to use all of their respective patent rights, proprietary rights and other interests in Hyaluronic Acid for use in the treatment of human conditions and diseases.

In May 1990, effective from January 22, 1990, the Company, acquired the 50% interest in the joint venture previously held by Norpharmco in exchange for 2,500,000 common shares of the Company and 150,000 warrants to purchase common shares in the Company. The exercise price of the warrants is $2.20 per share. The Board of Directors have valued the shares issued under this agreement at $1.96 per share for total consideration of $4,900,000. The acquisition was accounted for using the purchase method.

As part of the transactions, a significant shareholder of the Company guaranteed until May 1991 a minimum market value of a portion of the common shares issued. In exchange for financial undertakings assumed, the significant shareholder received 300,000 warrants to purchase common shares at a price of $2.40.

As a result of this transaction the following conditions are now in place:

(a) For a period of three years to May 1993, the Board of Directors of the Company will be comprised of a maximum of eight members made up of four nominees of Norpharmco and four nominees of another significant shareholder. Thereafter, both Norpharmco and the other significant shareholder must approve any expansion of the Board. Under certain circumstances the Board can be reconstituted giving Norpharmco the ability to nominate three quarters of the Board.

(b) For a period of three years to May 1993 the Company will pay $300,000 per year for the services of the principals of Norpharmco. This agreement can be renewed for a further three years and thereafter annually at mutually agreed terms. All new proprietary rights and know-how resulting from this agreement will belong to the Company.

(c) The Norpharmco Licence Agreement pursuant to which Norpharmco granted the Company, through its wholly owned subsidiary, a royalty free worldwide unlimited life licence to use its patents, proprietary interests and know-how of Hyaluronic Acid may be terminated by Norpharmco on the occurrence of certain events related to the insolvency of the Company.

(d) The Company will pay Norpharmco a royalty of 2½% of sales of any new products developed as a result of the Norpharmco Licence Agreement.

## 16. Related Party Transactions

During the year the Company made payments of $1,003,777 (1990 - $270,965; 1989 - $Nil) to a significant shareholder for research and development services.

Included in sales for the year ended December 31, 1991 is $637,454 (1990 - $141,500; 1989 - $Nil) for products sold to a significant shareholder for cancer therapy treatment. Included in accounts receivable at December 31, 1991 are amounts of $69,000 (1990 - $69,500; 1989 - $Nil) owed by a significant shareholder.

## 17. Subsequent Events

(a) Subsequent to year-end, the Company entered into an agency agreement with Loewen, Ondaatje, McCutcheon & Company Limited and Sprott Securities Limited and completed a private placement for the sale of 2,000,000 units for net proceeds of approximately $11,800,000. Each unit comprises one common share plus one half of a common share purchase warrant. One common share purchase warrant plus $7.625 will be required to purchase one additional common share. The private placement closed March 9, 1992. The funds are being held in escrow pending completion of a prospectus approved by the appropriate regulatory authorities. The warrants are exercisable for a period of eighteen months from the date of approval of the final prospectus by the appropriate regulatory authorities. An additional 100,000 common share purchase warrants may be issued by the Company and distributed by the agents.

(b) In March 1992 the Company acquired an equity interest in InterMune Life Sciences Inc. ("InterMune") for nominal consideration. On March 31, 1992 InterMune completed a private placement of common shares for net proceeds of approximately $3,000,000 and issued common shares in exchange for certain technology thereby reducing Hyal's equity interest to 45%. Concurrent with the completion of the private placement, Hyal sold to InterMune all of its right, title, patents and interest in and technology, invention and discovery relating to PP-14 and received $750,000 cash.

Under the terms of a shareholders' agreement among InterMune and its shareholders, Intermune's management agree that it shall vote the shares owned by management ("management shares") as directed by Hyal. Management shares currently account for 10% of Intermune's voting equity. This agreement terminates upon the earlier of: (i) Intermune completing an initial public offering approved by the appropriate regulatory authorities or (ii) $5,000,000 in further equity financing being raised by Intermune.

The shareholders' agreement permits Hyal to control Intermune, and accordingly the accounts of Intermune will be consolidated with Hyal with effect from March 31, 1992. The Company will record a dilution gain of approximately $1,400,000 as a result of this transaction.

(c) With effect from March 31, 1992, an officer and director of the Company resigned his position with Hyal. As part of the separation agreement, Hyal agreed to forgive $104,400 of notes receivable from this individual and a corporation controlled by the individual, and entered into an ongoing consulting agreement for a period of three years at $70,000 per annum.

# Corporate Directory

**Directors**
Donald C. Webster
Chairman
Helix Investments Limited
Venture Capital Investments

Samuel S. Asculai, Ph.D.
President and C.E.O.
Hyal Pharmaceutical Corporation

Arthur Falk, C.A.
Consultant

Dr. Rudolph E. Falk
Professor of Surgery, Immunology
& Pathology
University of Toronto;
President Falk Oncology Centre

Michael Levy
President
Milev Limited
Real Estate Investment Company

C.T. Marshall
Consultant

**Officers**
Donald C. Webster
Chairman

Samuel S. Asculai, Ph.D.
President and C.E.O.

Michael A. Byrne
Vice President Finance
and Corporate Secretary

David W. Harper
Vice President Development

Barbara E. Kay
Assistant Corporate Secretary

**Auditors**
Coopers & Lybrand
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**General Counsel**
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**Transfer Agent & Registrar**
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**Annual Meeting**
June 8, 1992 – 4:30 p.m.
The Toronto Stock Exchange
Auditorium, 2 First Canadian Place, Toronto, Ontario, Canada

**Stock Listing**
The Company's common stock is traded on the Toronto Stock Exchange under the symbol HPC.

**Toronto Stock Exchange Stock Price Information**
The high and low bid prices for the period January 1, 1991 to December 31, 1991 as reported by the Toronto Stock Exchange are:

| | $ High | $ Low |
|---|---|---|
| 1st Quarter | 2.35 | 1.75 |
| 2nd Quarter | 3.00 | 2.15 |
| 3rd Quarter | 4.15 | 2.50 |
| 4th Quarter | 6.10 | 3.50 |