

Nuvo Research Inc. *A YEAR of* PROGRESS



NUVO

ANNUAL REPORT 2006

LICENSING

Licensed the Canadian rights
to **PENNSAID®** and
PENNSAID PLUS to
SQUIRE PHARMACEUTICALS INC.,
a subsidiary of Paladin Labs Inc.

STRENGTHENING THE BALANCE SHEET

Closed a bought deal
public offering for gross proceeds of
\$15,000,000

Received
\$4,500,000
from SQUIRE PHARMACEUTICALS INC.
for additional rights to **PENNSAID®** and
PENNSAID PLUS

Received
\$4,500,000
from the exercise of warrants

Sold Nuvo's
MARKHAM HEAD OFFICE and surplus
property in **VARENNES, QUEBEC**, for
\$3,300,000

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FDA APPROVABLE LETTER

Received
APPROVABLE LETTER
for **PENNSAID**[®]
from the U.S. FDA

Nuvo Research Inc. A YEAR *of* PROGRESS

DRUG DEVELOPMENT

COMPLETED ANALYSIS OF

PENNSAID[®] PHASE III EFFICACY TRIAL

(Study 112) which *met all
Primary Efficacy Endpoints* and
confirmed the efficacy of Pennsaid[®].

COMPLETED ANALYSIS OF

**PENNSAID[®] PHASE III LONG-TERM,
OPEN-LABEL SAFETY TRIAL** (Study 112E),

which confirmed the long-term safety
of Pennsaid[®].

PROFILE

Nuvo Research Inc. is a publicly traded, Canadian pharmaceutical company headquartered in Mississauga, Ontario, with manufacturing facilities in Varennes, Quebec and Wanzleben, Germany, and a research and development facility in San Diego, California. Nuvo is focused on

DEVELOPING TARGETED THERAPEUTIC PRODUCTS

designed to produce minimal side effects. The Company develops drugs based on two technology platforms:

TRANSDERMAL DRUG DELIVERY and **IMMUNE SYSTEM**

REGULATION. Nuvo markets two products **PENNSAID®**,

a topical non-steroidal anti-inflammatory drug (NSAID)

used for the treatment of osteoarthritis and **OXOFERIN**,

a topical wound healing agent. Nuvo's primary focus is

obtaining approval to market, and ultimately commercialize

Pennsaid® in the U.S. market. Nuvo intends to leverage its

transdermal drug delivery capabilities to create a

portfolio of **TRANSDERMAL PRODUCTS** targeting a

variety of indications.

OUR PRODUCTS

Transdermal Drug Delivery

The Company's lead technology platform, a transdermal carrier, is designed to deliver therapeutic drugs through the skin directly to the disease site. Unlike oral medications, the Company's transdermal products do not rely on bloodstream circulation but offer site-specific treatment while limiting the body's systemic exposure to potentially harmful levels of chemical agents.

PENNSAID®

Pennsaid®, the Company's lead product, is used to treat the symptoms associated with knee osteoarthritis ("OA"). The drug combines a transdermal carrier (dimethyl sulfoxide, popularly known as "DMSO") with an active pharmaceutical ingredient, diclofenac sodium, a leading NSAID, and delivers it through the skin directly to the pain site. Nuvo's clinical trials suggest that Pennsaid® is as effective as oral diclofenac sodium, and has a significantly lower incidence of the typical adverse events associated with conventional oral NSAID treatment, such as gastrointestinal bleeding and cardiovascular side effects. Pennsaid® is marketed in Canada, several European countries and many Caribbean nations. The U.S. FDA issued an approvable letter, indicating Pennsaid® is approvable subject to Nuvo satisfying certain conditions for Pennsaid® in December 2006.

PENNSAID PLUS

Pennsaid Plus, is a follow on product to Nuvo's Pennsaid® and is designed to provide users with the efficacy of existing Pennsaid®, but with less frequent dosing and increased ease of application. A pivotal phase III trial of the product is expected to begin once the path for Pennsaid® approval in the United States is fully understood. The Canadian rights to market and sell the product are licensed to Squire Pharmaceuticals Inc.

PENECURE™

Penecure™, an antifungal medication intended for use in treating onychomycosis (a nail fungal infection), is the second product based on the Company's penetration research. Ex vivo permeation studies have shown that a combined transdermal carrier-antifungal medication can penetrate cadaver nails and deliver the active drug to the disease site at the nail bed.

Immune System Regulation

The Company's second technology platform focuses on immune system regulation. The immune system provides an essential defence against microorganisms, viruses, and substances it sees as foreign. Some infections, however, severely disrupt the system, resulting in immune dysfunction. Nuvo's immune regulation technology supports the immune system by targeting the macrophage, a type of white blood cell, to restore normal immune function.

Normally functioning macrophages alternate between two basic states: phagocytic and inflammatory. Phagocytic macrophages digest invading organisms, such as viruses, and initiate a biological pathway leading to a switch to the inflammatory state. Inflammatory macrophages, in turn, induce a variety of reactions – fever, sweating, swollen glands, malaise and appetite loss. This response, while entirely normal, must be turned on and off in a controlled manner.

Nuvo's technology is based on a chlorite solution code-named WF10. It appears to encourage a switch in macrophage state rebalancing the system and restoring proper immune function. Products based on this technology are aimed at expanding treatment options in oncology, immunology and the therapeutic management of chronic viral infections.

OXOFERIN™

Chronic, hard-to-heal wounds are a serious problem with increasing incidence. Chronic wounds are caused by such conditions as burns, pressure sores and poor circulation in the lower extremities. Conditions such as diabetes reduce blood flow to the extremities and increase the likelihood of developing chronic wounds. The Company markets a diluted form of WF10 in parts of Europe, Asia and South America under several trade names including Oxoferin™, as a wound healing agent. Oxoferin™ appears to stimulate the proliferation of fibroblasts – cells that manufacture connective tissue. New connective tissue leads to contraction, closure and faster healing. Nuvo is exploring improved formulations of this product.

WF10 – PANCREATIC CANCER

Preclinical evidence and clinical pilot data suggest that WF10 may be effective in treating certain cancers. The Company has commenced a Phase II clinical trial in Germany in an effort to demonstrate the efficacy of WF10 in combination with Xeloda® (capecitabine) in the treatment of pancreatic cancer.

2007 CLINICAL DEVELOPMENT PROGRAMS	Preclinical	Phase II/III	Commercialized
Arthritis – Pennsaid® (Canada, Europe and Caribbean)			
Arthritis – Pennsaid® (United States)			
Arthritis – Pennsaid Plus			
Onychomycosis – Penecure™			
Wound Healing – Oxoferin™ (Europe, Asia, South America)			
Pancreatic Cancer – WF10			

MESSAGE TO SHAREHOLDERS

A YEAR OF PROGRESS. In 2006, we made progress in **LICENSING, STRENGTHENING OUR BALANCE SHEET, DRUG DEVELOPMENT** and most importantly, we **CONTINUED TO ADVANCE PENNSAID®**, our topical non-steroidal anti-inflammatory drug (NSAID) for the treatment of osteoarthritis, towards commercialization in the United States.

The most critical development was the receipt of an “Approvable Letter” for Pennsaid® from the U.S. Food and Drug Administration (FDA) on December 28, 2006, which states that Pennsaid® is approvable for sale in the U.S. once certain conditions are met.

While the Approvable Letter is a significant step forward, it is at the same time disappointing. The New Drug Application (NDA) we filed in June 2006 addressed all of the issues raised by the FDA in its August 2002 “Non-Approvable Letter” for Pennsaid®. As a result, we anticipated receiving an approvable letter with resolution of Pennsaid® product labeling as the only condition to receiving final approval to market Pennsaid® in the U.S. We were surprised and disappointed that additional new conditions for approval were included in the Approvable Letter that had not been raised by the FDA in the Non-Approvable Letter or in previous reviews.

ON A POSITIVE NOTE, none of the additional conditions relate to the clinical efficacy or clinical safety of Pennsaid® as demonstrated in our clinical trials and NO ADDITIONAL PHASE III CLINICAL TRIALS HAVE BEEN REQUESTED.

However, the resolution of these new conditions will further delay the commercialization of Pennsaid® in the U.S.

Since December 28, 2006 we have interacted with the FDA to clarify the “path forward” to approval.

We have started the work necessary to conduct the short term trials and studies that we expect will provide the information necessary to address the majority of the FDA’s concerns. We hope to complete these short term trials and studies in time to file a response to the FDA in late 2007. There are certain conditions relating to dermal safety that we are continuing to address with the agency. We believe that these issues were adequately addressed in our NDA and that any FDA concerns on these points should be dealt with via appropriate post approval non-clinical studies and/or labeling warnings so as not to delay approval.

We are hopeful that the FDA will agree with our proposed “path forward” on these outstanding points; however, if they do not, it is possible they will request additional non-clinical studies be completed prior to approval. This could result in a significant delay in our submission of a complete response to the Approvable Letter and therefore to Pennsaid’s U.S. approval. Our preference is to resolve these issues with the FDA through consultation. If we are unsuccessful, we plan to utilize all means at our disposal to ensure Pennsaid® approval is not unduly or unfairly delayed.

We understand the uncertainty regarding the clarity and timing of the path forward is frustrating for our shareholders. We are determined to identify the shortest path forward acceptable to the FDA. Since we assumed management responsibility in 2004, Nuvo has overcome significant hurdles. Pennsaid® is closer than ever to our goal of obtaining FDA approval. We are determined that with the assistance of our experienced FDA advisors, we will overcome these final remaining impediments to approval.

The opportunity to market and sell what we believe will be the first topical NSAID for the treatment of osteoarthritis approved for sale in the U.S. is a tremendous one. As a result, we remain in licensing discussions with pharmaceutical companies motivated by this potential.

While pursuing the commercialization of Pennsaid® in the U.S. is of paramount importance, we recognize the need to broaden our product pipeline and intellectual property portfolio. Until we fully understand the path to approval for Pennsaid, we have decided to put on hold the clinical development of our product pipeline; Pennsaid Plus and Penecure™, our onychomycosis drug.

Our follow-on product to Pennsaid®, Pennsaid Plus, is designed to provide users with the efficacy of existing Pennsaid® but with less frequent dosing and increased ease of application. This line extension product strengthens our intellectual property position and provides potential licensing partners with an improved, proprietary follow-on product to Pennsaid®. In December 2006, recognizing the potential of Pennsaid Plus, our Canadian licensing partner for Pennsaid®, Paladin Labs Inc., licensed the right to market and sell Pennsaid Plus in Canada.

WE CONTINUE to expand our pipeline of other **TRANSDERMAL CARRIERS and products.**

We are increasingly encouraged by the opportunities identified through our 2005 acquisition of San Diego based fqubed, Inc. Utilizing the benefits of its high throughput penetration enhancer screening technology, we have developed and filed patents for promising new penetration enhancers. We believe these enhancers will provide the basis for future research and development projects aimed at delivering proven active molecules through the skin for the treatment of localized diseases.

During the year, we strengthened our advisory team with the addition of Dr. Jonathan Wilkin to Nuvo's Scientific Advisory Board. Dr. Wilkin, a dermatologist, directed the Division of Dermatology and Dental Products at the FDA from 1994 to 2005. His extensive

knowledge base in dermatology and regulatory matters will continue to be invaluable as we seek approval of Pennsaid®, develop Pennsaid Plus and expand our transdermal pipeline.

While the majority of our recent focus has been on Pennsaid® and transdermal drug delivery we have not ignored our immune system regulating drug, WF10. Our Phase II Pancreatic cancer trial for WF10 at the University of Heidelberg, Germany is ongoing and we expect it will provide valuable information on the effectiveness of WF10 in combination with Xeloda, a well known chemotherapy drug.

IN 2006 WE CONTINUED TO strengthen our balance sheet and ended the year with a **CASH BALANCE OF OVER \$11 MILLION compared to under \$3 million at the end of last year.**

During the year we: completed the sale of the two properties we identified as non-strategic for \$3.3 million; completed a bought deal financing for gross proceeds of \$15 million; completed licensing deals resulting in upfront payments and investments totaling \$4.5 million; and, received proceeds of \$4.5 million from the exercise of warrants. In January 2007, the Company received an additional \$5.2 million from the exercise of warrants under our warrant incentive program. We were also able to reduce our indebtedness in 2006 by approximately \$2 million to \$3.6 million at year end.

For 2007, our top priority remains the approval of Pennsaid® in the U.S. We understand all too well that Nuvo's success and the key to unlocking its value and potential is tied to commercializing Pennsaid® in the U.S. market. We will continue to move towards achieving this goal as quickly as possible.

We again thank our employees for their dedication and hard work, our board of directors and advisors for their guidance, and in particular you, our shareholders, for your ongoing patience and support.



Dan Chicoine,
Chairman
March 14, 2007



John London,
Vice Chairman
March 14, 2007



Henrich Guntermann,
President & Chief Executive Officer
March 14, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

FEBRUARY 28, 2007

The following information should be read in conjunction with Nuvo Research Inc.'s audited consolidated statements for the year ended December 31, 2006 and related notes, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts in the MD&A, financial statements and related notes are expressed in Canadian dollars, unless otherwise noted.

This MD&A contains forward-looking statements that are subject to risks and uncertainties beyond management's control. Actual results could differ materially from those expressed here. Risk factors are discussed more fully in the Company's Annual Information Form filed with the securities commissions in each Canadian province. Nuvo Research Inc. ("Nuvo" or the "Company") undertakes no obligation to revise forward-looking statements in light of future events.

OVERVIEW

Background

Nuvo is a publicly traded, Canadian drug development company focused on the development of targeted therapeutic products designed to produce minimal side effects. The Company develops drugs based on two technology platforms: transdermal drug delivery and immune system regulation.

Our first marketed product, Pennsaid® is a topical non-steroidal anti-inflammatory drug (NSAID) used for the treatment of osteoarthritis and is currently approved for sale and marketed under license or distribution agreements in Canada, several European countries and many Caribbean nations. Pennsaid allows the diclofenac solution to be delivered transdermally to a specific site and thus limits complications associated with systemic delivery. According to published clinical trials, Pennsaid is as effective as the maximum daily dose of comparable oral medication at relieving pain and stiffness associated with osteoarthritis of the knee, as well as improving overall well-being. There is currently no topical NSAID product approved in the approximately \$4 billion U.S. osteoarthritis pain relief market. In December 2006, the U.S. Food and Drug Administration ("FDA") issued an approvable letter that indicated Pennsaid is approvable subject to Nuvo satisfying certain conditions.

The Company and its subsidiaries employ a total of 87 people at the head office in Mississauga, Ontario, the Pennsaid manufacturing plant in Varennes, Quebec, the international sales office in Barbados, the WF10 manufacturing plant in Wanzleben, Germany and fqubed, Inc. ("fqubed") a research and development laboratory in San Diego, California.

Vision

On September 21, 2004 a new Board of Directors was elected and shortly thereafter a new senior management team was appointed. The new team's long-term vision is to build a profitable international pharmaceutical company focused on research and development ("R&D") and early-stage drug development in its core competencies of transdermal drug delivery and immune system regulation. To realize this vision management spent considerable effort over the past two years restructuring and recapitalizing the Company and moving the lead product Pennsaid through the FDA marketing approval process.

Transdermal Drug Delivery

The Company's lead technology platform, a transdermal carrier, is designed to deliver therapeutic drugs through the skin directly to the disease site. Unlike oral medications, the Company's transdermal products do not rely on bloodstream circulation but offer site-specific treatment while limiting the body's systemic exposure to potentially harmful levels of chemical agents.

A key component of the Company's growth strategy is the development of proprietary formulations that combine our expertise in identifying new transdermal drug delivery carriers with existing drug compounds for the treatment of localized diseases. Existing drug compounds have proven efficacy and safety so we believe we will be able to accelerate drug development and lower development risk as compared to traditional biotechnology and pharmaceutical companies. The Company is researching a number of different carriers and drug-carrier combinations through fqubed, our U.S. based research facility acquired in December 2005 that has the capability to solve skin delivery and anti-delivery problems by utilizing high-throughput experimentation systems that screen different soft material formulations based on their affect on skin. These candidates represent opportunities to change the method of administration for proven drugs from oral to topical. The Company is also researching new, potentially proprietary carriers that could improve its current transdermal product, Pennsaid. The Company has filed patent applications for several of these improved formulations.

The new carriers are designed to improve penetration of the therapeutic ingredient and possibly reduce dosage and application frequency. Thanks to the transdermal expertise acquired through Pennsaid development, Nuvo believes it is well-positioned to create even safer and more effective topical products and intends to leverage its skin-penetrating technologies to create a portfolio of transdermal products targeting a variety of indications.

Pennsaid®

Pennsaid, the first medication based on the transdermal drug delivery technology, is used to treat osteoarthritis symptoms. The drug combines a transdermal carrier with an active pharmaceutical ingredient, diclofenac sodium, a leading NSAID, and delivers it through the skin directly to the pain site.

The Company's initial submission for FDA approval of Pennsaid was made in 2001. Following an initial review of Pennsaid, the FDA issued a non-approvable letter in August 2002, detailing a number of deficiencies in the Company's submission. In consultation with the FDA, the Company designed two new Phase III clinical trials: a 12-week efficacy trial and a long-term safety trial in order to address deficiencies cited in the non-approvable letter. In late 2005 and early 2006, the Company completed these trials. The 12-week efficacy trial demonstrated that Pennsaid is superior to a placebo and equivalent to oral diclofenac sodium with statistically significant improvements in all three clinical endpoints required by the FDA. The long-term safety trial (Study 112E) was completed in the first quarter of 2006 and the results were consistent with the safety profile demonstrated in previous short-term trials of Pennsaid in that none of the typical adverse events associated with conventional NSAID treatment occurred.

In June 2006, the Company filed its New Drug Application (NDA) for Pennsaid with the FDA and on December 28, 2006 received an approvable letter. In its letter, the FDA indicated that Pennsaid is approvable subject to Nuvo satisfying certain conditions. In subsequent discussions with the FDA in early 2007 these conditions were discussed. While the matters raised in the Approvable Letter do not relate to clinical efficacy or clinical safety of Pennsaid and the FDA has not requested that Nuvo conduct any additional Phase III clinical trials the Company may be required to generate additional data before approval. Nuvo will continue discussions with the FDA to resolve each of their concerns. If approved by the FDA, Pennsaid will be permitted to be sold and marketed in the United States. However, there can be no assurance that the FDA will approve the sale or marketing of Pennsaid in the United States.

Penecure™

The Company's other product based on this technology is Penecure, an antifungal medication intended for use in treating onychomycosis (a nail fungal infection). Ex vivo permeation studies have shown that a combined transdermal carrier-antifungal medication can penetrate cadaver nails and deliver the active drug to the disease site at the nail bed. Onychomycosis is responsible for approximately half of all nail disease and affects an estimated 15% to 20% of people over

age 40 in North America. While both topical and oral medications are available for treating onychomycosis, orals are usually more effective but have serious side effects such as liver, kidney and other organ toxicities and a high recurrence rate of the infection (greater than 50%). Current worldwide sales of oral drugs for onychomycosis exceed \$1.4 billion and continue to increase in line with the aging populations who are more vulnerable to onychomycosis. Existing topical medications are inferior to oral products as they often cannot penetrate the nail well enough to have a therapeutic impact. Penetration of the nail is important as the fungus infects the full thickness of the nail and the tissue under the nail.

Immune System Regulation

WF10

The Company's second technology platform focuses on immune system regulation. The immune system provides an essential defence against microorganisms, viruses, and substances it sees as foreign and potentially harmful. Some infections, however, severely disrupt the system, resulting in immune dysfunction. Nuvo's immune regulation technology supports the immune system by targeting the macrophage, a type of white blood cell, to restore normal immune function.

Normally functioning macrophages alternate between one of two basic states: phagocytic and inflammatory. Phagocytic macrophages digest invading organisms, such as viruses, and initiate a biological pathway leading eventually to a switch to the inflammatory state. Inflammatory macrophages, in turn, induce a variety of reactions – fever, sweating, swollen glands, malaise and appetite loss – the common, uncomfortable signs of illness. This response, while entirely normal, must be turned on and off in a controlled manner.

Nuvo's technology platform is based on a chlorite solution code-named WF10. The drug appears to encourage a switch in macrophage state from inflammatory to phagocytic, or vice versa, rebalancing the system and restoring proper immune function. Products based on this technology are aimed at expanding treatment options in oncology, immunology and the therapeutic management of chronic viral infections.

The Company is conducting a Phase II clinical trial in an effort to demonstrate the efficacy of WF10 in combination with Xeloda® (capecitabine) in the treatment of pancreatic cancer. The trial is being conducted in Germany at the University of Heidelberg and the National Centre for Tumor Diseases. The trial will not be completed until 2008 at the earliest. Even if the results from this trial are favourable it will take several years before WF10 could be approved for marketing and sale in any jurisdiction.

Oxoferin[™]

A diluted form of WF10 is marketed by our European subsidiary in parts of Europe, Asia and South America as a topical wound healing agent under several trade names including Oxoferin.

By activating macrophages, Oxoferin appears to stimulate the proliferation of fibroblasts – cells that manufacture connective tissue. New connective tissue leads to contraction, closure and faster healing. Oxoferin has a track record of efficacy in treating chronic wounds. The Company's patents associated with Oxoferin have expired and the Company is exploring improved formulations of this product.

These chronic, hard-to-heal wounds are a serious problem with an increasing incidence. Chronic wounds can be caused by such conditions as burns, pressure sores and poor circulation in the lower extremities. Co-morbid conditions, such as diabetes and atherosclerosis, reduce blood flow to the extremities and also increase the likelihood of developing chronic wounds. In 2002 there were an estimated 5 to 7 million chronic wound cases in the United States and the incidence of these wounds is increasing at approximately 10% per year. In 2002, some 82 thousand people lost a foot or leg to complications from diabetes and the incidence of this complication continues to increase. The advanced wound care market has been estimated to be worth \$2.3 billion, and growing at 10 percent per year.

Intellectual Property

The pharmaceutical industry is a highly competitive sector where long-term success depends upon developing safe and effective proprietary products. Nuvo has the products and technologies, but in the case of its lead drug, Pennsaid, it no longer has the necessary intellectual property protection. Developing patent protection for its platforms and future products is a key driver for the long-term success of Nuvo.

The Company has developed new formulations for its transdermal drug delivery technology. With these new and more effective drug delivery carriers, the Company believes it will be able to develop proprietary drug products that require less active ingredient to achieve a therapeutic effect. While the Company believes its current formulations lower the likelihood of side effects associated with systemic drug distribution, its new transdermal carriers should help reduce the risks even further. The new formulation is also expected to result in less skin irritation due to the presence of an improved humectant (substance that promotes moisture retention) in the formulation.

Pennsaid Plus is the first product that will use one of the new drug delivery formulations. We expect additional development, testing, clinical trials and approval of this improved treatment for osteoarthritis to take three to four years. The timing of clinical trials for Pennsaid Plus will not be determined until after the path for the final approval of Pennsaid is known.

Nuvo intends to continue exploring new compounds for osteoarthritis and other disease indications using new transdermal carriers whose patent protection can be reasonably assured, in advance of any significant R&D expenditures.

Manufacturing

Nuvo's core business strategy excludes manufacturing and management expects to rely on partners or contracted third parties for the production of drugs developed in the future. However, given that the Company already had production facilities for Pennsaid, management has decided to continue operating these manufacturing operations for the foreseeable future.

The manufacturing facility in Varennes, Quebec has manufacturing, bottling and packaging capabilities and a research laboratory. In June 2000, the Company received an Establishment Licence from Health Canada in recognition of compliance with Good Manufacturing Practices ("GMP") regulations. In November 2000, after another successful GMP inspection, the U.K. Medicines Control Agency approved the facility for the manufacture, testing and warehousing of drug products destined for member countries in the European Union. In February 2002, the plant passed an FDA, pre-approval manufacturing inspection as part of the U.S. Pennsaid New Drug Application ("NDA") review and in December 2006, the plant was notified that it had passed an October 2006 FDA inspection conducted by the Department of Health and Human Services as part of the Pennsaid amended NDA review. The facility remains in compliance with current GMP regulations and is the production site for commercial quantities of Pennsaid, worldwide.

The facility is expected to continue operating below full capacity unless and until the FDA approves the Company's lead product Pennsaid and marketing begins in the United States. To maximize capacity utilization in the past, the Company had pursued contract manufacturing opportunities. While, these activities did not affect the ability to supply Pennsaid the Company decided in mid-2006 to suspend the pursuit of these opportunities so that the facility could

focus its efforts on preparing for FDA approval of the site, the potential US launch and clinical batch production for Pennsaid Plus. The Company expects that, with the addition of some new readily available equipment, its current manufacturing facilities have the production capacity to meet all current and anticipated demand for Pennsaid.

The Company also owns a 3,000 square-foot manufacturing facility in Wanzleben, Germany that produces the active ingredient in WF10 and Oxoferin™.

Capability to Deliver Results

Nuvo will need to spend considerable resources on research and development to advance current and future drug products utilizing its technology. The Company may finance these activities through revenues generated by licensing and co-development agreements for Pennsaid and Pennsaid Plus in the United States and other territories, and by raising funds in the capital markets.

In addition to devoting its own resources, Nuvo plans to work with partners earlier in the development process to leverage their experience and financial and intellectual capabilities. At this time Nuvo does not have any drug development partnerships in place. The Company has commercial partners in Canada, Portugal, Greece, Italy and the Caribbean for sales and marketing of Pennsaid.

The Company has sufficient internal staff to execute its current business plans, although it will have to hire more staff as activities expand. Its clinical and regulatory groups have successfully taken a product from the lab to approval in several countries, including Canada and the United Kingdom. Medical and scientific professionals are included among senior staff and Nuvo has established a Scientific Advisory Board comprising industry, regulatory and scientific experts to provide advice on the entire drug development process.

GOALS

Our primary focus is on the approval and commercialization of Pennsaid in the U.S. market. The U.S. osteoarthritis market represents a significant opportunity with annual sales estimated at approximately \$4 billion; an unmet need in the marketplace for a drug product that limits the systemic side effects associated with current COX-2 inhibitors and oral NSAIDs; and, expected marketing exclusivity for a period of at least three years under the Hatch Waxman Act.

The Company expects that it would commence sales and marketing of Pennsaid in the United States as soon as practical after receiving FDA approval. During 2006, the Company identified several suitable marketing partners and continues to discuss the terms of potential licensing agreements for the U.S. market with several of these companies.

LIQUIDITY

The Company has incurred substantial losses since its inception as it has invested significantly in drug development activities and other legacy ventures. At December 31, 2006 the Company had an accumulated deficit of \$176.7 million including a loss of approximately \$13.0 million in 2006.

At December 31, 2006 the Company had cash and cash equivalents of \$11.2 million and through the early warrant exercise program raised an additional \$5.2 million in January 2007.

The Company expects that it will continue to incur losses as it expands research and development activities, its pipeline and works toward the approval of Pennsaid in the United States. Even though management believes the cash resources currently available to the Company are sufficient to execute its 2007 plan, the Company's ability to continue as a going concern and to expand its product pipeline depends on its ability to secure additional licensing fees, co-development agreements and capital and ultimately achieve profitable operations.

CHANGE IN REPORTING PERIOD AND ACCOUNTING POLICY

Change in Year End

Effective December 31, 2005, the Company changed its financial year end from May 31 to December 31, making its financial results more readily comparable with other biotechnology and pharmaceutical companies. As a result of this change, this MD&A covers financial results for the year ended December 31, 2006 compared with the seven-month period ended December 31, 2005 (also referred to in this MD&A as the "Transition Year" or "Stub Year") and the fiscal year ended May 31, 2005.

All comparative figures, unless otherwise noted, compare the year ended December 31, 2006 with the seven-month period ended December 31, 2005 and the fiscal year ended May 31, 2005. Significant differences in revenue and expenses between the December 31, 2005 period and the other periods presented should be expected as it was only seven months in duration versus twelve for the other periods. None of the amounts presented for the period ended December 31, 2005 are annualized unless otherwise stated.

Property, Plant and Equipment

On January 1, 2006, the Company re-evaluated the amortization period and method used for all classes of property, plant and equipment. The Company determined that straight-line amortization is most appropriate for all asset classes and changed the method of amortization on a prospective basis for those categories of property, plant and equipment that were previously amortized on a declining balance basis. This change resulted in incremental amortization expense of \$48,000 for the year ended December 31, 2006.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. We have identified the following accounting policies that we believe require application of management's most subjective judgments, often requiring the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Our actual results could differ from these estimates and such differences could be material.

All significant accounting policies are disclosed in Note 2, "Summary of Significant Accounting Policies", of the consolidated financial statements.

Revenue Recognition

The Company recognizes revenue from research and development contracts and licensing arrangements which may include multiple elements. Revenue arrangements with multiple elements are reviewed in order to determine whether the multiple elements can be divided into separate units of accounting, if certain criteria are met. If separable, the consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. If not separable, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

Product sales are recognized as revenue upon delivery of the product and transfer of title to the customer provided the price is fixed and determinable and collection is reasonably assured. Revenue from product sales is recognized net of reserves for estimated sales discounts and allowances, returns, rebates and charge backs and revenue allocated to third parties under co-promotion agreements.

Up-front fees received in accordance with the sale of distribution rights, supply agreements and licensing rights are deferred and amortized into income on a systematic basis based upon the terms of the contractual arrangement. Amounts the Company expects to earn in the current year are included in the current portion of deferred revenue and amounts expected to be earned in subsequent periods are included in deferred revenue.

Revenues from research contracts are generally recognized on a percentage-of-completion basis. The percentage-of-completion for each contract is generally determined based on the proportion of accumulated project time incurred compared to the total anticipated time to complete the project. Amounts received in advance of recognition are included in deferred revenue.

Government Assistance

The Company incurs research and development expenditures that are eligible for government incentive programs such as investment tax credits. The credits recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by the taxation authorities and, accordingly, these amounts may vary. In 2006, \$290,000 [\$nil – December 31, 2005, \$nil – May 31, 2005] of refundable tax credits, were applied against research and development expenses.

Non-refundable tax credits are not accrued in the year in which the research and development expenditures are made, as there is no reasonable assurance that the credits will be realized. Such credits are accrued in the year in which it is determined that it is more likely than not that they will be realized.

Valuation Allowance for Future Tax Assets

The Company recorded a valuation allowance on future tax assets primarily related to operating losses, scientific research and development expense carryforwards and differences between the tax and accounting basis of capital assets. Management has assumed that the related tax benefits are not more likely than not to be realized based on our historical results and estimated future taxable income and tax planning strategies in the relevant jurisdictions. The implementation of tax planning strategies or the generation of future taxable income in these jurisdictions could result in the recognition of some portion or all of these future tax assets, which could result in a material increase in the results of operations through the recovery of future income taxes.

Stock-Based Compensation and Other Equity-Based Instruments

The Company accounts for stock option awards granted after June 1, 2002 under its stock option plan using the fair value method. The fair value of stock options at the grant date is determined using the Black-Scholes option pricing model and expensed over the vesting period of the options. To determine the fair value management must make assumptions about the volatility and expected dividend yield on the underlying stock and estimate the expected life for each option granted.

In addition, whenever the Company issues other equity based instruments such as common share purchase warrants, agent's compensation options, underwriter warrants or debt instruments not issued at fair value and containing equity features the Company must also determine fair value using the Black-Scholes options pricing model.

Impairment of Long-Lived Assets

Property, plant and equipment and other long-lived assets including intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In addition, goodwill and intangible assets with infinite lives are subjected to an annual impairment test. The recoverability of long-lived assets is determined by evaluating whether the carrying value of such assets can be recovered from estimated undiscounted future operating cash flows and as such requires us to make significant estimates on expected revenues from the commercialization of our products and services and the

related expenses. When an asset is impaired, according to the foregoing test, an impairment loss is measured and recognized as the excess of the carrying value of the asset over its fair value.

In the first half of 2006 the Company received a conditional offer to purchase a Company-owned property located in Varennes, Quebec (classified as "held for sale") that was lower than its carrying value. After assessing the offer and the current market conditions, an impairment charge of \$135,000 was recorded to reduce the carrying value of the asset to its expected net realizable value. This Varennes property had been classified as "held for sale" since an October 2004 decision to discontinue an expansion project at the Company's main manufacturing facility, also in Varennes. This facility, located adjacent to the main facility, was never operational as the main manufacturing plant has adequate capacity to meet expected demand. An impairment charge of \$2.8 million was charged to income, as a restructuring provision, in the year ended May 31, 2005.

In May 2005 a review of the Company's drug development plan for WF10 determined there were more promising indications for WF10 than its use in treating HIV/AIDS. While the Company had commenced development focused on some of these other indications, it was unable to determine their potential. As the original value of the intangibles was attributed to the potential of WF10 to treat HIV/AIDS and no development was being done with HIV/AIDS, the Company wrote off \$15.4 million of acquired technology and \$0.1 million of goodwill resulting in a total impairment charge of \$15.5 million to income in the fiscal year ended May 31, 2005.

Despite our going concern uncertainty, management did not deem it necessary to write-down any of our property, plant and equipment and other long-lived assets for this reason. We believe we should be able to obtain additional financing to allow us to pursue our activities until profitability is achieved and positive cash flow is generated. However, there can be no assurance that we will be able to raise such capital on favorable terms or that commercial agreements will be concluded or that we will receive payments under existing agreements.

SELECTED ANNUAL INFORMATION

<i>in thousands (except per share and share information)</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
OPERATIONS			
Product and research contract revenue, net of revenue allocation	\$ 3,459	\$ 2,708	\$ 7,199
License fees	789	192	–
Total revenue	4,248	2,900	7,199
Cost of goods sold	1,927	1,025	1,718
Operating expenses	16,414	9,819	17,099
Total expenses	18,341	10,844	18,817
Loss from operations	(14,093)	(7,944)	(11,618)
Other expense (income)	(898)	(2,057)	18,226
Loss from continuing operations	(13,195)	(5,887)	(29,844)
Discontinued operations	180	264	38
NET LOSS	\$ (13,015)	\$ (5,623)	\$ (29,806)
SHARE INFORMATION			
Loss per share continuing operations	\$ (0.09)	\$ (0.05)	\$ (0.14)
Net loss per share	\$ (0.09)	\$ (0.05)	\$ (0.14)
Weighted average outstanding shares for the period (in millions)	153.4	122.9	101.4
FINANCIAL POSITION			
Cash and cash equivalents	\$ 11,213	\$ 2,716	\$ 3,418
Total assets	17,619	10,257	10,588
Deferred revenue, including current portion	7,904	5,344	–
Long term debt, debentures and capital lease obligations, including current portions	3,013	3,517	3,329
Total liabilities	14,482	14,711	11,065

Fluctuations in Operating Results

Our results of operations have fluctuated significantly from period to period in the past and are likely to do so in the future. We anticipate that our quarterly and annual results of operations will be impacted for the foreseeable future by several factors, including the timing and amount of payments received pursuant to our current and future collaborations, and the progress and timing of expenditures related to our research, development and commercialization efforts. Due to these fluctuations, we believe that the period-to-period comparisons of our operating results are not necessarily a good indication of our future performance.

The change in the Company's fiscal year end from May 31st to December 31st in 2005 is a significant factor to consider in comparing consolidated results of operations between periods as the fiscal year ended

December 31, 2005 consists of only seven months of operations versus twelve months for the other periods presented and is referred to as the "transition year or stub year" in this MD&A. In addition, since September 2004 the Company has significantly restructured its operations by selling non-core assets and product lines, restructuring its acquisition commitments and restructuring the approach to marketing of Pennsaid in Canada as outlined below.

SIGNIFICANT TRANSACTIONS
Pennsaid in Canada

The most significant series of transactions affecting both the year ended December 31, 2006 and the seven-months ended December 31, 2005 were those involving the August 2005 sale of the Company's subsidiary, Dimethaid Health Care Ltd. ("DHCL"), to Paladin Labs Inc.

(“Paladin”) and two subsequent licensing agreements signed in 2006 for the marketing of Pennsaid and Pennsaid Plus in Canada.

DHCL (renamed Squire Pharmaceuticals Inc. (“Squire”) after it was acquired by Paladin) owns the rights to distribute Pennsaid in Canada and it had a Co-Promotion Agreement with Solvay Pharma Inc. (“Solvay”). On August 16, 2005 the Company completed the sale of 100% of the common shares of DHCL to Paladin as a means of monetizing a portion of the expected profits from future Canadian Pennsaid sales and eliminating our obligation to financially support sales and marketing activities in Canada. Consideration received by the Company included a cash payment of \$7.5 million, a long-term supply agreement for Nuvo to manufacture Pennsaid for the Canadian market and a share in future operating profits above specified targets as set out in the licensing agreement between the Company and DHCL. The Company retains all rights to Pennsaid outside Canada, subject to a 0.5% royalty payable on future U.S. revenues.

In the period ended December 31, 2005 the Company recorded the \$7.5 million cash payment as follows: \$2.0 million as proceeds from the sale of DHCL's common shares resulting in a gain of \$1.956 million; \$4.9 million as deferred revenue to be earned over the term of the license and supply agreements, which run to February 2014; and, \$0.6 million as deferred revenue to be earned from the supply of promotional goods over a three-year period ending August 31, 2008.

Prior to the August 16, 2005 sale of DHCL, the Company recorded sales of Pennsaid from DHCL to Canadian wholesalers at wholesale prices. Subsequent to August 16, 2005, the Company no longer records these sales. From August 16, 2005 to February 2014, the Company's Canadian revenue will include manufacturing revenue from the supply of Pennsaid to Squire, license fees from a share in future Canadian operating profits above specified targets and a systematic amortization of the deferred revenue referred to above. The Company's reported product sales will decline even if volumes are consistent as the price received for supplying Pennsaid to Squire is significantly lower than the wholesale price previously received when selling directly to the wholesalers, as is typical in contract manufacturing arrangements. The drop in reported sales will be partially mitigated as the Company is no longer required to share a portion of its Canadian Pennsaid revenue with Solvay as required under the Co-Promotion Agreement.

In addition, subsequent to August 16, 2005 the Company is not responsible for any sales and marketing costs relating to Pennsaid sales in Canada. Previously, under the Co-Promotion agreement between DHCL and Solvay, the Company paid half of these costs. These costs were effectively assumed by Paladin. The Company was

also able to eliminate some administrative and shipping costs as a result of the sale of DHCL.

Under the terms of the supply agreement between Squire and Nuvo, if either Nuvo or a subcontract supplier is unable to supply Pennsaid to Squire for more than ninety days, Squire has the right to terminate the supply and license agreements and make a claim for an amount determined by formula to compensate it for the unearned portion of the amounts paid under the agreements plus interest. In the event of such termination, all Canadian rights to Pennsaid revert back to the Company.

On January 16, 2006 the Company and Squire entered into an agreement which expanded their relationship with respect to the sale and marketing of Pennsaid in Canada. The terms of this expanded agreement included Squire making an up-front payment of \$3.25 million, providing an additional share of future operating profits, future royalties on the sales of Pennsaid commencing in 2010 and an investment of \$0.5 million in Nuvo through a three-year convertible debenture bearing interest at 8% per annum. The Company provided certain guarantees of the ongoing market performance of Pennsaid in the Canadian market over a four year period, which could require payments to be made if certain performance targets are not met. The Company's debenture and performance obligations are collateralized by revenue from Pennsaid sales in Europe, a second mortgage over Nuvo's manufacturing facility in Quebec, a second charge on all manufacturing assets in Quebec and all Pennsaid inventory and receivables as well as all intellectual property rights required to manufacture and market Pennsaid in Canada.

In the year ended December 31, 2006 the Company recorded the \$3.25 million cash payment as deferred revenue to be earned over the term of the agreement which runs to February 2014.

On December 22, 2006 Squire exercised its option to acquire a license from the Company to market and sell Pennsaid Plus in Canada which it obtained as part of the January 16, 2006 transaction. Pennsaid Plus is a follow-up product to Pennsaid. The Pennsaid Plus License includes an up-front cash payment of \$250,000, royalties on future Canadian sales of Pennsaid Plus and a potential milestone payment. As part of the licensing arrangement, Squire has also invested \$500,000 in Nuvo through a three-year convertible debenture bearing interest at 8% per annum. If specific milestones are not achieved by May 2008, the up-front payment must be returned to Squire.

In the year ended December 31, 2006 the Company recorded the \$250,000 cash payment as deferred revenue. No amounts will be recognized until the specific milestones are achieved.

RESULTS OF CONTINUING OPERATIONS

Product Sales, Contract Research Revenue and Gross Profit

<i>in thousands (except gross profit percentage)</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
Pennsaid revenue, net of allocation	\$ 2,479	\$ 2,314	\$ 6,555
WF10 revenue	769	336	599
Research and other contract revenue	211	58	45
Total product sales and research contract revenue	3,459	2,708	7,199
Cost of goods sold	1,927	1,025	1,718
GROSS PROFIT	\$ 1,532	\$ 1,683	\$ 5,481
GROSS PROFIT PERCENTAGE	44%	62%	76%

Product and research contract revenue for the year ended December 31, 2006 was \$3.5 million compared with \$2.7 million and \$7.2 million for the periods ended December 31, 2005 and May 31, 2005 respectively. The Company's Pennsaid product sales were \$2.5 million for the year ended December 31, 2006, up from \$2.3 million in the transition year but down from \$6.6 million in the fiscal year ended May 31, 2005. This 62% decrease in revenue between the year ended December 31, 2006 and the previous full year ended May 31, 2005 is due the sale of DHCL during the Company's transition year. As a result of the disposition, reported sales have declined as the price received for supplying Pennsaid to Squire is significantly lower than the price previously received selling directly to wholesalers, as is typical in manufacturing arrangements. The impact of this decrease in product sales on overall results has been somewhat offset by the new licensing revenue streams and reduced sales and marketing costs (see section entitled "Significant Transactions – Pennsaid in Canada.") Looking beyond the changes in the Company's reporting periods and the sale of DHCL, shipments of Pennsaid to Canadian wholesalers increased approximately 21% during the twelve-months ended December 31, 2006 versus the twelve-months ended December 31, 2005.

Product sales for 2006 also include recognition of \$200,000 of previously deferred revenue relating to the supply of free goods to Squire as per the long-term supply agreement with Paladin. Initially, upon the sale of DCHL to Paladin, \$600,000 of the up-front payment was allocated to the supply of free goods and deferred until the free goods are actually supplied as described in the section entitled "Significant Transactions – Pennsaid in Canada."

In Europe, the Company's strategy has been to enter licensing agreements with local partners, each of which obtained a geographically limited license to market and

sell Pennsaid. European sales of Pennsaid were \$1.1 million in the year ending December 31, 2006 versus \$0.6 million in the transition year and \$1.6 million in the full year ended May 31, 2005. The Company's European licensing partners have identified many issues that have adversely affected European sales growth including; failure to secure the support of key opinion leaders in the field of arthritis, insufficient investment in pre-launch marketing activities, the absence of clinical studies conducted in Europe, late publication of clinical study results and the improper positioning in Europe of Pennsaid against topical, rather than oral, NSAIDs. Currently, Pennsaid is distributed in the UK, Italy and Portugal and will launch in Greece during the first quarter of 2007. The Company is focused on consummating a licensing partnership for the U.S. Market which may be easier to accomplish if European marketing rights are also available. As such the Company does not intend to seek approval or partnerships for Pennsaid in other European countries such as Germany and France until it concludes a licensing partnership in the United States.

Pennsaid is also commercially available in certain Caribbean countries where marketing authorization comes automatically with regulatory approval in the United Kingdom and Canada. The Company has a distribution agreement with a Caribbean company covering most Caribbean nations, however, this market is limited in potential size and no sales to this distributor have occurred in any of the periods presented.

In Europe, Oxoferin™, a wound healing agent derived from WF10, is currently sold in Germany under the trade name "Oxovasin®". Oxoferin™ is also authorized for sale and marketed in India, Indonesia, Pakistan, Thailand and Venezuela. The Company sells the product in these markets in two forms depending on the terms of the specific marketing arrangement. In certain markets the Company sells Oxoferin™ prepackaged to local distributors. In the remaining markets the raw

material, TCDO, is sold to the customer who then produces Oxoferin™ for the local market. Sales of WF10 based products for the year ended December 31, 2006 were \$769,000 compared with \$336,000 and \$599,000 for the periods ended December 31, 2005 and May 31, 2005 respectively. The increase is primarily due to growing sales in Venezuela and Pakistan.

Research and other contract revenue for the year ended December 31, 2006 was \$211,000 compared with \$58,000 and \$45,000 for the periods ended December 31, 2005 and May 31, 2005. Substantially all of the revenue earned in 2006 was derived from the Company's San Diego based research facility that was acquired in December 2005. In prior years contract revenue was primarily earned through third party contract manufacturing opportunities fulfilled by the Varennes manufacturing facility. While, these activities did not affect our ability to supply Pennsaid the Company decided in mid-2006 to suspend the pursuit of these opportunities so that the facility could focus its efforts on preparing for FDA approval of the site, the potential US launch of Pennsaid and clinical batch production for Pennsaid Plus.

In the year ended December 31, 2006 and the periods ended December 31 and May 31, 2005, gross profit (calculated as total revenue excluding licensing fees less cost of goods sold) was \$1.5 million, \$1.7 million and \$5.5 million, respectively. Gross profit as a percentage of these revenue streams for the same three periods

was 44%, 62% and 76%, respectively. The gross profit percentage decline in both the current period and the transition year is due to the August 2005 sale of DHCL which supplies Pennsaid to Canadian distributors. The result is lower sales with the same cost structure resulting in a lower gross profit on Canadian sales. The inclusion of revenue from fubed in 2006 somewhat offset the decline.

As the Company sells product in a limited number of markets through exclusive agreements it receives most of its revenue from a limited number of customers. Sales to the Company's three largest customers were \$2.5 million, 72% of product and research contract revenue in 2006, versus \$1.4 million (45%) and \$5.7 million (56%) in the seven-month period ended December 31, 2005 and the year ended May 31, 2005, respectively.

Licensing Fees

During the year ended December 31, 2006 Nuvo recorded \$789,000 in license fee revenue that was previously deferred, compared with \$192,000 and \$nil for the periods ended December 31, 2005 and May 31, 2005 respectively. This represents the systematic recognition of a portion of the up-front fees received in 2005 and 2006 relating to the sale of DHCL and the agreement granting the additional rights to Squire as outlined in the section entitled "Significant Transactions – Pennsaid in Canada."

OPERATING EXPENSES

<i>in thousands</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
Research and development	\$ 6,618	\$ 4,122	\$ 5,991
Selling, general and administrative	6,900	4,096	10,574
Stock-based compensation	1,235	839	957
Amortization of property, plant and equipment	786	290	571
Interest, net	786	773	1,072
	16,325	10,120	19,165
Foreign currency (gain) loss	89	(301)	(2,066)
TOTAL OPERATING EXPENSES	\$ 16,414	\$ 9,819	\$ 17,099

Total operating expenses for year ended December 31, 2006 were \$16.4 million compared with expenses of \$9.8 million and \$17.1 million for the periods ended December 31, 2005 and May 31, 2005 respectively. The decline from May 31, 2005 is only 4%, despite significant reductions in selling, general and administrative costs; however, excluding the impact of foreign currency gains and losses operating expenses actually declined by \$2.8 million or 15% to \$16.3 million from \$19.2 million.

Research and Development

Research and development expenses were \$6.6 million for the year ended December 31, 2006, compared with \$4.1 million and \$6.0 million for the periods ended December 31, 2005 and May 31, 2005 respectively. This represents a 6% decrease versus the transition year, adjusting pro-rata for the shorter seven-month period, and a 10% increase over the year ended May 31, 2005. The transition year included a significant portion of the costs incurred to conduct the pivotal

Phase III trials for Pennsaid such that on a pro-rata basis spending is higher than both comparable periods. Current year spending did not decline further as formulation and enhancer research activities incurred at fqubed, the Company's new U.S. based research facility that was acquired in December 2005, costs relating to the submission of the NDA for Pennsaid to the U.S. FDA and preparatory work and preclinical studies related to Pennsaid Plus offset most of the impact of lower clinical trial costs.

The research and development projects incurring the majority of 2006 expenditures included:

- Completion of the statistical analysis of the Pennsaid Phase III efficacy and safety trial, designated 'Study 112', (a 775 patient five-armed, double-blinded, 12-week trial) confirming the effectiveness of Pennsaid in relieving symptoms of knee osteoarthritis;
- Completion and analysis of the Pennsaid Phase III long-term safety trial, designated Study 112E, (a 793 patient trial with 448 patients treated for at least 6 months and 116 patients for at least one year) confirming the safety profile of Pennsaid as seen in previous 3-month trials;
- Preparation of the Pennsaid NDA submitted to the FDA;
- Completion of preclinical studies and preparatory work for Pennsaid Plus phase III clinical trials;
- Formulation and enhancer research activities at fqubed; and,
- Conducting the Phase II trial of WF10 as an adjuvant therapy for pancreatic cancer.

During the year the Company incurred research and development expenditures that were eligible for investment tax credits. In 2006, the Company recorded \$290,000 of refundable tax credits that were applied against research and development expenses. No amounts were recognized in the prior periods. The credits recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by the taxation authorities and, accordingly, these amounts may vary.

The level of research and development expenditures varies depending upon the stage of development for drug products and candidates in the Company's pipeline and management's allocation of the Company's limited resources to these activities in general and to each drug specifically versus other corporate priorities. In 2007, the level of expenditure is dependent upon two key variables: the time, effort and research necessary to resolve all issues in the Approvable Letter for Pennsaid; and, the success, timing and terms of a licensing agreement for the marketing of Pennsaid in the U.S. market. Until these matters are resolved, the Company will direct the majority of its resources towards these two initiatives and not towards other research and development projects. As such, expenditures for the expansion of the Company's pipeline, the Phase III trial for Pennsaid Plus, advancement of the Company's onychomycosis drug, Penecure, and the ongoing Phase II trial for WF10 as a combination therapy for pancreatic cancer will be limited.

SELLING, GENERAL AND ADMINISTRATIVE (SG&A)

<i>in thousands</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
Selling and marketing	\$ 145	\$ 713	\$ 6,069
General and administrative	6,755	3,383	4,505
SELLING, GENERAL AND ADMINISTRATIVE	\$ 6,900	\$ 4,096	\$ 10,574

SG&A expenses were \$6.9 million for the year ended December 31, 2006, compared with \$4.1 million and \$10.6 million for the transition year ended December 31, 2005 and the fiscal year ended May 31, 2005, respectively. Adjusting pro-rata for the shorter period, this represents a 2% decrease over the period ended December 2005 and a 35% decrease over the fiscal year ended May 2005.

Reductions in selling and marketing expenses accounted for the decrease in SG&A costs. For the year ended December 31, 2006 selling and marketing costs were only \$145,000 compared with \$713,000 and \$6.1 million for the transition year ended

December 31, 2005 and the fiscal year ended May 31, 2005 respectively. These significant decreases are a result of the Company's change in strategic direction in September 2004 from a fully integrated pharmaceutical company to one focused on research and early-stage drug development. In October 2004, the Company's Canadian sales force was terminated and its U.K. sales and marketing contract was cancelled. Responsibility for Pennsaid's sales and marketing activities in Canada was transferred to Solvay under a co-promotion agreement. Under that agreement, sales and marketing costs were shared equally and in return Solvay received a percentage of the gross margin generated by Canadian sales. On August 16, 2005, DHCL

(including the subsidiary's rights and obligations under the co-promotion agreement) was sold to Paladin such that the results of operations subsequent to the sale do not include any sales and marketing costs related to the sale of Pennsaid in Canada.

Pennsaid is sold in Italy, Portugal and the Caribbean through distributors who assume the cost of marketing and distribution. The U.K. contract sales force agreement was terminated in October 2004 because the revenue generated was significantly less than the costs incurred. Pennsaid continues to be distributed in the U.K. through a contract logistics provider and is no longer actively promoted.

General and administrative expenses for the year ended December 31, 2006, were \$6.8 million compared with \$3.4 million and \$4.5 million for the seven-months ended December 31, 2005 and the year ended May 31, 2005, respectively. Adjusting for the shorter reporting period, general and administrative costs in the current period increased 16% versus the transition year and 50% versus the fiscal year ended May 31, 2005. The increase over prior periods is due to a full year of business development activities aimed at signing a licensing agreement for Pennsaid in the U.S., additional costs to strengthen and broaden the intellectual property portfolio, costs associated with establishing and maintaining the Company's Scientific Advisory Board, strengthening the senior management team and certain support functions, rent on the new corporate office and higher professional fees related to compliance with changes in Corporate Governance practices, securities regulations, tax planning and litigation.

Stock-Based Compensation

Compensation expense related to shares issued and options granted under the Company's three stock-based compensation plans was \$1.2 million for the year ended December 31, 2006 compared with \$839,000 and \$957,000 for seven-month period ended December 31, 2005 and the year ended May 31, 2005, respectively. The increase in 2006 is primarily due to the Share Purchase Plan. Under this plan eligible employees may contribute up to 10% of their annual base salary to the plan for the purchase of Nuvo common shares. The Company matches each participant's contribution by issuing Nuvo common shares having a value equal to the aggregate amount contributed by each participating employee. During 2006 the cost of this plan increased significantly as the participation rate rose, however, more notably the plan was offered twice due to the change in year end. It was offered in February 2006 on account of the transition year and it was offered in December 2006 on account of the current year. The plan was not offered during the transition year. During 2006, the Company matched

employee contributions by issuing 868,366 common shares and recording compensation expense equal to their fair value of \$335,000, \$nil for December 2005 and \$106,000 for the year ended May 2005.

Amortization of Property, Plant and Equipment

Amortization charges were \$786,000, \$290,000 and \$571,000 for the periods ended December 31, 2006, December 31, 2005, and May 31, 2005, respectively. The increase in the current period versus the May 31, 2005 twelve-month period is primarily due to amortization of the \$861,000 of laboratory, computer and other equipment obtained through the acquisition of fqubed, the majority of which is amortized over three years, offset partially, by the lower amortization at our manufacturing facility as many assets are now fully depreciated. The December 2005 reduction compared to May 2005 is due to the shorter reporting period and cessation of amortization on the assets reclassified as held for sale.

Interest, Net

Interest expense was \$1.1 million for the year ended December 31, 2006 compared to \$831,000 and \$1.1 million for the seven-month period ended December 31, 2005 and the year ended May 31, 2005 respectively. Compared to the previous full fiscal year the higher non-cash accretion charges on the November 2004 debentures in the current year were essentially offset by lower interest charges on the short-term loan as \$1.6 million was repaid into escrow in January 2006.

Interest revenue increased substantially to \$328,000 versus only \$58,000 and \$73,000 in the comparative periods as the Company maintained higher cash balances in 2006 following a mid-year financing that resulted in net proceeds to the Company of \$13.7 million.

As a result the net interest expense for the year of \$786,000 was essentially unchanged versus \$773,000 in the transition year and approximately \$0.3 million less than the \$1.1 million for the year ended May 31, 2005.

Foreign Currency Gains and Losses

The Company incurred foreign currency losses of \$89,000 for the year ended December 31, 2006 compared with gains of \$301,000 and \$2.1 million for the seven-month period ended December 31, 2005 and the year ended May 31, 2005 respectively. The current year loss is largely due to translation losses of integrated European operations. The gain in the seven-month period ended December 31, 2005 was due to a strengthening Canadian dollar versus both the Euro and US dollar generating translation gains on both our U.S. dollar denominated short-term loan and Euro denominated mortgage. The substantial gain recorded for the year ended May 31, 2005 was due to the weakening U.S dollar which reduced

the translated value of the U.S. dollar denominated acquisition commitments. The acquisition commitments balance of US\$27.7 million was discharged as at May 31, 2005 such that it had no impact on foreign exchange gains or losses in the transition year or 2006.

Loss from Operations

The loss from operations for year ended December 31, 2006 was \$14.1 million versus \$7.9 million for the seven-months ended December 31, 2005 and \$11.6 million for the year ended May 31, 2005.

As discussed earlier results between the periods are difficult to compare due to structural changes in the operations and the seven-month transition year. Nonetheless, excluding foreign currency gains and losses the loss from operations for 2006 is relatively

unchanged at \$14.0 million versus \$13.7 million in the fiscal year ended May 31, 2005.

On a segmented basis, Transdermal Drug Delivery (“TDD”) technology, which includes all Pennsaid activities, had a loss of \$13.6 million in 2006 and Immune System Regulation (“ISR”) technology, which includes all WF10 activities, incurred a loss of \$0.4 million. In the seven-months ended December 31, 2005 TDD technology and ISR technology incurred losses of \$7.7 million and \$0.2 million respectively and in the twelve-months ended May 31, 2005 were \$10.9 million and \$0.7 million, respectively. The losses incurred on ISR Technology are small relative to the TDD Technology as the level of research and development expenditures on this platform are relatively small and the WF10 manufacturing plant operates at a level close to breakeven.

OTHER INCOME (EXPENSES)

<i>in thousands</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
Gain on sale of assets	\$ 947	\$ -	\$ -
Restructuring (costs) recovery	86	101	(5,740)
Impairment charges	(135)	-	(15,488)
Gain on sale of subsidiary	-	1,956	-
Gain on debt settlements	-	-	4,137
Amortization of intangibles	-	-	(1,135)
OTHER INCOME (EXPENSES)	\$ 898	\$ 2,057	\$ (18,226)

As discussed in the earlier section entitled, “Vision”, the new senior management team that was appointed shortly after a new Board of Directors was elected on September 21, 2004 had a new long-term vision for the Company. The stated vision was to build a profitable international pharmaceutical company focused on research and development and early-stage drug development in its core competencies of transdermal drug delivery and immune system regulation. To realize this vision management spent considerable effort over the past two years restructuring, shedding non-core assets and recapitalizing the Company. As a result of this process several charges were booked to the income statement as discussed in the proceeding sections.

Gain on Sale of Assets

In January 2006, the Company sold its head office in Markham, Ontario for \$2.7 million, net of commissions and closing costs. Net book value was \$1.8 million resulting in a gain of \$0.9 million. On closing, US\$1.4 million (CDN\$1.6 million) was paid into escrow to discharge the mortgage on the property and \$45,000 was retained by the purchaser to cover the Company's

leaseback of the office from closing to March 31, 2006. The resulting net cash proceeds to the Company were \$1.1 million. On March 13, 2006 the Company moved its head office to smaller, more cost-efficient leased premises in Mississauga. There were no comparable amounts in the prior periods.

Restructuring Costs

Restructuring costs of \$5.7 million were recorded in the fiscal year ended May 31, 2005. These charges included a \$3.7 million non-cash write-down of construction in progress, plus a loss on disposal of packaging machinery following the Company's decision not to complete the expansion project at its Varennes, Quebec manufacturing facility. It also includes \$925,000 in severance costs to terminate the entire Canadian sales staff for Pennsaid and reduce the number of personnel at the Company's head office in Markham and international sales office in Barbados, \$688,000 in expenses related to the September 2004 proxy fight and \$391,000 related to the termination of the Company's U.K. sales and marketing contract.

During 2005 and 2006 the Company settled all out-standing claims for severance and recognized reductions of \$86,000 and \$101,000 in the restructuring provision for the year ended December 31, 2006 and transition year ended December 31, 2005, respectively.

Impairment Charges

In the first half of 2006 the Company received a conditional offer to purchase a Company-owned property located in Varennes, Quebec (classified as “held for sale”) that was lower than its carrying value. After assessing the offer and the current market conditions, a further impairment charge of \$135,000 was recorded to reduce the carrying value of the asset to its expected net realizable value. On October 31, 2006 the Company sold this property for \$389,000, net of commissions and closing costs, its approximate carrying value. The agreement of purchase and sale required \$50,000 to be paid on closing with the balance of \$375,000 due within one year. The purchaser has posted an irrevocable letter of credit in favour of the Company to support the obligation.

In May 2005, a review of the Company’s drug development plan for WF10 determined there were more promising indications for WF10 than its use in treating HIV/AIDS. While the Company had commenced development focused on some of these other indications, it was unable to determine their potential. As the original value of the intangibles was attributed to the potential of WF10 to treat HIV/AIDS and no development was being done with HIV/AIDS, the Company wrote off \$15.4 million of acquired technology and \$0.1 million of goodwill.

A total impairment charge of \$15.5 million was recorded in the year ending May 31, 2005.

Gain on Sale of Subsidiary

In August 2005, the Company recorded a \$2.0 million gain on the sale of its subsidiary DHCL to Paladin as described in the section entitled “Significant Transactions – Pennsaid in Canada”. There were no comparable amounts in the current or prior periods.

Gain on Debt Settlements

No gains on debt settlements were recorded for the year ended December 31, 2006 or the seven-month period ended December 31, 2005. For the year ended May 31, 2005 the Company recognized a \$4.1 million gain on debt settlements. Agreements were reached with creditors to accept approximately \$864,000 in full and final settlement of obligations totaling approximately \$5.0 million. Settled claims included those of the Company’s former U.K. sales and marketing partners.

Amortization of Intangibles

Amortization of intangibles for the both the year ended December 31, 2006 and the seven-months ended December 31, 2005 was \$nil following the impairment charge (see the section entitled, “Impairment Charges”) recorded in May 2005 that reduced the carrying value of acquired technology to \$nil. Amortization of intangibles recorded for the year ended May 31, 2005 prior to the impairment charge was \$1.1 million.

Discontinued Operations

Ophthalmic Products

Until October 2005 the Company distributed branded diagnostic and therapeutic ophthalmic products in Canada through its wholly owned subsidiary, Akorn Pharmaceuticals Canada Limited, which carried on business as Dioptic Laboratories (“Dioptic”). The operations and assets of this non-strategic subsidiary were sold in October 2005, resulting in a gain of \$285,000 that was partially offset by an operating loss of \$21,000. As a result net income from discontinued operations was \$264,000 for the seven-month period ended December 31, 2005. As part of the sale the Company was to receive \$175,000 contingent on receipt by the purchaser of Ontario formulary coverage for certain product rights (represented by DINs or Drug Identification Numbers) failing which, these rights would revert to the Company. In 2006 the purchaser received formulary coverage and paid the Company additional proceeds of \$175,000 such that for the year ended December 31, 2006 the Company generated net income from discontinued operations of \$180,000. In the year ended May 31, 2005 these discontinued operations generated net income of \$38,000.

Net Loss

For the year ended December 31, 2006 net loss was \$13.0 million, an increase over the \$5.6 million for the seven-month transition year ended December 31, 2005 which was primarily due to the additional five months of operations. The \$29.8 million net loss for the year ended May 31, 2005 was significantly higher than the current year primarily due to restructuring costs and the impairment charges recorded on the intangible assets offset somewhat by the gain on debt settlements.

Charges to Deficit

Retroactive Adjustment for Stock-Based Compensation
Effective June 1, 2004, the Company adopted the amended recommendations of the Canadian Institute of Chartered Accountants (CICA) handbook section 3870, “Stock-based Compensation and other Stock-based Payments.” The amended recommendations were applied retroactively to all employee stock options granted on or after June 1, 2002. Application of the

recommendations resulted in a \$2.1 million increase in the deficit on June 1, 2004 and an equivalent increase to contributed surplus. The adjustment represents the total compensation expense attributable to employee stock options granted on or after June 1, 2002 from their date of grant through May 31, 2004.

Acquisition Commitments

The acquisition commitments arose from the Company's 2002 purchase of the remaining 80% interest in Dimethaid AG that it did not own from its founder Dr. Kühne. The acquisition commitments were fair valued on a net present value basis at inception and were being accreted to their settlement values through charges to the deficit. Effective May 31, 2005 the Company entered into definitive agreements to restructure the remaining acquisition commitments. Under these agreements Dr. Kühne released the Company's US\$27.7 million obligation to him in return for CDN\$4.0 million of the Company's November 2004 debenture offering, 40 percent ownership in Dimethaid AG, a subsidiary that owns all of the worldwide intellectual property and exploitation rights for WF10 and all of the shares of Dimethaid GmbH, 6 percent of future WF10 licensing and royalty revenue and 100 percent ownership of WF10 marketing authorization for Thailand. The effect of these transactions was to reduce the deficit for the fiscal year ended May 31, 2005 by \$22.9 million.

As the acquisition commitments were restructured and discharged as of May 31, 2005 no accretion charges have been recorded since that date. In 2005, \$2.5 million of accretion charges to the deficit were recorded prior to the restructuring.

Net Loss Per Common Share

Net loss per common share and net loss per common share from continuing operations on both a basic and diluted basis were \$0.09 for the year ending December 31, 2006 versus \$0.05 for the transition year and \$0.14 for the year ended May 31, 2005.

The weighted average number of common shares outstanding on both a basic and diluted basis was 153.4 million for the year ending December 31, 2006 versus 122.9 million for the transition year and 101.4 million for the year ended May 31, 2005.

The net loss per common share in 2006 did not increase proportionately with the increase in the net loss due to the 25% increase in the weighted average number of common shares outstanding versus the transition year. The net loss used to calculate earnings per common share for the year ended May 31, 2005 is adjusted to include the accretion of and the gain on restructuring the acquisition commitments. As a result, the net loss for earnings per share calculations is reduced to \$14.5 million, only 10% higher than 2006; however, due to the lower number of shares outstanding, the loss per share is 56% higher than the current year.

LIQUIDITY AND CAPITAL RESOURCES

<i>(in thousands)</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Fiscal year ended May 31, 2005
Net loss	\$ (13,195)	\$ (5,887)	\$ (29,844)
Items not involving current cash flows	841	(647)	16,051
Cash used in operations	(12,354)	(6,534)	(13,793)
Net change in non-cash working capital	(1,535)	(1,712)	2,036
Cash used in operating activities	(13,889)	(8,246)	(11,757)
Cash provided by (used in) investing activities	2,165	(34)	(34)
Cash provided by financing activities	19,991	7,430	14,931
	8,267	(850)	3,140
Cash flow provided by discontinued operations	175	358	32
Effect of exchange rates on cash and cash equivalents	55	(210)	(170)
Net increase (decrease) in cash and cash equivalents	8,497	(702)	3,002
Cash and cash equivalents, beginning of period	2,716	3,418	416
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 11,213	\$ 2,716	\$ 3,418

Cash and Cash Equivalents

Cash and cash equivalents were \$11.2 million as at December 31, 2006, compared to \$2.7 million and \$3.4 million as at December 31, 2005 and May 31, 2005, respectively. At December 31, 2006 cash and cash equivalents include \$77,000 in term deposits that are posted as collateral against long-term debt and \$110,000 in guaranteed investment certificates that are posted as collateral against certain accounts payable.

Operating Activities

Cash used in operations was \$12.4 million for the year ended December 31, 2006 compared to \$6.5 million and \$13.8 million for the seven-month period ended December 31, 2005 and the year ended May 31, 2005, respectively. The cash used in the year ended May 31, 2005 was significantly lower than the reported net loss as non-cash charges were \$16.1 million.

Overall cash used in operating activities of \$13.9 million was higher in the current year versus each of the comparable periods where cash used in operating activities was \$8.2 million and \$11.8 million for the transition year and the fiscal year ended May 31, 2005, respectively. The current year increase versus December 31, 2005 is primarily due to the longer duration of the current period while the increase versus the year ended May 31, 2005 is primarily due to a \$1.5 million investment in working capital in the current year versus a \$2.0 million recovery of working capital.

The 2006 increase in non-cash working capital is due to: an approximate \$0.9 million reduction in accruals as investigator sites were paid all remaining amounts owed to them including holdbacks following the conclusion of the Pennsaid Phase III clinical trials; a \$279,000 increase in accounts receivable primarily related to foreign customers; and, a \$290,000 increase in the balance of refundable investment tax credits for eligible research and development expenditures.

Investing Activities

Net cash provided by investing activities totaled \$2.2 million for the year ended December 31, 2006 compared with net cash used in investing activities of \$34,000 in each of the prior periods. During 2006, the sale of the Company's former head office and furniture generated \$2.7 million in proceeds that were partially offset by \$593,000 in expenditures on laboratory equipment, computer upgrades and furniture and leasehold improvements for the new head office.

Cash used in investing activities in the seven-month period ended December 31, 2005 includes transaction costs of \$51,000 relating to the December 21, 2005 purchase of fqubed, Inc. ("fqubed"), based in San Diego, California. fqubed developed a proprietary technology to identify innovative formulations that can

efficiently deliver active therapeutics through the skin. Nuvo is using this technology to expand its pipeline of transdermally delivered drugs.

Nuvo completed the acquisition for total consideration of \$745,000, by issuing 4,339,875 common shares from treasury in satisfaction of \$694,000 (US\$600,000) of the purchase price and incurred transactions costs of \$51,000 that were settled in cash.

Financing Activities

Net cash provided by financing activities totaled \$20.0 million for the year ended December 31, 2006 compared with \$7.4 million and \$14.9 million for the seven-month period ended December 31, 2005 and the year ended May 31, 2005, respectively.

In 2006, \$20.0 million was provided from the following activities:

- \$18.6 million from the following issuances of common shares:
 - \$13.7 million of net proceeds from the June 20, 2006 bought deal financing consisting of 37,500,000 Units issued at a price of \$0.40 per Unit for gross proceeds of \$15 million. Each Unit consisted of one common share and one-third of one common share purchase warrant of the Company, each whole warrant entitling the holder thereof to acquire one common share at a price of \$0.50 per share until June 20, 2009. Once expenses associated with the financing were deducted, including an underwriting fee of 5.75%, net cash proceeds were \$13.7 million.
 - \$4.5 million in proceeds from the exercise of 10.7 million warrants. Approximately 6.8 million of the warrants were exercised in December 2006 under the warrant incentive program designed to encourage the early exercise of warrants from each of the three outstanding tranches. Under this program the Company amended the terms of the warrants issued in June 2004, November 2004 and June 2006 so that upon payment of a reduced exercise price of \$0.60, \$0.40 and \$0.40, respectively, and surrender of the holder's warrant the holder was entitled to receive one common share of Nuvo. The program commenced on December 11, 2006 and expired on January 31, 2007. If a warrant holder did not exercise his or her warrants prior to February 1, 2007, the warrants continue to be exercisable for common shares on the same terms as previously existed. In January 2007, an additional 12.7 million warrants were exercised under the program resulting in net proceeds to the Company of \$5.2 million.
 - \$0.4 million in employee contributions under the Share Purchase Plan and proceeds received on the exercise of stock options that resulted in a total of 1.9 million shares being issued; and,

- \$4.5 million received from Squire related to licensing agreements for Pennsaid and Pennsaid Plus (see "Significant Transactions – Pennsaid in Canada"). The payments included: \$3.5 million in licensing payments that were deferred and \$1.0 million in proceeds from the issue of convertible debentures in connection with these transactions; offset by,
- \$3.1 million in debt repayments that included a \$1.6 million payment into escrow on account of the short term loan so that the lender would discharge the mortgage on the Company's former head office and \$1.5 million in long term debt and capital lease repayments.

The Company generated cash from financing activities of \$7.4 million during the seven-months ended December 31, 2005. This cash was generated primarily from transactions involving the sale of DHCL to Paladin that in aggregate generated \$7.5 million in net proceeds:

\$2.0 million from the sale of DHCL; and \$5.5 million of up-front fees for the Canadian marketing rights to and a supply contract for Pennsaid which runs to February 2014 as explained in detail in the section entitled "Significant Transactions – Pennsaid in Canada".

During the year ended May 31, 2005 net cash provided by financing activities totaled \$14.9 million and consisted primarily of \$3.6 million in net proceeds from the June 10, 2004 special warrant private placement and \$11.2 million in net proceeds from the November 16, 2004 debenture offering. In addition, term loan balances declined by \$26,000 as \$700,000 in scheduled debt repayments were offset by the proceeds of a \$674,000 loan from Dr. Kühne (the 40% shareholder of the Company's subsidiary Dimethaid AG) received in October 2004. In January 2005, the Company issued 1,000,000 common shares to Dr. Kühne at a price of \$0.425 per share to settle \$425,000 of this loan.

SELECTED QUARTERLY INFORMATION (UNAUDITED)

The following is selected quarterly financial information for the last twelve quarterly reporting periods.

	Mar 31, 2006	June 30, 2006	Sept 30, 2006	Dec 31, 2006
<i>(in thousands, except per share data)</i>	3 Months	3 Months	3 Months	3 Months
Revenue	\$ 633	\$ 1,360	\$ 1,250	\$ 1,005
Net loss	(2,771) ⁽⁷⁾	(3,847)	(3,385)	(3,012)
Loss per share	\$ (0.02)	\$ (0.03)	\$ (0.02)	\$ (0.02)

	Feb 28, 2005	May 31, 2005	Aug 31, 2005	Dec 31, 2005
	3 Months	3 Months	3 Months	4 months
Revenue	\$ 1,613	\$ 2,118	\$ 1,296	\$ 1,604
Net income (loss)	328 ⁽⁸⁾	(19,083) ⁽⁴⁾	(1,612) ⁽⁵⁾	(4,011) ⁽⁶⁾
Net income (loss) ⁽¹⁾ per share	\$ (0.01)	\$ 0.02 ⁽²⁾	\$ (0.01)	\$ (0.03)

	Feb 29, 2004	May 31, 2004	Aug 31, 2004	Nov 30, 2004
	3 Months	3 Months	3 Months	3 Months
Revenue	\$ 3,412	\$ 1,973	\$ 1,634	\$ 1,834
Net loss	(3,670)	(12,892) ⁽⁹⁾	(4,236)	(6,815) ⁽⁶⁾
Loss per share ⁽¹⁾	\$ (0.08)	\$ (0.23)	\$ (0.08)	\$ (0.11)

- (1) For all periods ending prior to June 1, 2005 net income (loss) per share calculations are based on the net income or loss for the period, adjusted for charges to deficit for both accretion of and gains on acquisition commitments.
- (2) In the quarter ended May 31, 2005 there was a \$22.9 million gain on restructuring of acquisition commitments that exceeded the net loss of \$19.1 million for the quarter ended May 31, 2005; as a result, that quarter showed positive \$0.02 net income per share.
- (3) The quarter ended February 28, 2005 includes a \$4.1 million gain on debt settlements reached with suppliers and creditors.
- (4) The quarter ended May 31, 2005 includes a charge of \$15.5 million for the impairment of intangible assets and goodwill.
- (5) The quarter ended August 31, 2005 includes a \$2.0 million gain on the sale of DHCL.
- (6) The four-months ended December 31, 2005 includes a significant portion of the Phase III clinical trial costs for Pennsaid as final patient visits were completed.
- (7) The quarter ended March 31, 2006 includes a \$1.0 million gain on the sale of the Company's former head office.
- (8) The quarter ended November 30, 2004 includes \$5.6 million of restructuring costs.
- (9) The quarter ended May 31, 2004 includes a charge of \$6.4 million for the impairment of intangible assets and goodwill.

During 2006 revenue increased in the second and third quarters due to the launch of a new packaging format for Pennsaid in the Canadian market that required Nuvo to fill the pipeline at the wholesale level. Pennsaid revenue from foreign markets continues to vary quarter to quarter as the ordering patterns from our distributors are unpredictable and in some cases infrequent. The sale of DHCL in August 2005 as described in the section entitled “Significant Transactions – Pennsaid in Canada” significantly reduced the Company’s selling price in Canada as we no longer sell directly to wholesalers. As a result, the value of Pennsaid’s Canadian sales included in the Company’s consolidated results subsequent to the sale is significantly lower.

FOURTH QUARTER 2006 RESULTS

Highlights

- The U.S. Food and Drug Administration (FDA) issued an Approvable Letter for Pennsaid;
- The Company signed a licensing deal with Paladin Labs Inc. for the sale and marketing of Pennsaid Plus in Canada; and,
- The Company received proceeds of \$2.7 million under the Early Warrant Incentive Program that commenced on December 11, 2006.

Comparative Period

For the fourth quarter ended December 31, 2006 there is no easily comparable period due to the change in Company’s year end from May 31st to December 31st in 2005. The comparative period ended December 31, 2005 is four months in duration.

Operating Results

Revenues for the three-months ended December 31, 2006 were \$1.0 million compared with revenues of \$1.6 million for the four-months ended December 31, 2005. The decrease was primarily due to the shorter reporting period and a significant decline in Canadian Pennsaid sales as Squire readjusted their inventory levels in the quarter. Pennsaid shipments to Canadian wholesalers for the three-months ended December 31, 2006 increased by a modest 2% over the three-months ended December 31, 2005.

Total operating expenses for the three-month period ended December 31, 2006 declined to \$3.9 million compared with \$5.3 million for the four-months ended December 31, 2005. The decrease in expenses is primarily due to the shorter reporting period. However, the mix of costs did change as higher selling, general and administrative expenses in the current quarter due to licensing activities, corporate governance and consulting costs and a foreign currency loss were offset by reductions in research and development expenditures, lower levels of stock-based compensation expense and interest income versus interest expense in the comparable period.

Included in operating expenses are research and development costs which were \$1.2 million for the three-month period ended December 31, 2006 compared with \$2.0 million for the four-months ended December 31, 2005. In the period ending December 31, 2005 the Company was incurring significant costs for the Pennsaid Phase III efficacy and safety trial (“Study 112”) and the Pennsaid Phase III long-term open-label safety trial (“Study 112E”). During the current quarter the Company focused its efforts on the resubmitted NDA for Pennsaid and formulation and enhancer research activities at fqubed our research facility in the United States.

The loss from operations for the three-months ended December 31, 2006 was \$3.2 million versus \$4.4 million in the four-months ended December 31, 2005. The decline was again due to the shorter reporting period and the factors outlined in the preceding paragraphs. The Company recorded a \$0.1 million restructuring provision recovery in each of the periods and reported net income from discontinued operations of \$0.1 million in 2006 and \$0.3 million in 2005 related to Ophthalmic Products. As a result the net loss for the three-months ended December 31, 2006 was \$3.0 million compared with \$4.0 million for the four-month period ended December 31, 2005.

Liquidity

Cash and cash equivalents on hand at December 31, 2006 of \$11.2 million were essentially unchanged versus September 30, 2006 as cash used by operating activities of \$3.4 million was offset by cash provided by financing activities, discontinued operations and the effect of changes in foreign currency exchange rates.

Cash used in operating activities of \$3.4 million was significantly lower than the \$5.0 million used in the four-month period ended December 31, 2005 due to the shorter reporting period and a large investment in non-cash working capital in the comparable period as previously accrued costs for Study 112 and 112E clinical trials were paid to the investigators who conducted the trials.

During the fourth quarter of 2006, the Company generated \$3.2 million in net cash from financing activities that included: \$2.9 million from the exercise of warrants and stock options and employee contributions under the Stock Purchase Plan; \$500,000 in proceeds on the issuance of the debenture to Paladin; and, \$250,000 as an upfront licensing payment for Pennsaid Plus in Canada; offset by, \$417,000 in long-term and capital lease repayments. Amounts in the comparable period were insignificant.

During the fourth quarter the Company used only \$7,000 in cash and cash equivalents versus \$4.8 million in the comparable four month period ended December 31, 2005.

CONTRACTUAL OBLIGATIONS

The following table lists the Company's contractual obligations as at December 31, 2006.

<i>in thousands</i>	Payments due by fiscal year					
	Total	2007	2008	2009	2010	2011
Short-term loan	\$ 557	\$ 557	\$ -	\$ -	\$ -	\$ -
Long-term debt	928	648	70	70	70	70
Capital lease obligations	100	36	36	24	3	1
Operating leases	1,026	273	264	167	154	168
Research and other contracts	263	263	-	-	-	-
	\$ 2,874	\$ 1,777	\$ 370	\$ 261	\$ 227	\$ 239

Capital Lease Obligations

During 2006, the Company acquired capital assets with a cost of \$96,000 through the assumption of capital lease obligations. The obligations bear interest at a weighted average effective rate of approximately 9.9%. Prior to 2006 the Company had not entered into any capital lease obligations. The total minimum lease payments under these leases are included in contractual obligations table.

OFF BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

RELATED PARTY TRANSACTIONS

Contract research services totaling \$58,000 for the year ended December 31, 2006 versus \$18,000 for the seven-months ended December 31, 2005 and \$nil for the year ended May 31, 2005 were provided by a researcher who holds a PhD in pharmacokinetics and who is a family member of one of the Company's officers. These services have been charged at fair market value and have been accounted for in research and development expenses.

OUTSTANDING SHARE DATA

The number of common shares outstanding as at January 31, 2007 was 196,771,593 an increase of 13,472,782 since December 31, 2006. The increase is due to the issue of 346,491 common shares on the conversion of debentures with a face value of \$158,000, 13,050,721 issued on the exercise of common share purchase warrants and 75,570 shares issued in settlement of professional fees. The Company received \$5.3 million in cash proceeds from these issuances.

On January 31, 2007, subsequent to the conclusion of the warrant incentive program, the Company had 32.6 million warrants outstanding, 16.7 million stock options outstanding and debentures potentially convertible into 14.2 million common shares.

LITIGATION

From time to time, during the ordinary course of business, the Company is threatened with, or is named as a defendant in various legal proceedings including lawsuits based upon product liability, personal injury, breach of contract and lost profits or other consequential damage claims.

Leadenhall

The Company's former head office property was subject to a \$2.0 million mortgage (the "Mortgage"). As previously disclosed, the Mortgage balance due is in dispute with Leadenhall Bank & Trust Company Limited ("the Mortgagee"). The Mortgage dispute centers on the calculation and amount of interest owing and is the subject of an Ontario court action (the "Ontario Action") commenced in April 2005. The Mortgagee's position is that interest should be calculated at a rate of 2% per month calculated monthly; including interest on late payments; and costs. The Company's position is that the Mortgage is null and void and should be discharged, or alternatively, that the interest payable is limited to 5 percent per annum pursuant to the provisions of the Interest Act (Canada). Subsequent to the filing by the Mortgagee of its Statement of Claim and the Company of its Statement of Defense and Counterclaim, a liquidator (the "Liquidator") of the Mortgagee was appointed by the courts of the Bahamas, where the Mortgagee is situated.

In November of 2005, the Company negotiated a written agreement (the "Settlement Agreement") with the Liquidator to settle all claims pursuant to the Ontario Action for US\$1,067,000 (CDN\$1,241,000) (the "Settlement Amount") payable out of closing funds received on the sale of the Company's former head office. The Settlement Agreement is subject to the approval of the Bahamian court that appointed the Liquidator. The Liquidator agreed to seek court approval as soon as possible. The Liquidator did not seek court approval prior to the completion of the head office sale, and in order to allow the sale to

proceed, the Liquidator and the Company entered into an escrow arrangement (the “Escrow Agreement”) pursuant to which the Liquidator agreed that upon payment of US\$1,370,000 (CDN\$1,598,000) to the Liquidator in escrow to be held pending court approval of the Settlement Agreement, the Liquidator would deliver a discharge of the Mortgage. In January 2006, the said amount was paid to the Liquidator in escrow, the Mortgage was discharged and the sale of the head office was completed. Under the terms of the Escrow Agreement, the balance of the amount paid into escrow, US\$303,000 (approximately CDN\$353,000 at current exchange rates), is to be released to the Company upon approval by the Bahamian court of the Settlement Agreement.

The Liquidator has continually delayed seeking court approval of the Settlement Agreement and has not yet presented it to the Bahamian court for approval. Since April 2006, the Liquidator has indicated that while it still intends to present the Settlement Agreement to the court for its consideration, it will not recommend that the court approve it. In addition, in February 2007, correspondence from the Liquidator’s Bahamian legal counsel indicates that if the Court does not approve the Settlement Agreement, the Liquidator will request that the Bahamian court order that all escrowed funds, including the \$US303,000 (CDN\$353,000) be released to the Liquidator and not the Company. The Liquidator’s legal counsel further suggested that the full amount in escrow is insufficient to retire the mortgage principal plus interest at the alleged interest rate of 2% per month and that the Liquidator may pursue the Company for the deficiency. If the Bahamian court does not approve the Settlement Agreement, the Escrow Agreement contemplates that the Ontario Action will continue to determine the respective rights of the parties to the escrow funds. The Company has retained legal counsel in the Bahamas to pursue court approval of the Settlement Agreement and to ensure that if the Settlement Agreement is not approved, that the escrow continues in accordance with the terms of the Escrow Agreement so that entitlement to the escrow funds can be determined in the Ontario Action. A hearing of the Bahamian court to review these matters is scheduled for March 8, 2007.

Ontario Securities Commission (“OSC”)

In October 2004, the Company received a letter from the OSC indicating it was reviewing the disclosures and trading activity of the Company and requesting that the Company provide, among other things, records pertaining to the FDA and the late-stage or Phase III testing of Pennsaid, as well as the Company’s May 21, 2004 special warrant financing.

During 2006, the Company received a series of letters from the OSC requesting additional information and documentation related to the disclosure of the status of the Company’s original application to the FDA for approval of Pennsaid. These letters indicate that the OSC’s concerns are focused on the accuracy of the disclosure in two prospectuses filed by the Company prior to the date that the new Board of Directors was elected and management team was appointed in September 2004. Most recently, the OSC’s communications with Company and certain of its former directors indicates that it is contemplating proceedings to consider whether the Company engaged in conduct warranting the OSC making an order against it. Although staff of the OSC has advised certain of the former outside directors of the Company that they do not intend to take any proceedings against those individuals at this time, those former directors may be able to make a claim against the Company under the indemnity provisions contained in the Corporate By-Law for the legal costs associated with their interactions with the OSC concerning this disclosure, some of which may be recoverable under the Company’s insurance. Management has estimated the amount likely incurred by the former directors and has accrued this amount as at December 31, 2006.

The Company continues to co-operate and communicate with the OSC, has provided the OSC with all requested information and documentation, and will continue to assist it in its review and investigation of this matter. However, despite this co-operation, the Company could still be subject to regulatory sanctions and penalties and/or civil liability in the event of a determination that there was any misrepresentation in its historical disclosures or a determination that there was any other contravention of securities laws.

Research Capital Corporation

On June 7, 2006, the Company received a letter from counsel to Research Capital Corporation (“RCC”) asserting that as a result of the bought deal equity financing completed by the Company on June 20, 2006, RCC is entitled to payment of \$1.5 million and common shares of the Company equal to 8% of the shares issuable pursuant to an underwriting agreement for an offering that was contemplated but did not proceed in September 2005. RCC was not involved in the financing. The letter further stated that if the demanded cash payment and common shares were not received on or before June 12, 2006 then a court action would commence by RCC against the Company. On September 15, 2006, RCC commenced legal proceedings against the Company by filing a Statement of Claim with the Ontario Superior Court of Justice.

The Statement of Claim claims that RCC is entitled to (i) damages in the amount of \$1.5 million or alternatively damages of \$1.0 million (ii) 3 million warrants to purchase common shares at a price of \$0.50 and an option to purchase \$5 million in units of the Company or alternatively to (i) and (ii), \$350,000, and in each case interest and costs. Management of the Company believes that RCC's claim is without merit. The Company has filed a Statement of Defence and Counterclaim and intends to vigorously defend its position. Since the delivery of the Plaintiff's Reply and Defence to Counterclaim in late 2006, no further steps have been taken in this proceeding.

Other

Rebecca E. Keeler, the Company's former president and chief executive officer, was terminated in September 2004. The Company's position is that the termination is for cause and no cash payment is owed, and no provision has been made in these financial statements. In the event it is determined that Mrs. Keeler's employment was terminated without just cause, she will be entitled to receive a cash payment of \$600,000, which is two times her former annual salary. In 2005, the Company received a letter from Mrs. Keeler's solicitors stating they do not agree with the Company's position that the termination was for just cause and if a settlement cannot be negotiated, they intend to commence legal action. There has been no further communication.

SUBSEQUENT EVENT

On January 1, 2007 the Company completed a short-form amalgamation with certain of its subsidiaries. Akorn Pharmaceuticals Canada Limited, Excelpharm Inc., Femina Inc., Dimethaid Management Inc. and Dimethaid Manufacturing Inc. were amalgamated with Nuvo Research Inc. after Board approval and in accordance with the Business Corporations Act (Ontario). The amalgamated entity continues as Nuvo Research Inc. No new securities were issued as a result of the amalgamation and outstanding securities of the Company prior to the amalgamation continue to represent securities of the amalgamated entity. The amalgamation was completed in an effort to simplify the Company's structure.

RECENT ACCOUNTING PRONOUNCEMENTS

Financial Instruments – Recognition and Measurement

In January 2005, the CICA released new *Handbook Section 3855, Financial Instruments – Recognition and Measurement*, effective for annual and interim periods beginning on or after October 1, 2006. This new section prescribes when a financial instrument

is to be recognized on the balance sheet and at what amount, sometimes using fair value and at other times using cost-based measures. It also specifies how financial instrument gains and losses are to be presented and defines financial instruments to include accounts receivable and payable, loans, investments in debt and equity securities, and derivative contracts.

The adoption of this new guidance is not expected to have a material impact on the Company's consolidated financial statements.

Comprehensive Income and Equity

In January 2005, the CICA released new *Handbook Section 1530, Comprehensive Income*, and *Section 3251, Equity*, effective for annual and interim periods beginning on or after October 1, 2006. *Section 1530* establishes standards for reporting comprehensive income. The section does not address issues of recognition or measurement for comprehensive income and its components. *Section 3251* establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in this section are in addition to *Section 1530*.

The adoption of this new guidance is not expected to have a material impact on the Company's consolidated financial statements.

Harmonizing of Canadian and International Standards

In March 2006, the Accounting Standards Board of the CICA released its new strategic plan which proposes to abandon Canadian GAAP and affect a complete convergence to the International Financial Reporting Standards. At the end of a transitional period of approximately five years, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies. The Company will closely monitor changes arising from this convergence.

RISK FACTORS

Prospects for companies in the biotechnology and pharmaceutical industry generally may be regarded as uncertain given the nature of the industry and, accordingly, investments in biotechnology and pharmaceutical companies should be regarded as speculative. Research and development involves a high and significant degree of risk. An investor should carefully consider the risks and uncertainties described below, as well as other information contained in this Management's Discussion and Analysis of Operating Results as well as broader risk factors discussed in the Company's Annual Information Form (AIF). The risks and uncertainties described below are not an exhaustive list. Additional risks and uncertainties not presently known to the Company or that the Company believes to be immaterial may also adversely affect

the Company's business. If any one or more of the following risks occur, the Company's business, financial condition and results of operations could be seriously harmed. Further, if the Company fails to meet the expectations of the public market in any given period, the market price of the Company's common shares could decline. Before making an investment decision, each prospective investor should carefully consider the risk factors set out below and those included in the AIF and other public documents.

Need for Additional Financing

The Company has an ongoing need for substantial capital resources to research and develop, commercialize and manufacture its products and technologies. The Company has only limited participation in Pennsaid sales in those markets where it has currently been approved. Until the Company receives FDA approval for Pennsaid and has a U.S. marketing partner, Pennsaid revenues are expected to be insufficient to provide the capital required to be self-sustaining without the need for future financings. There can be no assurance that the Company will have enough capital to develop or commercialize any further products without future financings.

The Company is considering a number of options to raise required funds. These include licensing and co-development agreements for Pennsaid and Pennsaid Plus in the United States and other territories, initiating a public offering and conducting additional warrant incentive programs.

Uncertainty of Product Development

There can be no assurance that such products as Penecure™, the Company's antifungal drug treatment for onychomycosis (nail infection), WF10 and Pennsaid Plus will be successfully developed in a timely manner, or that they will prove to be more effective than products based on existing or new technologies, or that a sufficient number of medical professionals will recommend their use. The risk that a product may fail clinical trials, the Company's inability to successfully complete development, or a decision for financial or other reasons to halt development of any product, particularly in instances where significant capital expenditures have already been made, could have a material adverse effect on the Company.

Patents and Proprietary Technology

The Company's key patents for Pennsaid expired in 2004 in the United States, 2005 in Canada and 2006 in the European Union, except in Italy, where the Pennsaid patent was granted a patent extension (Supplementary Protection Certificate) until 2011.

While a period of marketing exclusivity may be granted by the FDA and individual European countries following approval of a new product, there is no assurance of such exclusivity being granted. The Company has filed patent applications for formulations of its follow-up product Pennsaid Plus; however, there can be no assurance that these patents will be granted or that Pennsaid Plus will not infringe that patents of others.

The Company's patents for WF10 as an adjunct to radiation and chemotherapy expired in 2006 in Europe and Japan and will expire in 2007 in Canada. The Company's WF10 patents for autoimmune disease, organ transplant or graft rejection, lymphoma and inflammation manifested as hepatitis or chronic obstructive pulmonary disease, expire in 2018 in several European Union countries, including the United Kingdom. When these patents expire, the Company will lose its exclusive rights to exploit them. There can be no assurance that the Company will receive governmental approval for its products or will be able to successfully commercialize its products prior to patent expiry, a failure that could result in a material adverse effect on the Company's business, financial condition and operational results.

Regardless of the validity of the Company's patents, there can be no assurance that others will be unable to obtain patents or develop competitive non-infringing products or processes that permit such parties to compete with the Company.

Preclinical and Clinical Testing

The Company must demonstrate through pre-clinical studies and clinical trials that its drug products are safe and efficacious before the Company can obtain regulatory approval for the commercial sale of such products. The results from pre-clinical studies and clinical trials may not be indicative of results obtained in additional or larger clinical trials, and there can be no assurance that any clinical trials of the Company or any of the Company's collaborators will demonstrate safety and efficacy, achieve regulatory approvals or result in marketable products. A number of companies in the biotechnology and pharmaceutical industry have suffered significant setbacks in advanced clinical trials, even after achieving promising results in earlier trials and pre-clinical studies. Unsatisfactory results may cause the Company to reduce or abandon future testing or commercialization of particular products and this may have a material adverse effect on the Company.

Development Time

It takes considerable time to develop new prescription drugs, to obtain the necessary regulatory approvals permitting sales, to establish appropriate distribution channels and market acceptance, and to obtain insurer reimbursement approvals. This time period is generally three to ten years and exposes the Company to significant risks, including the development of competing products, loss of investor interest, shifting consumer preferences, changes in personnel and new regulatory requirements. During this lengthy period, the Company often incurs significant development-related costs without obtaining offsetting revenues.

Nuvo intends to manage this risk by entering into development partnerships with other industry players. The Company hopes to leverage both the financial and intellectual capital associated with experienced partners, reducing the time to commercialization and improving the likelihood of product approval.

Competition

The pharmaceutical industry is characterized by evolving technology and intense competition. The Company is engaged in areas of research where developments are expected to continue at a rapid pace. Many companies, including major pharmaceutical as well as specialized biotechnology companies, are engaged in activities focused on medical conditions similar to those targeted by the Company. The Company's success depends upon maintaining its competitive position in the research, development and commercialization of transdermal delivery products and technologies. Competition from pharmaceutical, chemical and biotechnology companies, as well as universities and research institutes, is intense and expected to increase. Many of these organizations have substantially greater research and development capabilities, experience in manufacturing, marketing, financial and managerial resources, and they represent significant competition.

There can be no assurance that developments by others will not render the Company's products or technologies non-competitive or obsolete.

Pennsaid

Several major pharmaceutical companies have developed oral COX-2 selective NSAIDs designed to reduce gastrointestinal side effects associated with other types of NSAIDs. Some of these products have been taken off the market in response to safety concerns. Those that remain represent competition for market share. While the Company believes that topical administration gives Pennsaid a better safety profile

than oral NSAIDs, the drug may be subject to regulations and regulatory decisions of governing bodies, such as the FDA in the United States, including label warnings that apply to NSAIDs generally.

In North America, other topical products are available over the counter. Generally, they provide limited relief from pain. This may fuel a perception that all topically applied painkillers are the same, making it all the more difficult to convince physicians and their patients of the value of the Company's product, Pennsaid.

In Europe and some Asian countries, several major pharmaceutical companies market topical NSAIDs. To date, these drugs have not been approved for use in North America, although the Company believes that major pharmaceutical companies are developing topical NSAIDs for the U.S. and Canadian markets. Like Pennsaid, these drugs may minimize the gastrointestinal side effects associated with oral NSAIDs. These products, if approved by the regulatory authorities for sales in Canada and the United States, may present competition for Pennsaid in North America.

To deal with the competition Nuvo has developed new formulations for its transdermal drug delivery technology that *in vitro* appear to be significantly more efficient at penetrating skin. This may allow for reduced dosage while providing the same level of relief, making the product even more attractive and enhancing its patent protection. There can be no assurance that these new formulations will show clinically significant efficacy, receive patent protection or that they will meet all government regulatory testing requirements.

Penecure

Several companies are at various stages of developing products targeting the treatment of onychomycosis. These products may represent competition for Penecure's market share.

WF10

Several major pharmaceutical companies are at various stages of developing products targeting the immune system. Some of these products have already been approved for marketing and as such, represent competition for market share.

The Company's own experience with WF10 is limited. The last Phase III HIV/AIDS trial produced disappointing results and the early-stage pancreatic cancer trial at the University of Heidelberg in Germany has recruited subjects at a much slower pace than expected such that feedback has been limited thus far.

Obtaining Government and Regulatory Approvals

The Company may encounter difficulties or excessive costs in securing necessary approvals or licenses in Canada and the United States, an obstacle that could delay or prevent the Company from marketing its products.

The Company may not obtain regulatory approvals in countries outside Canada and the United States. It may be required to incur significant costs in obtaining or maintaining foreign regulatory approvals. Failure to obtain necessary regulatory approvals, the restriction, suspension or revocation of existing approvals or any other failure to comply with regulatory requirements, could have a material adverse effect on the Company's business, financial condition and operational results.

Even if initial approval is obtained, further research, including post-marketing studies, may be required to expand indications covered under the product monograph. Also, regulatory agencies require post-marketing surveillance programs to monitor side effects. Results of post-marketing programs may limit or expand additional marketing of the drug. Unexpected safety problems could lead to withdrawal of the drug from the market and possible civil action.

Changes in Government Regulation

The business of the Company may be adversely affected by such factors as changes in the regulatory environment with respect to intellectual property, regulation or export controls. Such changes remain beyond the Company's control and have an unpredictable impact.

Generic Drug Manufacturers

Regulatory approval for competing generic drugs can be obtained without investing in the same level of costly and time-consuming clinical trials the Company has conducted. Because of substantially reduced development costs generic drug manufacturers are often able to charge much lower prices for their products than the original developer.

The Company may face competition from manufacturers of generic drugs on some of the products it commercializes, since a number of the Company's patents have expired or will shortly.

Limited Marketable Products, Reimbursement and Product Pricing

There can be no assurance that Pennsaid will be successfully commercialized in current markets or that the additional regulatory approvals necessary to commercialize Pennsaid in other markets will be obtained. In Canada, private health coverage insurers have generally approved reimbursement of Pennsaid costs, but government health authorities have not approved such reimbursement. The Company's ability

to realize the full commercial potential of Pennsaid or other therapeutic products may depend on the extent to which patient costs are reimbursed by government health administration authorities, private health coverage insurers (outside of Canada) and other organizations. Furthermore, even after approval for reimbursement for Pennsaid is obtained from private health coverage insurers or government health authorities, it may be eliminated at any time. Significant uncertainty exists as to the reimbursement status of newly approved health-care products and there can be no assurance that third-party coverage will be sufficient to give the Company an appropriate return on its investment in developing existing or new products. Increasingly, government and other third-party payers are attempting to contain expenditures by limiting coverage and reimbursement levels for new therapeutic products. Inadequate coverage or reimbursement could adversely affect market acceptance of the Company's products.

Third-party payers increasingly challenge the pricing of pharmaceutical products. Moreover, the trend toward managed healthcare in the United States, the growth of organizations such as health maintenance organizations, and legislative proposals to reform healthcare and government insurance programs, could significantly influence the purchase of healthcare services and products, resulting in lower prices and reduced demand for the Company's products. In addition, in many international markets, the government controls the prices of prescription drugs.

Dependence on Sales and Marketing Partnerships

The Company has limited sales and marketing experience and lacks the financial or other resources to undertake marketing and advertising activities worldwide. Accordingly, the Company intends to rely on marketing arrangements, including possible joint ventures, licensing or other third-party arrangements, to distribute its products in all jurisdictions. There can be no assurance that the Company will be able to find marketing and distribution partners in applicable jurisdictions or be able to enter into any marketing and distribution arrangements on any terms, acceptable or not. Moreover, there can be no assurance that its partners will dedicate the resources needed to successfully market and distribute the Company's products and maximize sales.

Personnel

The Company depends on certain key senior officers and scientific personnel. The loss of any of these individuals could have a material adverse effect on the Company. The Company does not maintain key-man insurance on any employees.

The Company's success depends, in large part, on its ability to continue to attract and retain qualified scientific and management personnel. It faces intense competition for such personnel and consultants.

The Company may not be able to attract and retain qualified management and scientific personnel in the future. Also, it must provide training for its growing employee base due to the highly specialized nature of pharmaceutical products.

Further, the Company expects that our potential expansion into areas and activities requiring additional expertise, such as further pre-clinical studies, clinical trials, governmental approvals, sales and marketing will place additional requirements on its management, operational and financial resources. The Company expects these demands will require an increase in the number of management and scientific personnel and the development of additional expertise by existing management personnel. The failure to attract and retain such personnel, or to develop such expertise, could materially adversely affect prospects for the Company's success. In addition, to attract qualified personnel the Company may be required to establish offices in different jurisdictions. Failure of personnel in different jurisdictions to work effectively together could materially adversely affect the Company's success.

Given these potential challenges current personnel may be unable to adapt or may not have the appropriate skills and the Company may fail to assimilate and train new employees. Highly skilled employees with the education and training that the Company requires, especially employees with significant experience and expertise in drug delivery systems, are in high demand. Once trained, employees may be hired by the Company's competitors.

Litigation

From time to time, during the ordinary course of business, the Company is threatened with, or is named as a defendant in various legal proceedings including lawsuits based upon product liability, personal injury, breach of contract and lost profits or other consequential damage claims.

A significant judgment against the Company, or the imposition of a significant fine or penalty, or a finding that the Company has failed to comply with laws or regulations, or a failure to settle any dispute on satisfactory terms could have a significant adverse impact on the Company's ability to continue operations. A discussion of current litigation is included in the section entitled "Litigation".

Potential Product Liability

The Company may be subject to product liability claims associated with the use of its products, and there can be no assurance that liability insurance will be available on commercially reasonable terms. Product liability claims might also exceed the amounts, or fall outside, of such coverage. Claims against the Company, regardless of their merit or potential outcome, may also have a material adverse effect on the Company's ability to obtain physician endorsement of its products or expand its business.

Dependence on Key Suppliers

The Company purchases key raw materials necessary for the manufacture of its products from a limited number of suppliers around the world and in the case of dimethyl sulfoxide (one of the key ingredients in Pennsaid) a single supplier to whom we have granted the exclusive right to manufacture for us. It may be difficult for us to find another manufacturer if the supplier is unable to supply us with a sufficient amount of our dimethyl sulfoxide or if we are forced for any other reason to find another supplier. It could take another supplier a significant period of time to develop and certify the necessary processes to manufacture the product on terms acceptable to us. There may not be suppliers that are able to meet our volume or quality requirements at a price that is as favourable to us as those we currently have.

Any operating, production or quality problems experienced by these suppliers that result in a reduction or interruption in supply could significantly delay the manufacture and sale of our products.

In addition, the FDA requires that suppliers of certain raw materials be FDA approved, their Master Drug File (MDF) be referenced in your NDA and that adequate stability data exist for your product using the approved supplier's raw material. As a result, in the case where only a single approved supply source exists for product marketed in the United States (or other regulated jurisdictions) the Company is at risk should a supplier lose its FDA manufacturing approval, terminate our access to its MDF, be unable to manufacture product, choose not to supply the Company or decide to increase prices. In the United States, the Company has only one approved supplier for dimethyl sulfoxide and its active pharmaceutical ingredient (API).

Manufacturing Risks

The Company's current manufacturing capabilities are limited to its site in Varennes, Quebec which is the sole manufacturer of Pennsaid for all markets and its site in Wanzleben, Germany which produces TCDO, the active ingredient in WF10 and Oxoferin™. The Company has never achieved capacity in these facilities although it has manufactured Pennsaid® and TCDO for existing markets and produced clinical batches. This will expose the Company to the following risks, any of which could delay or prevent the commercialization of its products, result in higher costs, or deprive it of potential product revenues:

- The Company may encounter difficulties in achieving volume production, quality control and quality assurance, as well as with shortages of qualified personnel. Accordingly, it might not be able to manufacture sufficient quantities to meet its clinical trial needs or to commercialize its products.
- The Company's manufacturing facilities are required to undergo a satisfactory current good manufacturing practices, or GMP, inspection prior to regulatory approval and are obliged to operate in accordance with FDA, European and other nationally mandated GMP, which govern manufacturing processes, stability testing, record keeping and quality standards. A failure to establish and follow GMPs and to document adherence to such practices may lead to significant delays in the availability of material for clinical study and may delay or prevent filing or approval of marketing applications for its products.
- Changing manufacturing locations may be difficult and the number of potential manufacturers is limited. Changing manufacturers generally requires re-validation of the manufacturing processes and procedures in accordance with FDA, European and other nationally mandated GMPs. Such re-validation may be costly and time-consuming. It may be difficult or impossible for the Company to quickly find replacement manufacturers on acceptable terms, if at all.

The Company's manufacturing facilities are subject to ongoing periodic unannounced inspections by the FDA, and corresponding state and foreign agencies, including European ones, to ensure strict compliance with GMPs and other government regulations. Failure by the Company to comply with applicable regulations could result in sanctions being imposed on it, including fines, injunctions, civil penalties, failure of the government to grant review of submissions or market approval of drugs, delays, suspension or withdrawal of approvals, seizures or recalls of product, operating restrictions, facility closures and criminal prosecutions, any of which could harm the Company's business.

Hazardous Materials and Environmental

The Company's products involve the use of hazardous materials, and as a result it is exposed to potential liability claims and costs associated with complying with laws regulating hazardous waste. The Company's research and development and manufacturing activities involve the use of hazardous materials, including chemicals, and are subject to federal, provincial and local laws and regulations governing the use, manufacture, storage, handling and disposal of hazardous materials and waste products in the jurisdictions where they reside. However, accidental injury or contamination from these materials may occur. In the event of an accident, the Company could be held liable for any damages, which could exceed its available financial resources. In addition, the Company may be required to incur significant costs to comply with environmental laws and regulations in the future.

Acquisition and Integration of Complementary Technologies or Businesses

The Company may pursue product or business acquisitions that could complement or expand its business. However, it may not be able to identify appropriate acquisition candidates in the future. If an acquisition candidate is identified, the Company may not be able to successfully negotiate the terms of any such acquisition or finance such acquisition. Any such acquisition could result in unanticipated costs or liabilities, diversion of management's attention from the core business, the expenditure of resources and the potential loss of key employees, particularly those of the acquired organizations. In addition, the Company may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future, which may harm its business.

To the extent the Company issues common shares or other rights to finance any acquisition, existing shareholders may be diluted. They may also result in goodwill and other long-lived assets that are subject to impairment tests, which could result in future impairment charges.

Losses Due to Foreign Currency Fluctuations

The Company anticipates that the majority of the revenue from commercialization of its product candidates may be in currencies other than Canadian dollars. Fluctuation in the exchange rate of the Canadian dollar relative to these other currencies could result in the Company realizing a lower profit margin on sales of its product candidates than anticipated at the time of entering into such commercial agreements. Adverse movements in exchange rates could have a material adverse effect on the Company's financial condition and results of operations.

International Operations

The Company has operations outside of Canada, primarily in Europe, Barbados and the United States in order to market, distribute and manufacture certain of its products and may expand further in the future. Participation in international markets requires resources and management attention and subjects the Company to business risks, including the following:

- different regulatory requirements for approval of its product candidates;
- dependence on local distributors;
- longer payment cycles and problems in collecting accounts receivable;
- adverse changes in trade and tax regulations;
- currency risks.

The occurrence of any of these or other factors may cause the Company's international operations not to be successful and could lower the prices at which they can sell products or otherwise have an adverse effect on the Company's operating results.

Volatility of Share Price

Market prices for pharmaceutical-related securities, including those of the Company, have been historically volatile. Future announcements concerning the Company or its competitors – including the results of testing, technological innovations, new commercial products, government regulations, developments concerning proprietary rights, litigation, cash flow and public concerns about the safety of the Company's products – may have a significant impact on the market price of the Company's common shares. In addition, there can be no assurance that the common shares will continue to be listed on the TSX.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Disclosure Controls

The Company's Chief Executive Officer ("CEO") and Vice President, Finance and Chief Financial Officer ("CFO") have reviewed the disclosure controls in place as at December 31, 2006 and have concluded that they provide reasonable assurance that all material information relating to the Company would be made known to them. While the CEO and CFO believe that the Company's disclosure controls and procedures provide reasonable assurance they are also aware that any control system can only provide reasonable, not absolute, assurance of achieving its control objectives.

Internal Controls Over Financial Reporting

Management is also responsible for the design of internal controls over financial reporting ("ICFR") within the Company in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, the design of any system of control is based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all future events, no matter how remote, or that the degree of compliance with the policies or procedures may not deteriorate. Accordingly, even effective ICFR can only provide reasonable, not absolute, assurance of achieving the control objectives for financial reporting.

During 2006, the Board of Directors recruited a new Chief Financial Officer to, among other tasks; co-ordinate the assessment of the Company's ICFR and remedy any weaknesses or deficiencies. Based on the initial evaluation of the overall control structure a Manager of Information Technology and additional finance staff were added to strengthen controls, enable senior review of activities in these key areas and to assist in completing the evaluation of the Company's ICFR.

The design of the Company's ICFR was evaluated by management, including the Chief Executive Officer and Chief Financial Officer, in accordance with criteria established in the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Multilateral Instrument 52-109 as at December 31, 2006. Based on this evaluation management has concluded that the following disclosable weaknesses existed, as at December 31, 2006 and require internal control improvements.

Limited Resources – Segregation of Duties

Given the Company's size it had limited resources within the finance department to adequately segregate duties and to permit or necessitate the comprehensive documentation of all policies and procedures that form the basis of an effective design of ICFR. As a result, the Company is highly reliant on the knowledge of a limited number of employees and on the performance of mitigating procedures during its financial close and

consolidation process to ensure that the consolidated financial statements are presented fairly in all material respects. As of December 31, 2006 the Company had hired additional finance staff, expanded its month end close and consolidation process to include new post closing procedures, added additional analysis and review procedures to the month end close and consolidation process and documented the key accounting policies and procedures necessary to address these weaknesses.

The process of comprehensively documenting and disseminating all policies and procedures that could have an impact on financial reporting will be completed in 2007. In addition, the process of recruiting additional resources for the finance group, necessary to further strengthen ICFR, is currently underway.

Inventory

Management identified a weakness in the inventory count procedures at one of its subsidiaries. The weakness exists as the subsidiary employs four employees, of whom only one is financially literate, such that adequate segregation of duties is not possible. New inventory count procedures will be implemented prior to the next count to strengthen all noted weaknesses.

At our other manufacturing facility the lack of comprehensively documented policies and procedures related to inventory valuation were identified by management as a reportable weakness. Currently, the plant is running under capacity as the Company does not have FDA approval to market its product in U.S. and, therefore, comprehensive inventory valuation and cost accounting policies and procedures have not been fully developed. Comprehensive policies and procedures for inventory valuation have been drafted and will be implemented in 2007. Management has relied on certain compensating controls and review to ensure this weakness does not result in a misstatement of inventory.

Information Technology Systems

The accounting software used by the Company to maintain the accounts of its two largest legal entities has significant control limitations due to the age of the software and the operating system on which it is based. The Company is currently investigating alternatives to this software as part of a larger plan to upgrade finance application software in 2007.

In addition, the Company does not have comprehensive access and change control procedures or monitoring activities to ensure that control procedures over information systems were being performed or functioning as intended. The IT Manager hired in the fourth quarter of 2006 will be documenting and improving procedures in these areas in 2007.

Reliance on Spreadsheets

A significant amount of the information used to prepare financial statements and to analyze and review the financial information is generated through the use of spreadsheets. The Company relies heavily on review procedures and detective controls to ensure the accuracy of the information generated rather than preventive controls based on a broad Company framework of controls for the creating, editing and maintaining spreadsheets. If cost effective, the Company intends to introduce such a framework in 2007.

As a result of management's review of the design of ICFR and the process of comprehensively documenting the Company's policies and procedures we identified several areas where, although controls were in place, better controls could be implemented to improve the overall control environment. Given the constraints of time and available resources, management was unable to implement these changes prior to year end but intends to do so in 2007.

During 2006, the Company: strengthened its management team with the addition of a new Chief Financial Officer, an Information Technology Manager and other finance staff; began a process of comprehensively documenting its policies and procedures and implementing new controls where possible; implemented additional month end close and consolidation analysis and review procedures; and engaged experts to assist in areas of finance such as taxation where the Company does not have in-house expertise. All of these changes are intended to improve the system of ICFR.

Subsequent to year end, the Company continued the projects discussed above but has not made any additional material changes to its system of ICFR.

ADDITIONAL INFORMATION

Additional information relating to the Company, including the Company's most recently filed annual information form and information circular, can be found on SEDAR at www.sedar.com

AUDITORS' REPORT

To the Shareholders of Nuvo Research Inc.

We have audited the consolidated balance sheets of Nuvo Research Inc. as at December 31, 2006 and 2005 and the consolidated statements of loss and deficit and of cash flows for the year ended December 31, 2006 and the seven-month period from June 1, 2005 to December 31, 2005. 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, 2006 and 2005 and the results of its operations and its cash flows for the year and the seven-month period then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at May 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated August 16, 2005.



Chartered Accountants
Toronto, Ontario
February 26, 2007

MANAGEMENT'S REPORT

The accompanying consolidated financial statements have been prepared by management and approved by the Board of Directors of the Company. Management is responsible for the information and representations contained in these financial statements and the accompanying Management's Discussion and Analysis. The financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies followed by the Company are set out in note 2 to the consolidated financial statements.

To assist management in discharging these responsibilities, the Company maintains a system of procedures and internal controls which are designed to provide reasonable assurance that its assets are safeguarded, that transactions are executed in accordance with management's authorization, and that the financial records form a reliable base for the preparation of accurate and timely financial information.

The Company's external auditors are appointed by the shareholders. They independently perform the necessary tests of accounting records and procedures to enable them to report their opinion as to the fairness of the consolidated financial statements and their conformity with Canadian generally accepted accounting principles.

The Board of Directors ensures that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through an Audit Committee composed of three Directors, all of whom are not involved in the day-to-day operations of the Company. The Audit Committee meets quarterly with management, and with external auditors to review audit recommendations and any matters that the auditors believe should be brought to the attention of the Board of Directors. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis and recommends their approval by the Board of Directors.



President and Chief Executive Officer
February 28, 2007



Vice President, Finance and Chief Financial Officer
February 28, 2007

CONSOLIDATED BALANCE SHEETS

<i>(thousands of Canadian dollars)</i>	As at December 31, 2006 \$	As at December 31, 2005 \$	As at May 31, 2005 \$
ASSETS			
CURRENT			
Cash and cash equivalents <i>(note 4)</i>	11,213	2,716	3,418
Accounts receivable	968	612	813
Other receivable <i>(note 7)</i>	375	–	–
Inventories <i>(note 5)</i>	1,051	823	869
Prepaid expenses and other	892	569	414
Current assets of discontinued operations <i>(note 22)</i>	–	–	39
TOTAL CURRENT ASSETS	14,499	4,720	5,553
Property, plant and equipment <i>(note 6)</i>	3,120	3,216	2,790
Assets held for sale <i>(note 7)</i>	–	2,321	2,245
TOTAL ASSETS	17,619	10,257	10,588
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)			
CURRENT			
Accounts payable and accrued liabilities	3,008	3,809	5,921
Short term loan <i>(note 9)</i>	557	2,041	1,806
Deferred revenue <i>(note 10)</i>	1,352	879	–
Current portion of long term debt and capital lease obligations <i>(note 11)</i>	677	1,324	665
Current liabilities of discontinued operations <i>(note 22)</i>	–	–	9
TOTAL CURRENT LIABILITIES	5,594	8,053	8,401
Deferred revenue <i>(note 10)</i>	6,552	4,465	–
Long term debt and capital lease obligations <i>(note 11)</i>	337	1,035	1,766
Debentures <i>(note 12)</i>	1,999	1,158	898
TOTAL LIABILITIES	14,482	14,711	11,065
SHAREHOLDERS' EQUITY (DEFICIENCY)			
Common shares <i>(note 13)</i>	165,400	145,404	144,588
Warrants <i>(note 14)</i>	9,402	9,720	9,720
Contributed surplus <i>(note 15)</i>	4,885	3,957	3,127
Cumulative translation adjustment	114	114	114
Deficit	(176,664)	(163,649)	(158,026)
TOTAL SHAREHOLDERS' EQUITY (DEFICIENCY)	3,137	(4,454)	(477)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)	17,619	10,257	10,588

See accompanying notes.

On behalf of the Board:



Director



Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

<i>(thousands of Canadian dollars except per share amounts)</i>	Year ended December 31, 2006	Seven-months ended December 31, 2005	Year ended May 31, 2005
	\$	\$	\$
REVENUE			
Product and research contract revenue	3,459	3,226	10,112
Revenue allocation	–	(518)	(2,913)
Licensing fees <i>(note 10)</i>	789	192	–
	4,248	2,900	7,199
EXPENSES			
Cost of goods sold	1,927	1,025	1,718
Research and development <i>(note 25)</i>	6,618	4,122	5,991
Selling, general and administrative expenses	6,900	4,096	10,574
Stock-based compensation <i>(note 16)</i>	1,235	839	957
Amortization of property, plant, and equipment	786	290	571
Foreign currency (gain) loss	89	(301)	(2,066)
Interest, net <i>(note 18)</i>	786	773	1,072
	18,341	10,844	18,817
LOSS FROM OPERATIONS	(14,093)	(7,944)	(11,618)
Gain on sale of assets <i>(note 7)</i>	947	–	–
Restructuring (costs) recovery <i>(note 19)</i>	86	101	(5,740)
Impairment charges <i>(notes 7 and 8)</i>	(135)	–	(15,488)
Gain on sale of subsidiary <i>(note 20)</i>	–	1,956	–
Gain on debt settlements <i>(note 21)</i>	–	–	4,137
Amortization of intangibles <i>(note 8)</i>	–	–	(1,135)
LOSS FROM CONTINUING OPERATIONS	(13,195)	(5,887)	(29,844)
NET INCOME FROM DISCONTINUED OPERATIONS <i>(note 22)</i>	180	264	38
NET LOSS	(13,015)	(5,623)	(29,806)
Deficit, beginning of period	(163,649)	(158,026)	(141,383)
Retroactive adjustment for stock-based compensation <i>(note 16)</i>	–	–	(2,143)
Accretion of acquisition commitments <i>(note 23)</i>	–	–	(7,551)
Gain on restructuring acquisition commitments <i>(note 23)</i>	–	–	22,857
DEFICIT, END OF PERIOD	(176,664)	(163,649)	(158,026)
Net income (loss) per common share from <i>(note 17):</i>			
continuing operations – basic and diluted	\$(0.09)	\$(0.05)	\$(0.14)
discontinued operations – basic and diluted	0.00	0.00	0.00
Net loss per common share – basic and diluted	\$(0.09)	\$(0.05)	\$(0.14)

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(thousands of Canadian dollars)</i>	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
OPERATING ACTIVITIES – continuing operations			
Net loss	(13,195)	(5,887)	(29,844)
Items not involving current cash flows:			
Amortization	786	290	1,706
Deferred revenue recognized	(1,015)	(192)	–
Stock-based compensation and payments <i>(note 16)</i>	1,297	939	957
Accretion of interest on debentures <i>(note 12)</i>	569	272	261
Impairment charges <i>(notes 7 and 8)</i>	135	–	15,488
Loss (gain) on disposal of property, plant & equipment	(947)	–	3,758
Gain on sale of subsidiary <i>(note 20)</i>	–	(1,956)	–
Non-cash foreign exchange gain on acquisition commitments <i>(note 23)</i>	–	–	(1,982)
Gain on debt settlements <i>(note 21)</i>	–	–	(4,137)
Other	16	–	–
Net change in non-cash working capital balances <i>(note 24)</i>	(1,535)	(1,712)	2,036
CASH USED IN OPERATING ACTIVITIES – continuing operations	(13,889)	(8,246)	(11,757)
INVESTING ACTIVITIES – continuing operations			
Acquisition of fqubed, Inc. <i>(note 3)</i>	–	(51)	–
Acquisition of property, plant and equipment	(593)	(11)	(97)
Proceeds from disposal of property, plant & equipment	2,758	28	63
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES – continuing operations	2,165	(34)	(34)
FINANCING ACTIVITIES – continuing operations			
Issuance of common shares, net of related costs <i>(note 13)</i>	18,581	–	3,766
Issue of debentures, net of related costs <i>(note 12)</i>	1,000	–	11,191
Proceeds from license and supply agreements <i>(note 10)</i>	3,500	5,500	–
Repayment of short term loan <i>(note 9)</i>	(1,598)	–	–
Repayments of long term debt and capital lease obligations	(1,492)	(26)	(26)
Proceeds on sale of subsidiary <i>(note 20)</i>	–	1,956	–
CASH PROVIDED BY FINANCING ACTIVITIES – continuing operations	19,991	7,430	14,931
Cash flow provided by discontinued operations	175	358	32
Effect of exchange rate changes on cash and cash equivalents	55	(210)	(170)
Net increase (decrease) in cash and cash equivalents during the period	8,497	(702)	3,002
Cash and cash equivalents, beginning of period	2,716	3,418	416
CASH AND CASH EQUIVALENTS, END OF PERIOD	11,213	2,716	3,418
Interest paid	451	241	755

See accompanying notes, including note 16 regarding non-cash transactions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

1. NATURE OF BUSINESS AND GOING CONCERN ASSUMPTION

The Company is a publicly traded Canadian pharmaceutical company with manufacturing operations. The Company is focused on two platforms: transdermal drug delivery and immune system modulation.

Transdermal Drug Delivery

The Company's original transdermal drug delivery technology facilitates site-specific therapeutics that are delivered topically, (through-the-skin) using the Company's skin-penetrating technologies. Pennsaid®, the first product utilizing this technology, targeting osteoarthritis, has completed the development stage and commercial activities are underway in Canada and Europe.

Immune System Modulation

The Company's immune system modulation technology is based on a proprietary chlorite solution named WF10. The Corporation has commenced a Phase II clinical trial in an effort to demonstrate the efficacy of WF10 in combination with Xeloda® (capecitabine) in the treatment of pancreatic cancer.

Corporate Name Change

On September 21, 2005 shareholders of the Company approved a name change for the Company from Dimethaid Research Inc. to Nuvo Research Inc.

Going Concern

These consolidated financial statements have been prepared on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. At December 31, 2006 the Company has an accumulated deficit of \$176,664 including a loss of \$13,015 in 2006. The Company's ability to continue as a going concern depends on its ability to secure additional licensing fees, secure co-development agreements, obtain additional capital and ultimately achieve profitable operations.

These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Management has prepared these consolidated financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") which are presented in Canadian dollars on a basis consistent with prior years, except as described in this note under the subheadings: Change in Year End and Property, Plant and Equipment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Basis of Consolidation

These consolidated financial statements include the accounts of the Company and all of its subsidiaries the most significant of which are as follows:

	% Ownership			
	December 31, 2006	December 31, 2005	May 31, 2005	
Dimethaid Manufacturing Inc.	100%	100%	100%	
Dimethaid Management Inc.	100%	100%	100%	
Dimethaid International Inc. and its subsidiaries: Dimethaid (UK) Ltd.; and, Dimethaid SV Inc.	100%	100%	100%	
Dimethaid Immunology Inc.	100%	100%	100%	
Dimethaid AG and its subsidiary Dimethaid GmbH	60%	60%	60%	
fqubed, Inc.	100%	100%	0%	Acquired December 2005
Akorn Pharmaceuticals Canada Limited (operating as Dioptic Laboratories)	100%	100%	100%	Operations sold October 2005 (classified as discontinued operations)
Dimethaid Health Care Ltd.	0%	0%	100%	Shares sold August 2005

All significant inter-company balances and transactions have been eliminated.

Change in Year End

Effective December 31, 2005, the Company changed its financial reporting year end from May 31 to December 31.

Use of Estimates

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include only highly liquid investments with original maturities of three months or less. Cost approximates fair value.

Inventories

Inventory is comprised of raw materials, work-in-process and finished goods. Raw materials are stated at the lower of cost and replacement cost with cost determined on a first-in, first-out basis. Manufactured inventory (finished goods and work-in-process) are valued at the lower of cost and net realizable value. Cost includes the cost of raw materials, direct labour and the application of attributable overheads.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Assets acquired under capital leases are carried at cost that is the present value of minimum lease payments after deduction of any executory costs.

Amortization of property, plant and equipment is provided for over the estimated useful lives from the date the asset becomes available for use as follows:

		For the year ending December 31, 2006		For the periods ending May 31, 2005 and December 31, 2005
Buildings	10 to 25 years	Straight-line	10 to 25 years	Straight-line
Leasehold improvements	Term of lease	Straight-line	Term of lease	Straight-line
Furniture and fixtures	5 years	Straight-line	20%	Declining balance
Computer equipment	3 years	Straight-line	30%	Declining balance
Computer software	1 to 3 years	Straight-line	1 to 3 years	Straight-line
Production, laboratory and other equipment	3 to 5 years	Straight-line	20%	Declining balance

On January 1, 2006, the Company re-evaluated the amortization period and method used for all classes of property, plant and equipment. The Company determined that straight-line amortization is most appropriate for all asset classes and changed the method of amortization on a prospective basis for those categories of property, plant and equipment that were previously amortized on a declining balance basis. The impact of this change was incremental amortization expense of \$48 for the year ended December 31, 2006.

Intangibles

Acquired technology is considered to have a finite life and is amortized on a straight-line basis over its estimated useful life, ranging from eleven to fifteen years.

Goodwill represents the excess of the cost of an acquired enterprise over the net amounts assigned to assets acquired and liabilities assumed less any subsequent writedowns for impairment. Goodwill is subject to an annual impairment test using a fair value test. Goodwill impairment is evaluated between annual tests upon the occurrence of certain events or circumstances.

Impairment of Long-lived Assets

Long-lived assets are comprised of property, plant and equipment and intangibles subject to amortization. The Company reviews the carrying value of long-lived assets for potential impairment when there is evidence that events or changes in circumstances exist that indicate the carrying value might not be recoverable. The recoverability of long-lived assets is determined by evaluating whether the carrying value of such assets can be recovered from estimated undiscounted future operating cash flows. When an asset is impaired, according to the foregoing test, an impairment loss is measured and recognized as the excess of the carrying value of the asset over its fair value.

Leases

Leases are classified as either capital or operating. Those leases which transfer substantially all the benefits and risks of ownership of property to the Company are accounted for as capital leases. The capitalized lease obligation reflects the present value of future lease payments, discounted at the appropriate interest rate. Assets under capital leases are amortized based on the useful life of the asset. All other leases are accounted for as operating with rental payments being expensed as incurred.

Revenue Recognition

The Company recognizes revenue from research and development contracts and licensing arrangements which may include multiple elements. Revenue arrangements with multiple elements are reviewed in order to determine whether the multiple elements can be divided into separate units of accounting, if certain criteria are met. If separable, the consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. If not separable, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Product sales are recognized as revenue upon delivery of the product and transfer of title to the customer provided the price is fixed and determinable and collection is reasonably assured. Revenue from product sales is recognized net of reserves for estimated sales discounts and allowances, returns, rebates charge backs and revenue allocated to third parties under co-promotion agreements.

Up-front fees received in accordance with the sale of distribution rights, supply agreements and licensing rights are deferred and amortized into income on a systematic basis based upon the terms of the contractual arrangement. Amounts the Company expects to earn in the current year are included in the current portion of deferred revenue and amounts expected to be earned in subsequent periods are included in deferred revenue.

Revenues from research contracts are generally recognized on a percentage-of-completion basis. The percentage-of-completion for each contract is generally determined based on the proportion of accumulated project time incurred compared to the total anticipated time to complete the project. Amounts received in advance of recognition are included in deferred revenue.

Research and Development

Research costs, other than capital expenditures, are charged to operations as incurred. Development expenses are charged to operations as incurred unless such costs meet Canadian GAAP criteria for deferral and amortization. No development costs have been deferred to date.

Government Assistance

Government assistance received under incentive programs, including investment tax credits, for qualifying research and development activities is accounted for using the cost reduction method, whereby they are netted against the related expense or capital expenditure to which they relate when there is reasonable assurance that the credits will be realized.

Foreign Currency Translation

Transactions undertaken in foreign currencies are translated into an entities functional currency at exchange rates prevailing at the time the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency of the entity at the exchange rate prevailing on the Consolidated Balance Sheet dates. Non-monetary assets and liabilities are translated at historical exchange rates. Exchange gains and losses are included in the Consolidated Statements of Loss.

All subsidiaries are considered to be integrated operations and are translated into Canadian dollars using the temporal method; consequently all monetary assets and liabilities are remeasured at the exchange rate prevailing at the Consolidated Balance Sheet dates. Non-monetary assets and liabilities are measured at historical exchange rates. Revenue and expense items are measured at the average rate of exchange in effect during the period in which they occur, except for amortization expense which is measured at the historic exchange rate of the applicable asset. Resulting gains and losses are included in the Consolidated Statements of Loss.

Net Loss Per Common Share

Basic net loss per common share is calculated using the weighted average number of common shares outstanding during the year.

Diluted net loss per common share is calculated assuming the weighted average number of common shares outstanding during the year is increased to include the number of additional common shares that would have been outstanding if the dilutive potential shares had been issued. The dilutive effect of warrants and stock options is determined using the treasury stock method. The dilutive effect of convertible securities is determined using the "if-converted" method. Unvested, forfeitable options granted to non-employees are excluded when determining the dilutive potential shares.

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws expected to apply when the asset is realized or the liability settled. A valuation allowance is provided against the future tax assets to the extent that it is more likely than not that the assets will not be realized.

Stock-based Compensation and Other Stock-based Payments

The Company has three stock-based compensation plans: the Share Option Plan; the Share Purchase Plan; and, the Share Bonus Plan, as described in Note 16. The Company measures and recognizes compensation expense based on the fair-value of the common shares or options issued.

Under the Share Option Plan, the fair value of an option is estimated on the date of the grant using the Black-Scholes option pricing model and is amortized as compensation expense over the vesting period. These expenses are included in stock-based compensation expense and credited to contributed surplus. When options are exercised, the proceeds received by the Company, together with the fair value amount in contributed surplus, are credited to common shares. Share options issued to non-employees are recorded as an expense at their fair value on the date they are earned.

Under the Share Purchase Plan, consideration paid by employees on the purchase of common shares is credited to common shares when the shares are issued. The fair value of the Company's matching contribution, determined based upon the trading price of the common shares, is recorded as compensation expense. These expenses are included in stock-based compensation expense and credited to common shares.

Under the Share Bonus Plan, the fair value of the direct award of common shares, determined based upon the trading price of the common shares, is recorded as compensation expense. These expenses are included in stock-based compensation expense and credited to common shares.

3. ACQUISITION

fqubed, Inc.

On December 21, 2005, the Company acquired all of the common shares of fqubed, Inc. ("fqubed"), based in San Diego, California. In cooperation with the University of California, San Francisco, fqubed developed a proprietary technology to identify innovative formulations that can efficiently deliver active therapeutics through the skin. Nuvo is using this technology to expand its pipeline of transdermally delivered therapeutics.

Nuvo completed the acquisition for total consideration of \$745, including transactions costs of \$51. The Company issued 4,339,875 common shares from treasury in satisfaction of \$694 (US\$600) of the purchase price. The results of fqubed's operations have been included in the Company's consolidated financial statements since December 21, 2005, the date of acquisition. The acquisition was accounted for using the purchase method and the net effect on the Company's Consolidated Balance Sheet upon acquisition was as follows:

	\$
Current assets	46
Laboratory, computer and other equipment	861
Current liabilities	(162)
	745
<hr/>	
Consideration represented by:	\$
Cash	51
Common shares issued	694
	745

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Nuvo is also obligated to pay royalties to the former fubed shareholders subject to a maximum of US\$1.0 million for pharmaceutical products and US\$3.0 million for non-pharmaceutical products based on future sales of yet to be developed transdermal products that use specifically identified formulations developed by fubed prior to the closing date. No amounts have been earned to date.

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include \$77 in term deposits that are posted as collateral against long term debt (see note 11 – “Long term debt – Mortgage”) and \$110 in guaranteed investment certificates that are posted as collateral against certain accounts payable.

5. INVENTORIES

Inventories consist of the following as at:

	December 31, 2006	December 31, 2005	May 31, 2005
	\$	\$	\$
Raw materials	423	284	356
Work in process	486	305	288
Finished goods	142	234	225
	1,051	823	869

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	As at December 31, 2006		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Land	124	–	124
Buildings	2,105	766	1,339
Leasehold improvements	122	20	102
Furniture and fixtures	240	82	158
Computer equipment	320	206	114
Computer software	257	135	122
Production, laboratory and other equipment ⁰	2,632	1,471	1,161
	5,800	2,680	3,120

	As at December 31, 2005		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Land	124	–	124
Buildings	2,088	619	1,469
Leasehold improvements	8	8	–
Furniture and fixtures	85	57	28
Computer equipment	247	140	107
Computer software	151	84	67
Production, laboratory and other equipment	2,412	991	1,421
	5,115	1,899	3,216

	As at May 31, 2005		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Land	124	–	124
Buildings	2,095	535	1,560
Leasehold improvements	8	8	–
Furniture and fixtures	201	59	142
Computer equipment	236	118	118
Computer software	158	25	133
Production, laboratory and other equipment	1,652	939	713
	4,474	1,684	2,790

(i) Production, laboratory and other equipment at December 31, 2006 includes cost of \$96 and accumulated amortization of \$8 for assets under capital leases [December 31, 2005 and May 31, 2005 – \$nil]. Amortization of property, plant and equipment for the year ended December 31, 2006 includes \$8 related to assets under capital leases [seven-months ended December 31, 2005 and year ended May 31, 2005 – \$nil]

7. ASSETS HELD FOR SALE

Assets held for sale are as follows as at:

	December 31, 2006	December 31, 2005	May 31, 2005
	\$	\$	\$
Land	–	600	600
Buildings	–	1,600	1,600
Other	–	121	45
Total	–	2,321	2,245

Assets are presented as held for sale if they meet the criteria to be classified as such under CICA 3475 “Disposal of Long-Lived Assets and Discontinued Operations”. Such assets are carried at the lower of carrying value and fair value less costs to sell.

As at May 31, 2005 and December 31, 2005 the Company had two properties “held for sale”, its head office in Markham, Ontario and an unutilized property located in Varennes, Quebec. The Varennes property was classified as “held for sale” subsequent to October 2004 when the Company decided not to complete an expansion project at its manufacturing facility and subsequently listed this property and on-site materials for sale. This facility was never operational and the main manufacturing plant has adequate capacity for forecasted demand. The head office property was classified as “held for sale” when it was listed for sale in 2005 subsequent to a reduction in head office staff and the elimination of the Company’s Canadian sales force that significantly reduced space requirements.

On January 6, 2006 the Company sold its head office for \$2,744, net of commissions and closing costs. Net book value was \$1,797, resulting in a gain on disposal of \$947. On closing, US\$1,370 (CDN\$1,598) was paid into escrow to discharge the mortgage on the property (see note 31) and \$45 was retained by the purchaser to cover the leaseback of the office until March 31, 2006. The resulting net cash proceeds to the Company were \$1,090. The Company subsequently moved its head office to leased premises in Mississauga.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

In the first half of 2006 the Company received a conditional offer to purchase the property located in Varennes that was lower than the carrying value. After assessing the offer and the current market conditions, a further impairment charge of \$135 was recorded to reduce the carrying value to the expected net realizable value. On October 31, 2006 the Company sold its property in Varennes for \$389 net of commissions and closing costs, its approximate carrying value. The agreement of purchase and sale required \$50 to be paid on closing with the balance of \$375 due within one year. The purchaser posted an irrevocable letter of credit in favour of the Company to support the obligation.

8. INTANGIBLES

Intangibles consist of:

	As at December 31, 2006 and 2005 and May 31, 2005			
	Cost \$	Accumulated amortization \$	Accumulated write-down \$	Net book value \$
Acquired technology	26,812	5,346	21,466	-
Goodwill	445	-	445	-
	27,257	5,346	21,911	-

All of the technology and goodwill was acquired through the acquisition of Switzerland based Dimethaid AG (formerly Oxo Chemie AG) and was originally valued based on the purchase method of accounting for acquisitions.

In May 2005 a review of the Company's drug development plan for WF10 determined there were more promising indications for WF10 than its use in treating HIV/AIDS. While the Company had commenced development focused on some of these other indications, it was unable to determine their potential. As the original value of the intangibles was attributed to the potential of WF10 to treat HIV/AIDS and no development was being done with HIV/AIDSs, the Company wrote off \$15,365 of acquired technology and \$123 of goodwill resulting in a total charge of \$15,488 to continuing operations for the fiscal year ended May 31, 2005.

9. SHORT TERM LOAN

The following is a continuity schedule of the short term loan:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Balance, beginning of period	2,041	1,806	1,962
Accrued interest expense	105	243	431
Interest payments	-	-	(336)
Payment into escrow	(1,598)	-	-
Foreign currency loss (gain)	9	(8)	(251)
Balance, end of period	557	2,041	1,806

The Company's short term loan from Leadenhall Bank & Trust Company Limited ("Leadenhall") was originally extended to the Company in July 2003. The original terms of the \$2.0 million loan were for interest to accrue at 2% per month and for full repayment to occur on May 31, 2004. The repayment date was extended on two occasions; first to September 30, 2004 and subsequently to February 28, 2005. The loan was collateralized by a subsidiary of the Company through a CDN\$ 2.0 million mortgage charge on the Company's Markham head office. In March 2005, the Company took the position that there were a number of deficiencies relating to the loan and that no interest or a lesser amount of interest was payable and ceased making payments of interest or principal on the mortgage. Leadenhall commenced legal action in April 2005 as fully discussed in note 31, "Contingencies and Other Matters". Leadenhall subsequently entered receivership and is being run by a court appointed liquidator in the Bahamas.

In January 2006, in order to facilitate the sale of the building the liquidator and the Company reached an agreement whereby the Company paid \$1,598 into escrow, and the liquidator discharged the mortgage.

10. DEFERRED REVENUE

Deferred revenue is as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Balance, beginning of period	5,344	-	-
Upfront payments from Squire Pharmaceuticals Inc.	3,500	5,500	-
Advances on research contracts not recognized in the period received	85	36	-
	8,929	5,536	-
<i>less:</i>			
Amortization of license and supply agreements	789	192	-
Delivery of promotional goods under supply agreement	200	-	-
Recognition of prior year research contract revenue	36	-	-
	7,904	5,344	-
Amount to be recognized within one year	1,352	879	-
Balance, end of period	6,552	4,465	-

Upfront Payments from Squire Pharmaceuticals Inc.

Dimethaid Health Care Ltd. ("DHCL") was a wholly owned subsidiary of the Company until it was sold to Paladin Labs Inc. ("Paladin") on August 16, 2005 as described in note 20. Subsequent to the acquisition by Paladin, DHCL was renamed Squire Pharmaceuticals Inc. ("Squire").

As fully described in note 20, on August 16, 2005 the Company received \$5,500 upon the sale of a license to market Pennsaid in Canada, an agreement to supply Pennsaid for the Canadian market and a share in future operating profits above specified targets. The Company recorded the payment as deferred revenue, \$4,900 to be earned over the term of the license and supply agreements, which run to February 2014, and \$600 to be earned from the supply of promotional goods over a three year period ending August 31, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

On January 16, 2006 the Company and Squire entered into an agreement which expanded their relationship with respect to the sale and marketing of Pennsaid in Canada. The terms of this expanded agreement included Squire making an up-front payment of \$3,250, providing an additional share of future operating profits, future royalties on the sales of Pennsaid commencing in 2010 and an investment of \$500 in Nuvo through a three-year convertible debenture (see note 12). The Company has provided certain guarantees of the ongoing market performance of Pennsaid in the Canadian market over a four year period, which could require payments to be made if certain targets are not met. The first interim measurement date will occur in 2007. The Company's debenture and performance obligations are collateralized by revenue from Pennsaid sales in Europe, a second mortgage over Nuvo's manufacturing facility in Quebec, a second charge on all manufacturing assets in Quebec and all Pennsaid inventory and receivables as well as all intellectual property rights required to manufacture and market Pennsaid in Canada.

On December 22, 2006 Squire exercised its option to acquire a license from the Company to market and sell Pennsaid Plus in Canada which it obtained as part of the January 16, 2006 transaction. Pennsaid Plus is a follow-on product to Pennsaid. The Pennsaid Plus License includes an up-front payment of \$250, royalties on future Canadian sales of Pennsaid Plus and a potential milestone payment. As part of the licensing arrangement, Squire has also invested \$500 in Nuvo through a three-year convertible debenture (see note 12). If specific milestones are not achieved by May 2008, the up-front payment must be returned to Squire.

11. LONG TERM DEBT AND CAPITAL LEASE OBLIGATIONS

Long term debt and capital lease obligations consist of the following as at:

	December 31, 2006	December 31, 2005	May 31, 2005
	\$	\$	\$
Government debt	511	1,602	1,602
Mortgage	418	494	580
Shareholder loan	-	263	249
Capital lease obligations	85	-	-
	1,014	2,359	2,431
Less amounts due within one year	677	1,324	665
Balance, end of period	337	1,035	1,766

Government Debt

The loan from Investissement Quebec ("IQ") is collateralized by a first mortgage on the Varennes facility. Interest is based on the variable rate set by IQ plus 2% per annum, 9.5% at December 31, 2006, and matures in June 2007. Prior to October 2006, the loan had also been collateralized by a mortgage on the second Varennes facility that was sold. In order to facilitate the release of IQ's mortgage on this property the Company agreed to make an additional principal repayment of \$103 concurrent with closing of the sale. The term of the loan remains unchanged such that the seven remaining equal monthly installments of principal and interest have been reduced to \$73 (previously \$84).

Mortgage

The mortgage of EURO 272 [December 31, 2005 – EURO 358, May 31, 2005 – EURO 376] is collateralized by the plant, equipment and inventory of the Company's subsidiary located in Wanzleben, Germany. Interest is fixed at 6.0% per annum, payable quarterly. Principal is repayable in the amount of EURO 67 (CDN\$ 103) in March 2007 and thereafter in nine equal semi-annual installments of EURO 23 (CDN\$ 35) with the loan maturing in 2011. In addition, as a result of an agreement reached with the lender to resolve certain alleged defaults under subjective clauses contained in the mortgage, the Company agreed to place cash collateral of EURO 50 (CDN\$ 77) in an interest bearing account with the lender as at December 31, 2006 and to increase this collateral to EURO 100 in March 2007.

Shareholder Loan

The shareholder loan from Dr. Kühne, the former principal of Oxo Chemie AG, was repaid during 2006. The \$674 loan was originally provided in October 2004 bearing interest at a rate of 6 percent per annum. In January 2005, the Company issued 1,000,000 common shares to Dr. Kühne at a price of \$0.425 per share to settle \$425 of this loan.

Capital Lease Obligations

The Company leases lab and office equipment under capital leases expiring at various dates through May 2011, for which the minimum future lease payments are as follows for the years ending December 31:

	\$
2007	36
2008	36
2009	24
2010	3
2011	1
Total minimum lease payments	100
Less: amount representing interest (approximately 9.9%)	15
Present value of minimum lease payments	85
Current portion of capital lease obligations	28
	57

Interest paid on capital lease obligations amounted to \$3 for the year ended December 31, 2006 [seven-months ended December 31, 2005 and year ended May 31, 2005 – \$nil].

Principal Repayments

Aggregate maturities of long term debt and capital lease obligations are estimated to be as follows for the years ending December 31:

	\$
2007	677
2008	102
2009	92
2010	73
2011	70
	1,014

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Unless noted otherwise all amounts shown are in thousands of Canadian dollars

12. DEBENTURES

The following table summarizes the debentures outstanding as at:

	Face Value Outstanding as at December 31, 2006 \$	Carrying Value		
		December 31, 2006 \$	December 31, 2005 \$	May 31, 2005 \$
November 2004 Unsecured Convertible Debentures, interest payable semi-annually at 5%, maturing November 2009, convertible into common shares at \$0.30 or \$0.39 ⁽ⁱ⁾	4,136	1,341	1,158	898
January 2006 Convertible Debenture, interest payable semi-annually at 8%, maturing January 2009, collateralized and convertible into common shares at \$0.456 ⁽ⁱⁱ⁾	158	158	–	–
December 2006 Convertible Debenture, interest payable semi-annually at 8%, maturing December 2009, collateralized and convertible into common shares at \$0.60 ⁽ⁱⁱⁱ⁾	500	500	–	–
	4,794	1,999	1,158	898

- (i) On November 16, 2004 the Company completed the sale of 12,800 units at a price of \$1,000 each, providing \$11.2 million in net proceeds. An additional 4,000 units were issued to Dr. F.W. Kühne to satisfy obligations arising from the May 2002 purchase of Oxo Chemie AG (see note 23). Each unit consisted of one 5% convertible, unsecured debenture in the principal amount of \$1,000, maturing on November 16, 2009, plus 1,667 common share purchase warrants (see note 14). The Company may elect to pay interest in either cash or in Nuvo common shares. At any time prior to maturity, holders other than Dimethaid directors or officers may convert debentures into common shares at a price of \$0.30 per share (for directors and officers, the conversion price is \$0.39 per share). Each warrant allows holders to acquire, at no additional charge, one common share at an exercise price of \$0.45 until November 16, 2007, or \$0.48 until November 16, 2009. Subsequent to November 16, 2007, if the trading price of the Company's common shares equals or exceeds 125% of the conversion price the Corporation may redeem the debentures for 102% of the face value plus accrued and unpaid interest. Total warrants issued were 34,367,565 including 6,361,965 warrants issued to the underwriters. The estimated fair value of the warrants, \$9,482, was determined using the Black-Scholes option pricing model. The debentures were recorded at fair value using an implicit discount rate of 45% and are being accreted up to their maturity value through charges to the Consolidated Statements of Loss and Deficit as shown in the table below.
- (ii) On January 16, 2006, Squire purchased a \$500 debenture as part of a transaction described in note 12. The Company may elect to pay interest in either cash or in Nuvo common shares based on the weighted average trading price for the previous ten trading days. If the weighted average trading price of the Company's common shares exceeds \$0.912 per share for ten trading days the Company is entitled to call the debentures for early redemption. The debenture is collateralized by revenue from Pennsaid sales in Europe, a second mortgage over Nuvo's manufacturing facility in Quebec, a second charge on all manufacturing assets in Quebec and all Pennsaid inventory and receivables as well as all intellectual property rights required to manufacture and market Pennsaid in Canada.
- (iii) On December 22, 2006 Squire purchased an additional \$500 debenture in a separate transaction described in note 12. The Company may elect to pay interest in either cash or in Nuvo common shares based on the weighted average trading price for the previous ten trading days. If the weighted average trading price of the Company's common shares exceeds \$1.20 per share for ten trading days the Company is entitled to call the debentures for early redemption. If the Company fails to achieve a specific milestone by May 21, 2008 the holder has the right to demand immediate repayment of the debenture. The collateral is identical to that provided for the January 2006 Convertible debenture.

The following is a continuity schedule of the debentures outstanding:

	Common shares issuable upon conversion (000s)	Carrying value \$	Value at maturity \$
Issuance in November 2004	55,615	2,020	16,800
Converted to shares	(37,417)	(1,383)	(11,225)
Accretion charged to interest expense		261	
Balance, May 31, 2005	18,198	898	5,575
Converted to shares	(250)	(12)	(75)
Accretion charged to interest expense		272	
Balance, December 31, 2005	17,948	1,158	5,500
Converted to shares	(5,296)	(728)	(1,706)
Issuances in 2006	1,930	1,000	1,000
Accretion charged to interest expense		569	
Balance, December 31, 2006	14,582	1,999	4,794

Subsequent to December 31, 2006 Squire converted the remaining outstanding balance of the January 2006 Convertible Debenture into common shares.

13. CAPITAL STOCK

Authorized

Unlimited first and second preferred shares, issuable in series
Unlimited common shares

Preferred Shares

There were no outstanding preferred shares as at December 31, 2006 or 2005 or May 31, 2005. Preferred Shares may be issued from time to time in one or more series. The number of shares, designation, rights, privileges, restrictions and conditions are determinable by the Company's Board of Directors. Preferred Shares are entitled to priority over the common shares with respect to the payment of dividends and distributions in the event of the dissolution, liquidation or winding-up of the Company. Except as required by law or the provisions of any series, the holders of Preferred Shares as a class are not entitled to receive notice of, attend or vote at any meeting of common shareholders of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Common Shares

The following is a continuity schedule of the common shares outstanding:

	Number of shares (000's)	Consideration \$
Balance, May 31, 2004	75,968	135,369
Issued pursuant to June 2004 Special Warrant Private Placement ⁽ⁱ⁾	7,285	3,386
Warrants exercised (note 14)	75	62
Debentures converted into shares (note 12)	37,417	5,047
Issued in settlement of shareholder loan (note 11)	1,000	425
Employee contributions to share purchase plan (note 16)	288	106
Cost of employer's portion of share purchase plan (note 16)	287	106
Directors fees settled in shares (note 16)	193	87
Balance, May 31, 2005	122,513	144,588
Debentures converted to shares (note 12)	250	13
Issued to acquire fqubed (note 3)	4,340	694
Professional fees settled in shares (note 16)	605	109
Balance, December 31, 2005	127,708	145,404
Issued pursuant to June 2006 Bought Deal ⁽ⁱⁱ⁾	37,500	11,513
Debentures converted to shares (note 12)	5,296	728
Warrants exercised (note 14)	10,727	6,957
Options exercised (note 16)	200	66
Professional fees settled in shares (note 16)	132	62
Employee contributions to share purchase plan (note 16)	868	335
Cost of employer's portion of share purchase plan (note 16)	868	335
Balance, December 31, 2006	183,299	165,400

(i) On June 10, 2004, the Company completed the June 2004 Special Warrant Private Placement financing, raising \$3,386 in net proceeds on the issuance of 7,285,341 special warrants at \$0.58 each. In July 2004, these special warrants were converted into 7,285,341 common shares and 7,285,341 common share warrants under the terms of the private placement. The common share warrants have a three-year life and an exercise price of \$0.73. As part of the transaction, an additional 364,268 compensation warrants were issued to the underwriters. The underwriter warrants had a two year life and an exercise price of \$ 0.58.

(ii) On June 20, 2006, the Company closed a bought deal equity financing (the "June 2006 Bought Deal"). At closing, a total of 37.5 million units ("Units") were issued at a price of \$0.40 per Unit for gross proceeds of \$15 million. Each Unit consisted of one common share and one-third of one common share purchase warrant of the Company, each whole warrant entitling the holder thereof to acquire one common share at a price of \$0.50 per share until June 20, 2009. Once expenses associated with the financing were deducted, including an underwriting fee of 5.75%, net cash proceeds were \$13,720. The warrants, including Underwriter Warrants (see note 14), were fair valued using the Black-Scholes option pricing model. Consequently, \$2,207 of the cash proceeds are allocated to the warrants and the balance of \$11,513 is allocated to the common shares.

Shareholders' Rights Plan

On December 16, 1992 share purchase rights (the "rights") were issued to holders of common shares under a shareholders' rights plan (the "plan") and the Company was authorized to issue rights in respect of common shares issued subsequent to that date but prior to the tenth business day following the earlier of [i] the date of a public announcement that a person has acquired 20% or more of the voting shares of the Company, or [ii] the date of commencement, or first public announcement, of the intent of any person to commence a takeover bid that would result in such a person owning 20% of the voting shares of the Company. Following the occurrence of the above, the rights will trade separately from the common shares and following the occurrence of certain takeover events described in the plan, each right will entitle the holder thereof to purchase from the Company common shares of the Company at a 50% discount to the market price. The plan was amended on August 12, 1998, and approved for a period of five years by the shareholders on October 22, 1998. A renewal of this plan was approved by the shareholders on October 21, 2003 under the same terms and is effective until 2008.

14. WARRANTS

The following is a continuity schedule of the warrants outstanding:

	Number of warrants (000's)	Exercise price \$	Fair value \$	Expiry date
Issued June 10, 2004 ⁽ⁱ⁾	7,285	0.73	185	June 10, 2007
Issued June 10, 2004 ⁽ⁱⁱ⁾	364	0.58	58	June 10, 2006
Issued November 16, 2004 ⁽ⁱⁱⁱ⁾	34,368	0.45 – 0.48	9,482	Nov 16, 2009
Exercised	(75)	0.68	(5)	
Balance, May 31, 2005 and December 31, 2005	41,942	0.50	9,720	
Issued June 20, 2006 ^(iv)	12,500	0.50	1,704	June 20, 2009
Underwriter Warrants issued June 20, 2006 ^(v)	2,156	0.40	503	June 20, 2008
Expired	(339)	0.58	(54)	
Exercised	(10,727)	0.43	(2,471)	
Balance, December 31, 2006	45,532	0.50	9,402	

- (i) Common share warrants issued pursuant to the June 2004 Special Warrant Private Placement (the “June 2004 Warrants”). (see note 13⁽ⁱ⁾)
- (ii) Underwriter warrants issued pursuant to the June 2004 Special Warrant Private Placement (the “June 2004 Underwriter Warrants”). (see note 13⁽ⁱⁱ⁾)
- (iii) Common share warrants issued pursuant to the November 2004 Unsecured Convertible Debenture Offering (the “November 2004 Warrants”). (see note 12). Under the terms of these warrants, if the trading price of the Company’s common shares exceeds \$2.50 for 20 consecutive days the Company has the right to call these warrants.
- (iv) Common share warrants issued pursuant to the June 2006 Bought Deal (the “June 2006 Warrants”). (see note 13^(iv))
- (v) Underwriter Warrants issued to the underwriters for services provided in conjunction with the June 2006 Bought Deal (the “June 2006 Underwriter Warrants”) are each exercisable into one Unit at a price of \$0.40 per Unit. Each Unit consists of one share and one-third of one common share purchase warrant of the Company, each whole warrant is exercisable under the terms described in note 13^(v)

The June 2004 Warrants were valued at the difference between the proceeds received from the sale of the special warrants and the TSX closing price of the common shares on June 10, 2004. The Company estimated the fair value of all other warrant issues using the Black-Scholes option pricing model. The fair value of the warrants and the assumptions used to determine fair value on the dates of issue were as follows:

	June 2004 Underwriter Warrants	November 2004 Warrants	June 2006 Warrants	June 2006 Underwriter Warrants
Expected option life (years)	2	5	1	1
Expected volatility	54%	133%	107%	107%
Risk-free interest rate	2.9%	4.8%	4.2%	4.2%
Fair value of warrants issued	\$0.16	\$0.34	\$0.15	\$0.23

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

On November 20, 2006 the Company announced a warrant incentive program (the “Incentive Program”) designed to encourage the early exercise of warrants. The Company amended the June 2004 Warrants, the November 2004 Warrants and the June 2006 Warrants so that upon payment of a reduced exercise price of \$0.60, \$0.40 and \$0.40, respectively, and surrender of the holder’s warrant in accordance with applicable procedures, the holder is entitled to receive one common share of Nuvo. The period to exercise warrants under the Incentive Program commenced December 11, 2006 and expired on January 31, 2007. If a warrant holder did not exercise his or her warrants prior to February 1, 2007, the warrants continue to be exercisable for common shares on the same terms as previously existed. At December 31, 2006 the warrants outstanding by tranche and the reduced exercise prices available under the Incentive Program are as follows:

	Expiry Date	Original Exercise Price \$	Incentive Program Exercise Price \$	Number of warrants (000's)
June 2004 Warrants	June 10, 2007	0.73	0.60	7,235
November 2004 Warrants	November 16, 2009	0.45	0.40	27,141
June 2006 Underwriter Warrants ^o	June 20, 2008	0.40	n/a	2,156
June 2006 Warrants	June 20, 2009	0.50	0.40	9,000
				45,532

(i) The June 2006 Underwriter Warrants were not eligible to participate in the Incentive Program.

Subsequent to December 31, 2006 an additional 12.7 million warrants were exercised under the Incentive Program resulting in proceeds of approximately \$5.2 million.

15. CONTRIBUTED SURPLUS

The following table summarizes the changes in the contributed surplus account:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Balance, beginning of period	3,957	3,127	220
Retroactive adjustment for stock-based compensation (note 2)	–	–	2,143
Compensation expense recognized on employee and director stock options	900	830	764
Employee and director stock options exercised	(26)	–	–
Warrants expired	54	–	–
Balance, end of period	4,885	3,957	3,127

16. STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

Under the Company’s Amended and Restated Share Incentive Plan there are three sub plans: the Share Purchase Plan, the Share Option Plan, and the Share Bonus Plan. The original plan was amended and restated effective September 21, 2005 when shareholders of the Company approved an amendment authorizing a maximum aggregate total of 15% of the Company’s outstanding common shares to be issued as options or shares under the plan allocated as follows to the three sub-plans: Share Option Plan 10%, Share Purchase Plan 3%, and Share Bonus Plan 2%.

Share Option Plan

Under the Share Option Plan the Company may grant options to purchase common shares to officers, directors, employees or consultants of the Company or its affiliates. Options issued under the Share Option Plan are granted for a term not exceeding ten years from the date of grant. All options issued to date have a life of either 5 or 10 years. In general, options have vested either immediately upon grant or over a period of one to three years. Under the provisions of the Plan the exercise price of all stock options shall not be less than the closing price of the common shares on the last trading date immediately preceding the grant date of the option.

As at December 31, 2006 the number of unoptioned shares available to be reserved was 4,952,176 [December 31, 2005 – 6,352,616 and May 31, 2005 – 1,098,717]. Any unexercised options that are surrendered, terminate or expire without being exercised become unoptioned and are available for reissuance under the Share Option Plan.

The following is a continuity schedule of the options outstanding:

	Number of options (000's)	Range of exercise price (\$)	Weighted average exercise price (\$)
Balance, May 31, 2004	2,590	1.08 – 5.95	3.82
Granted	5,116	0.30 – 0.57	0.34
Expired	(2,697)	0.31 – 5.95	3.14
Balance, May 31, 2005	5,009	0.30 – 5.95	0.63
Granted	10,525	0.18 – 0.20	0.20
Expired	(57)	0.57 – 5.95	3.35
Balance, December 31, 2005	15,477	0.18 – 5.95	0.33
Granted	1,583	0.37 – 0.39	0.38
Exercised	(200)	0.20	0.20
Expired	(183)	0.20 – 5.95	0.51
Balance, December 31, 2006	16,677	0.18 – 5.95	0.33

The following table summarizes the outstanding and exercisable options held by directors, officers, employees and consultants at December 31, 2006:

Exercise Price Range	Outstanding			Exercisable	
	Number of Options (000's)	Remaining contractual life (years)	Weighted average exercise price	Vested Options	Weighted average exercise price
\$0.18 – \$0.20	10,175	8.8	\$0.20	6,783	\$0.20
\$0.30 – \$0.39	6,029 ⁽ⁱ⁾	8.1	\$0.34	4,946	\$0.33
\$0.57	98	7.4	\$0.57	66	\$0.57
\$1.12 – \$5.95	375	4.6	\$3.78	375	\$3.78
	16,677	8.4	\$0.33	12,170	\$0.36

(i) Includes 600 options at \$0.385 with a remaining contractual life of 9.9 years granted to a consultant that are forfeitable and unvested.

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Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Effective June 1, 2004, the Company adopted the amended recommendations of the Canadian Institute of Chartered Accountants (CICA) handbook section 3870, "Stock-based Compensation and other Stock-based Payments." The amended standard requires recognition of all stock-based compensation transactions at fair value. The amended recommendations were applied retroactively to all employee stock options granted on or after June 1, 2002. Application of the recommendations resulted in a \$2,143 increase in the deficit on June 1, 2004 and an equivalent increase to contributed surplus. The adjustment represents the total compensation expense attributable to employee stock options granted on or after June 1, 2002 from their date of grant through May 31, 2004.

The Company determines compensation expense by estimating the fair value of stock options at the date of grant using the Black-Scholes option pricing model. The weighted average fair value of stock options granted during the period and the assumptions used to determine fair value on the dates of grant were as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Expected option life (years)	2	10	5 to 10
Expected volatility	104%	52 – 90%	54 – 93%
Risk-free interest rate	4.4%	3.7 – 3.9%	4.0 – 4.9%
Expected dividend yield	0%	0%	0%
Weighted average fair value of options granted	\$0.21	\$0.13	\$0.27

Share Purchase Plan

Under the Share Purchase Plan eligible officers, employees or consultants of the Company or its affiliates may contribute up to 10% of their annual base salary to the plan to purchase Nuvo common shares. The Company matches each participant's contribution by issuing Nuvo common shares having a value equal to the aggregate amount contributed by each participating employee. As at December 31, 2006 the number of shares available for issuance under this plan was 1,774,479 [December 31, 2005 – 3,511,211 and May 31, 2005 – 354,983].

During 2006, employees contributed \$335 [December 31, 2005 – \$nil, May 31, 2005 – \$106] to the plan and the Company matched these contributions by issuing 868,366 common shares [December 31, 2005 – nil, May 31, 2005 – 287,534] with a fair value of \$335 [December 31, 2005 – \$nil, May 31, 2005 – \$106] that was recorded as compensation expense. Total shares issued under this plan during the year ending December 31, 2006 were 1,736,732 [seven-months ended December 31, 2005 – nil and year ended May 31, 2005 – 575,068].

Share Bonus Plan

Under the Share Bonus the Company can issue common shares to eligible directors, officers or employees of the Company or its affiliates as a discretionary bonus. In addition, consultants are also eligible to receive common shares in lieu of cash compensation. As at December 31, 2006 the number of shares available for issuance under this plan was 2,950,895 [December 31, 2005 – 2,950,895 and May 31, 2005 – 62,765].

During the 2006, compensation expense of \$nil [seven-months ended December 31, 2005 – \$9 and year ended May 31, 2005 – \$87] was recorded under this Plan and no shares [seven-months ended December 31, 2005 – 604,909 and year ended May 31, 2005 – 192,836] were issued.

Summary of Stock-based Compensation and Other Stock-based Payments

The composition of stock-based compensation and other stock-based payments is as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Stock option compensation expense	900	830	764
Cost of the employer's portion of shares issued to employees under the Share Purchase Plan	335	-	106
Directors fees paid in common shares	-	9	87
Stock-based compensation expense	1,235	839	957
Other stock-based payments			
Payment for services included in selling, general and administrative expenses	62	100	-
Acquisition of fqubed – share component (note 3)	-	694	-
Settlement of acquisition commitments (note 23)	-	-	4,000
Settlement of loan in shares (note 11)	-	-	425

17. NET LOSS PER COMMON SHARE

Net loss per common share is calculated as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Loss from continuing operations	(13,195)	(5,887)	(29,844)
Accretion of acquisition commitments	-	-	(7,551)
Gain on restructuring acquisition commitments	-	-	22,857
Comprehensive loss from continuing operations	(13,195)	(5,887)	(14,538)
Net income from discontinued operations	180	264	38
Comprehensive net loss	(13,015)	(5,623)	(14,500)
Average number of basic and diluted common shares outstanding for the period (millions)	153.4	122.9	101.4
Basic and diluted loss per common share from continuing operations	(\$0.09)	(\$0.05)	(\$0.14)
Basic and diluted loss per common share from discontinued operations	\$0.00	\$0.00	\$0.00
Basic and diluted net loss per common share	(\$0.09)	(\$0.05)	(\$0.14)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

The calculation of diluted loss per common share excludes all options, warrants and convertible debentures for all periods as they were anti-dilutive. Basic and diluted earnings per common share from discontinued operations are computed by dividing net earnings from discontinued operations by the respective average number of common shares.

The following table presents the maximum number of shares that would be outstanding if all dilutive and potentially dilutive instruments were exercised or converted as at:

	December 31, 2006 (000s)	December 31, 2005 (000s)	May 31, 2005 (000s)
Common shares issued and outstanding (note 13)	183,299	127,708	122,513
Warrants outstanding (note 14) ⁽ⁱ⁾	45,532	41,942	41,942
Stock options outstanding (note 16) ⁽ⁱⁱ⁾	16,077	15,477	5,009
Convertible debentures (note 12)	14,582	17,948	18,198
	259,490	203,075	187,662

(i) Excludes 719 warrants potentially issuable upon the exercise of the June 2006 Underwriter Warrants. (see note 14(v))

(ii) Excludes 600 options granted to a consultant that are unvested and forfeitable.

18. INTEREST, NET

Interest, net consists of:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Interest on long term debt, capital lease obligations and debentures	425	262	384
Interest on short term loan	105	242	431
Accretion of debentures	569	272	262
Interest income	(328)	(58)	(73)
Other	15	55	68
Interest, net	786	773	1,072

19. RESTRUCTURING COSTS

Restructuring costs of \$5.7 million were recorded in the fiscal year ended May 31, 2005. These charges included a \$3.7 million non-cash write-down of construction in progress, plus a loss on disposal of packaging machinery following the Company's decision not to complete the expansion project at its Varennes, Quebec manufacturing facility. It also includes \$925, in severance costs to terminate the entire Canadian sales staff for Pennsaid and reduce the number of personnel at the Company's head office in Markham and international sales office in Barbados, \$688 in expenses related to the September 2004 proxy fight and \$391 related to the termination of the Company's U.K. sales and marketing contract.

During 2005 and 2006 the Company settled all outstanding claims for severance and recognized a reduction of \$86 in the severance provision for the year ended December 31, 2006 [seven-months ended December 31, 2005 – \$101]. The composition of the restructuring costs (recovery) is as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Impairment of construction in progress (note 7)	–	–	2,757
Loss on production equipment returned to vendor	–	–	979
Severance	(86)	(101)	925
Proxy costs related to the 2004 annual general meeting	–	–	688
Termination of U.K. sales and marketing contract	–	–	391
Restructuring costs (recovery)	(86)	(101)	5,740

Total restructuring costs accrued in the financial statements are as follows as at:

	December 31, 2006 \$	December 31, 2005 \$	May 31, 2005 \$
Restructuring accrual, beginning of period	181	585	–
Restructuring costs (recovery)	(86)	(101)	5,740
Non-cash portion of provisions	–	–	(3,736)
Debt settlements	–	–	(391)
Payments	(51)	(303)	(1,028)
Restructuring accrual, end of period	44	181	585

20. GAIN ON SALE OF SUBSIDIARY

On August 16, 2005, the Company sold 100% of the common shares of its subsidiary Dimethaid Health Care Ltd. (“DHCL”) to Paladin Labs Inc. (“Paladin”). Consideration for the transaction included a cash payment of \$7,500, a long-term supply agreement for Nuvo to manufacture Pennsaid for the Canadian market and a share in future operating profits above specified targets. DHCL owned the rights to distribute Pennsaid in Canada and had a Co-Promotion Agreement with Solvay Pharma Inc. under which they were responsible for the sales and marketing activities of Pennsaid. The Company retained all rights to Pennsaid outside Canada. The impact of this transaction on the consolidated results of the Company will be a reduction of Canadian product sales revenue and gross margins offset by an increase in licensing fees, reduced selling, general and administrative expenses and elimination of the revenue allocation to Solvay under the Co-Promotion Agreement.

The Company recorded the cash payment as follows: \$2,000 as proceeds from the sale of DHCL’s common shares resulting in a gain of \$1,956, net of transaction costs and the carrying value of the shares; \$4,900 as deferred revenue to be earned over the term of the license and supply agreements, which run to February 2014; and, \$600 as deferred revenue to be earned from the supply of promotional goods over a three year period ending August 31, 2008.

The sale of DHCL reduced the Company’s Canadian non-capital tax loss carryforwards by approximately \$32 million. In addition, at the time of sale DHCL had approximately \$827 of refundable tax credits. Under the terms of the agreement with Paladin, these credits will be returned to Nuvo once collected, subject to certain holdback restrictions. The Company has recorded a \$627 reserve against these tax credits.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

21. GAIN ON DEBT SETTLEMENTS

In February 2005, agreements were reached with creditors of the Company and its subsidiaries to accept approximately \$864 in full and final settlement of obligations totaling approximately \$5 million resulting in a gain on debt settlement of approximately \$4,137. The claims that have been settled include those of the Company's former U.K. sales and marketing partners.

22. DISCONTINUED OPERATIONS

During the seven-month period ended December 31, 2005 the Company sold the assets and operations of its non-strategic subsidiary, Dioptic Laboratories. Dioptic Laboratories distributed branded diagnostic and therapeutic ophthalmic products in Canada. As part of the sale of the assets of Dioptic the Company was to receive \$175 contingent on receipt by the purchaser of Ontario formulary coverage for certain product rights (represented by "DINs" or Drug Identification Numbers). In 2006 formulary coverage was received and the Company recognized additional proceeds of \$175. The Company has now received all contingent payments relating to Dioptic and does not expect any additional cash flows.

The results of discontinued operations were as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Product revenue	-	38	139
Cost of goods sold	-	(44)	(37)
Sale of DINs	175	185	-
Gain on sale of assets	-	100	-
Selling, general and administrative expenses	5	(15)	(62)
Interest, net	-	-	(2)
Net income from discontinued operations	180	264	38

The assets and liabilities of discontinued operations were as follows as at:

	December 31, 2006 \$	December 31, 2005 \$	May 31, 2005 \$
Inventory and other current assets	-	-	39
Accounts payable	-	-	(9)
Net assets of discontinued operations	-	-	30

23. GAIN ON RESTRUCTURING ACQUISITION COMMITMENTS

On May 31, 2002, the Company completed the acquisition of the remaining 80% of Oxo Chemie AG (“Oxo”) from its founder Dr. Kühne. Oxo (later renamed Dimethaid AG) is a Swiss-based company that developed and commercialized proprietary therapeutic products for treating immune dysfunction. At inception, the purchase price, which was payable in annual instalments, could be paid using any combination of cash or common stock of the Company at the Company’s discretion. Consequently, the discounted value of the purchase price was recorded as “Acquisition commitments” in Shareholders’ Equity on the Consolidated Balance Sheet. In 2002 and 2003 common shares of the Company were issued in partial satisfaction of the “Acquisition commitments”.

In October 2004, the Company entered into an agreement with Dr. Kühne to restructure the remaining undiscounted “Acquisition commitments” of US\$27,722. Effective May 31, 2005, the Company entered into definitive agreements to effect the restructuring. Under these agreements Dr. Kühne released the Company from its remaining commitment to him in return for \$4,000 of the Company’s November 2004 debenture offering, 40 percent ownership in both Dimethaid AG which owns all of the worldwide intellectual property and exploitation rights for WF10 and its German subsidiary Dimethaid GmbH, 6 percent of future WF10 licensing and royalty revenue and 100 percent ownership of WF10 marketing authorization for Thailand. The effect of these transactions was to reduce the deficit in the year ended May 31, 2005 by \$22,857.

Continuity of Acquisition Commitments

The acquisition commitments have been subject to accretion, foreign currency gains and losses and the gain on restructuring through charges to the statements of loss and deficit as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Balance, beginning of period	-	-	21,278
Foreign currency gain (charged to operations)	-	-	(1,972)
Accretion charges to deficit	-	-	7,551
Balance, prior to restructuring	-	-	26,857
Debentures issued	-	-	(4,000)
Gain on restructuring acquisition commitments	-	-	(22,857)
Balance, end of period	-	-	-

24. NET CHANGE IN NON-CASH WORKING CAPITAL

The net change in non-cash working capital consists of:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Accounts payable and accrued liabilities	(712)	(1,804)	820
Accounts receivable	(272)	201	237
Inventories	(228)	46	491
Prepaid expenses and other	(323)	(155)	488
Net change in non-cash working capital	(1,535)	(1,712)	2,036

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

25. INCOME TAXES

Future Tax Assets and Liabilities

Future income taxes represent the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of temporary differences that give rise to significant portions of the future tax assets are as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Non-capital loss carryforwards	11,830	10,928	19,290
Canadian Scientific Research and Experimental Development [SR&ED] expenditure pool carryforward	1,717	669	3,438
Investment tax credits	918	352	1,887
Financing costs	795	705	891
Tax basis of property, plant and equipment in excess of accounting value	3,178	3,073	3,024
Other	1,336	972	204
Future tax assets before valuation allowance	19,774	16,699	28,734
Less: Valuation allowance	(19,774)	(16,699)	(28,734)
Net future tax assets	-	-	-

Loss Carryforwards and Canadian SREDS

The Company and its subsidiaries have non-capital losses available for carryforward to reduce future years' taxable income, the benefit of which has not been recorded. These losses and the related future tax asset by jurisdiction are as follows:

	Expiry Period	Non-capital losses \$	Future tax asset \$
Canada	2007 to 2026	27,900	9,209
United States ⁽ⁱ⁾	2009 to 2013	2,200	834
Switzerland	2008 to 2015	12,700	1,234
Germany	Indefinite	600	183
Barbados	2009 to 2014	14,800	370
		58,200	11,830

(i) The United States losses carried forward include \$1,900 of losses acquired upon the purchase of fubed in 2005. Due to our acquisition of control of this entity there are restrictions imposed on the use of these losses.

The Company has approximately \$5.2 million of Canadian scientific research and experimental development (SR&ED) expenditures for Federal tax purposes that are available to reduce taxable income in future years and have an unlimited carryforward period, the benefit of which has not been reflected in these financial statements. SR&ED expenditures are subject to audit by the tax authorities and accordingly, these amounts may vary.

The Company has net capital losses of \$8.0 million in Canada available to offset net taxable capital gains in future years.

Government Assistance

The Company incurred research and development expenditures that are eligible for investment tax credits. The credits recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by the taxation authorities and, accordingly, these amounts may vary. In the year ended December 31, 2006, \$290 [seven-months ended December 31, 2005 and year ended May 31, 2005 – \$nil] of refundable tax credits, were applied against research and development expenses.

In addition, the Company has investment tax credits that it may carry forward for Canadian federal tax purposes as follows:

Year of credit	Amount \$	Year of expiry
December 31, 2005	434	2015
December 31, 2006	700	2026
	1,134	

The benefits of these non-refundable investment tax credits have not been recognized in the financial statements.

26. COMMITMENTS

The Company has commitments under research and other service contracts and minimum future rental payments under operating leases for the years ending December 31 as follows:

	Research and other service contracts \$	Operating leases \$	Total \$
2007	263	273	536
2008	–	264	264
2009	–	167	167
2010	–	154	154
2011	–	155	155
2012	–	13	13
	263	1,026	1,289

For the year ended December 31, 2006 payments under operating leases totaled \$326 [seven-months ended December 31, 2005 – \$24 and year ended May 31, 2005 – \$45.]

The Company has a long term supply agreement with a third party manufacturer for the supply one of its key raw materials for an initial term extending through October 31, 2012. The agreement obligates the Company to purchase 100% its requirements from the third party at specified pricing but does not contain any commitment to purchase set quantities.

27. FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments

The Company has determined the estimated values of its financial instruments based on appropriate valuation methodologies. However, considerable judgment is required to develop these estimates. Accordingly, these estimated values are not necessarily indicative of the amounts the Company could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of each class of financial instruments are discussed below.

Short term financial assets and liabilities, including cash and cash equivalents, accounts receivable, other receivable, accounts payable, accrued liabilities and short term loan, are valued at their carrying amounts as presented in the consolidated balance sheets. The carrying values of the amounts are reasonable estimates of fair value due to the short period to maturity of these financial instruments.

Rates currently available to the Company for long term debt, with similar terms and remaining maturities have been used to estimate the fair value of the debentures, long term debt and capital lease obligations. These fair values approximate the carrying values for all instruments, except for the November 2004 Convertible Debentures that have an estimated fair value of \$2.9 million.

Credit Risk

The Company's cash and cash equivalents subject the Company to a significant concentration of credit risk. The Company has guaranteed investment certificates of \$10.8 million invested with a single issuer; however, this risk is mitigated as the issuer is a major Canadian bank.

The Company, in the normal course of business, is exposed to credit risk from its global customers most of whom are in the pharmaceutical industry. The accounts receivable are subject to normal industry risks in each geographic region in which the Company operates. The company attempts to manage this risk by dealing with creditworthy customers. At December 31, 2006 the Company's three largest customers represent 61% [December 31, 2005 – 88%; May 31, 2005 – 30%] of accounts receivable.

The other receivable is secured by an irrevocable letter of credit (see note 7).

Interest Rate Risk

The long term loan with Investissement Quebec bears interest at that organization's variable interest rate (see note 11), which could fluctuate, however, the loan will be fully repaid during 2007 such that the interest rate risk is not considered material. Other long term debt and capital lease obligations are at fixed interest rates.

Currency Risk

The company operates globally, which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the US dollar and Euro but also transacts in other foreign currencies. The Company currently does not use financial instruments to hedge these risks.

28. SEGMENTED INFORMATION

Segments

Beginning in late 2004 the management of the Company undertook a program to reorganize the business of the Company. The program included: the sale of non-core product lines, the sale of non-strategic assets, the recapitalization of the Company, the outsourcing of product sales and marketing through licensing arrangements, refocusing on two research and development platforms: transdermal drug delivery and immune system modulation. In late 2006 the reorganization was substantively completed.

Now that the reorganization has been completed segment reporting has been restated to reflect the Company's focus on its two key platforms. The accounting policies for the segments are the same as those described in note 2 to the consolidated financial statements. Intersegment transactions are accounted for at exchange values. From a financial perspective executive management uses the loss from operations to assess the performance of each segment.

The following tables show certain information with respect to operating segments:

	Transdermal Drug Delivery	Immune System Modulation	Total
Year ended December 31, 2006	\$	\$	\$
Total revenue	3,479	769	4,248
Amortization of property, plant and equipment	630	156	786
Interest revenue	328	-	328
Interest expense	1,084	30	1,114
Loss from operations	(13,649)	(444)	(14,093)
Assets	16,112	1,507	17,619
Property, plant and equipment	2,543	577	3,120
Additions to property, plant and equipment ⁽ⁱ⁾	687	4	691
Seven-months ended December 31, 2005			
Total revenue	2,564	336	2,900
Amortization of property, plant and equipment	200	90	290
Interest revenue	59	-	59
Interest expense	813	19	832
Loss from operations	(7,702)	(242)	(7,944)
Assets	8,900	1,357	10,257
Property, plant and equipment	2,487	729	3,216
Additions to property, plant and equipment	8	3	11
Year ended May 31, 2005			
Total revenue	6,602	597	7,199
Amortization of property, plant and equipment	415	156	571
Interest revenue	73	-	73
Interest expense	1,085	60	1,145
Loss from operations	(10,872)	(746)	(11,618)
Assets	9,109	1,479	10,588
Property, plant and equipment	1,974	816	2,790
Additions to property, plant and equipment	79	18	97

(i) Includes \$96 of assets acquired under capital leases.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

Geographic Information

The geographic destination of the Company's sales to its external customers is as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Canada	2,198	1,924	4,981
Europe	1,178	706	1,720
Other foreign countries	872	270	498
	4,248	2,900	7,199

The geographic location of the Company's property, plant and equipment is as follows:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Canada	1,893	1,618	1,963
Europe	577	729	816
Other foreign countries	650	869	11
	3,120	3,216	2,790

Significant Customers

The following table presents product and research contract revenue generated and accounts receivable due from the Company's three largest customers:

	Year ended December 31, 2006 \$	Seven-months ended December 31, 2005 \$	Year ended May 31, 2005 \$
Sales	\$ 2,479	\$ 1,449	\$ 5,697
Percentage of product and research contract revenue	72%	45%	56%
Accounts receivable	\$ 598	\$ 538	\$ 245
Percentage of total trade accounts receivable	61%	88%	30%

29. RELATED PARTY TRANSACTIONS

Contract research services totalling \$58 for the year ended December 31, 2006 [seven-months ended December 31, 2005 – \$18 and year ended May 31, 2005 – \$nil] were provided by a researcher who holds a PhD in pharmacokinetics and who is a family member of one of the Company's officers. These services have been charged at fair market value and have been accounted for in research and development expenses.

30. ECONOMIC DEPENDENCE

The Company purchases key raw materials necessary for the manufacture of its products from a limited number of suppliers around the world. It may be difficult for the Company to find other manufacturers if any of these suppliers is unable to supply it with a sufficient amount of raw material or if it is forced for any other reason to find another supplier. In addition, the FDA requires that suppliers of certain raw materials be FDA approved, their Master Drug File (MDF) be referenced in the sponsor's NDA and that adequate stability data exist for the product using the approved supplier's raw material. As a result, in the case where only a single approved supply source exists for product marketed in the United States (or other regulated jurisdictions) the Company is at risk

should a supplier lose its FDA manufacturing approval, terminate access to its MDF, be unable to manufacture product, choose not to supply the Company or decide to increase prices. The loss of any of these suppliers of key raw materials could have a materially adverse effect on the Company's financial position and results of operations.

31. CONTINGENCIES AND OTHER MATTERS

Contingencies

Rebecca E. Keeler, the Company's former president and chief executive officer, was terminated in September 2004. The Company's position is that the termination is for cause and no cash payment is owed, and no provision has been made in these financial statements. In the event it is determined that Mrs. Keeler's employment was terminated without just cause, she will be entitled to receive a cash payment of \$600, which is two times her former annual salary. In 2005, the Company received a letter from Mrs. Keeler's solicitors stating they do not agree with the Company's position that the termination was for just cause and if a settlement cannot be negotiated, they intend to commence legal action. There has been no further communication.

The Company's former head office property was subject to a \$2.0 million mortgage (the "Mortgage"). As previously disclosed, the Mortgage balance due is in dispute with Leadenhall Bank & Trust Company Limited ("the Mortgagee"). The Mortgage dispute centers on the calculation and amount of interest owing and is the subject of an Ontario court action (the "Ontario Action") commenced in April 2005. The Mortgagee's position is that interest should be calculated at a rate of 2% per month calculated monthly; including interest on late payments; and costs. The Company's position is that the Mortgage is null and void and should be discharged, or alternatively, that the interest payable is limited to 5 percent per annum pursuant to the provisions of the Interest Act (Canada). Subsequent to the filing by the Mortgagee of its Statement of Claim and the Company of its Statement of Defense and Counterclaim, a liquidator (the "Liquidator") of the Mortgagee was appointed by the courts of the Bahamas, where the Mortgagee is situated.

In November of 2005, the Company negotiated a written agreement (the "Settlement Agreement") with the Liquidator to settle all claims pursuant to the Ontario Action for US\$1,067 (CDN\$1,241) (the "Settlement Amount") payable out of closing funds received on the sale of the Company's former head office. The Settlement Agreement is subject to the approval of the Bahamian court that appointed the Liquidator. The Liquidator agreed to seek court approval as soon as possible. The Liquidator did not seek court approval prior to the completion of the head office sale, and in order to allow the sale to proceed, the Liquidator and the Company entered into an escrow arrangement (the "Escrow Agreement") pursuant to which the Liquidator agreed that upon payment of US\$1,370 (CDN\$1,598) to the Liquidator in escrow to be held pending court approval of the Settlement Agreement, the Liquidator would deliver a discharge of the Mortgage. In January 2006, the said amount was paid to the Liquidator in escrow, the Mortgage was discharged and the sale of the head office was completed. Under the terms of the Escrow Agreement, the balance of the amount paid into escrow, US\$303 (approximately CDN\$353 at current exchange rates), is to be released to the Company upon approval by the Bahamian court of the Settlement Agreement.

The Liquidator has continually delayed seeking court approval of the Settlement Agreement and has not yet presented it to the Bahamian court for approval. Since April 2006, the Liquidator has indicated that while it still intends to present the Settlement Agreement to the court for its consideration, it will not recommend that the court approve it. In addition, in February 2007, correspondence from the Liquidator's Bahamian legal counsel indicates that if the Court does not approve the Settlement Agreement, the Liquidator will request that the Bahamian court order that all escrowed funds, including the \$US303 (CDN\$353) be released to the Liquidator and not the Company. The Liquidator's legal counsel further suggested that the full amount in escrow is insufficient to retire the mortgage principal plus interest at the alleged interest rate of 2% per month and that the Liquidator may pursue the Company for the deficiency. If the Bahamian court does not approve the Settlement Agreement, the Escrow Agreement contemplates that the Ontario Action will continue to determine the respective rights of the parties to the escrow funds. The Company has retained legal counsel in the Bahamas to pursue court approval of the Settlement Agreement and to ensure that if the Settlement Agreement is not approved, that the escrow continues in accordance with the terms of the Escrow Agreement so that entitlement to the escrow funds can be determined in the Ontario Action. A hearing of the Bahamian court to review these matters is scheduled for March 8, 2007. The continuity schedule outlining the transactions relating to and the amount accrued in these consolidated financial statements for this Short Term Loan are described in note 9.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

In October 2004, the Company received a letter from the OSC indicating it was reviewing the disclosures and trading activity of the Company and requesting that the Company provide, among other things, records pertaining to the FDA and the late-stage or Phase III testing of Pennsaid, as well as the Company's May 21, 2004 special warrant financing.

During 2006, the Company received a series of letters from the OSC requesting additional information and documentation related to the disclosure of the status of the Company's original application to the FDA for approval of Pennsaid. These letters indicate that the OSC's concerns are focused on the accuracy of the disclosure in two prospectuses filed by the Company prior to the election of the new Board of Directors and appointment of the current management team in September 2004. Most recently, the OSC's communications with the Company and certain of its former directors indicates that it is contemplating proceedings to consider whether the Company engaged in conduct warranting the OSC making an order against it. Although staff of the OSC has advised certain of the former outside directors of the Company that they do not intend to take any proceedings against those individuals at this time, those former directors may be able to make a claim against the Company under the indemnity provisions contained in the Corporate By-Law for the legal costs associated with their interactions with the OSC concerning this disclosure, some of which may be recoverable under the Company's insurance. Management has estimated the amount likely incurred by the former directors and has accrued this amount as at December 31, 2006.

The Company continues to co-operate and communicate with the OSC, has provided the OSC with all requested information and documentation, and will continue to assist it in its review and investigation of this matter. However, despite this co-operation, the Company could still be subject to regulatory sanctions and penalties and/or civil liability in the event of a determination that there was any misrepresentation in its historical disclosures or a determination that there was any other contravention of securities laws.

On June 7, 2006, the Company received a letter from counsel to Research Capital Corporation ("RCC") asserting that as a result of the bought deal equity financing completed by the Company on June 20, 2006, RCC is entitled to payment of \$1.5 million and common shares of the Company equal to 8% of the shares issuable pursuant to an underwriting agreement for an offering that was contemplated but did not proceed in September 2005. RCC was not involved in the financing. The letter further stated that if the demanded cash payment and common shares were not received on or before June 12, 2006 then a court action would commence by RCC against the Company. On September 15, 2006, RCC commenced legal proceedings against the Company by filing a Statement of Claim with the Ontario Superior Court of Justice. The Statement of Claim claims that RCC is entitled to (i) damages in the amount of \$1.5 million or alternatively damages of \$1.0 million (ii) 3 million warrants to purchase common shares at a price of \$0.50 and an option to purchase \$5 million in units of the Company or alternatively to (i) and (ii), \$350,000, and in each case interest and costs. Management of the Company believes that RCC's claim is without merit. The Company has filed a Statement of Defence and Counterclaim and intends to vigorously defend its position. Since the delivery of the Plaintiff's Reply and Defence to Counterclaim in late 2006, no further steps have been taken in this proceeding.

32. COMPARATIVE FIGURES

Certain figures in the December 31, 2005 and May 31, 2005 financial statements have been re-classified to conform to the basis of presentation for the year ended December 31, 2006.

CORPORATE LEADERSHIP

BOARD OF DIRECTORS AND EXECUTIVE OFFICERS

Daniel N. Chicoine, BComm, CA
Chairman

John C. London, LLB, LLM
Vice Chairman and Secretary

Henrich R.K. Guntermann, MD, MSc
Director, President and Chief Executive Officer

David A. Copeland, BMath, CA
Director and Chair of the Audit Committee

Anthony E. Dobranowski, BSc, MBA, CA
Director

Klaus von Lindeiner,
Dr en droit (U. of Geneva)
Director

Jacques Messier, DVM, MBA
Director and Chair of the Compensation and Corporate Governance Committee

James L. Moulds, MAcc, CA
Vice President, Finance and CFO

Grant J. Britchford, BComm, CA
Vice President, Financial Planning

SCIENTIFIC ADVISORY BOARD

Stefan Meuer, MD
Director, Institute of Immunology University Hospital, Heidelberg

Lee S. Simon, MD
Associate Clinical Professor Harvard Medical School Formerly, Director, Division of Anti-inflammatory, Analgesic and Ophthalmic Drug Products, FDA

Rolf M. Zinkernagel, MD, PhD
Professor, Department of Pathology University of Zurich

Jonathan Wilkin, MD
Private Consultant Formerly, Director, Division of Dermatologic and Dental Drug Products, FDA

CORPORATE INFORMATION

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Web Site: www.nuvoresearch.com

AUDITORS

BDO Dunwoody LLP
Toronto, Canada

LEGAL COUNSEL

Goodmans LLP
Toronto, Canada

TRANSFER AGENT/REGISTRAR

Common Shares and Warrants expiring June 10, 2007

CIBC Mellon Trust Company
320 Bay Street, P.O. Box 1
Toronto, Ontario, Canada
M5H 4A6
Tel. 1 (800) 387-0825
(general stock transfer inquiries)
Fax. (416) 643-5660 or (416) 643-5661
Email: inquiries@cibcmellon.com

Warrants expiring June 20, 2009 and November 16, 2009

Computershare Trust Company
of Canada
100 University Avenue
4th Floor, North Tower
Toronto, Ontario, Canada
M5J 2Y1
Tel. 1 (800) 564-6253

We invite you to the Annual Meeting of Shareholders:

Tuesday, May 1, 2007 at
9:00 a.m. (Toronto time) at the
TSX Broadcast Centre
130 King Street West
Toronto, Ontario, Canada
M5X 1J2

STOCK EXCHANGE LISTING

The Toronto Stock Exchange
Symbol: NRI

INVESTOR RELATIONS

Christina Bessant
Equicom Group Inc.
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CURRENCY

All amounts in this annual report
are in Canadian dollars unless
otherwise indicated.

This annual report may contain forward-looking statements subject to risks, assumptions and uncertainties which may cause Nuvo's actual future results or performance to differ materially from those expressed herein. Risk factors are discussed in the Company's Annual Information Form and other public filings. Nuvo undertakes no obligation to revise or update forward-looking statements to reflect subsequent information, events, results or circumstances.

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