



**Neovasc Inc.  
Management's Discussion  
and Analysis**

Form 51-102F1

**FOR THE THREE MONTHS ENDED  
MARCH 31, 2011 AND 2010**

**Q1  
2011**

## **FORM 51-102F1: MANAGEMENT'S DISCUSSION AND ANALYSIS**

This discussion and analysis covers the unaudited interim consolidated financial statements of Neovasc Inc. (the "Company" or "Neovasc") for the three months ended March 31, 2011 and 2010.

The Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations should be read in conjunction with the unaudited interim consolidated financial statements and notes thereto for the three months ended March 31, 2011 (included as part of Neovasc Inc.'s quarterly filing).

### **FORWARD-LOOKING STATEMENTS**

This discussion and analysis, contains forward-looking statements that are not based on historical fact, including without limitation statements containing the words "believes", "may", "plan", "will", "estimate", "continue", "anticipates", "intends", "expects", and similar expressions, including the negative of such expressions. These statements are only predictions.

Forward-looking statements and information should be considered carefully. Undue reliance should not be placed on forward-looking statements and information as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements and information involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, which contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements and information will not occur and may cause actual results or events to differ materially from those anticipated in such forward-looking statements and information. The assumptions made by Neovasc include the ability of the Company to obtain and enforce timely patent protection for its technologies, the development of products; the timing of receipt of regulatory approvals; the sufficiency of budgeted expenditures in carrying out planned activities; and the availability and cost of labour and services (see 'Risks and Uncertainties').

More particularly and without limitation, this discussion and analysis contains forward-looking statements and information concerning the potential of Neovasc and the timing of market acceptance of the Company's technology products.

There are also other factors that may cause the actual results, events or developments to be materially different from any future results, events or developments expressed or implied by such forward-looking statements and information. Such factors include, among others, the stage of development, additional capital requirements, the impact of the global economic downturn, the ability to develop, manufacture and commercialize its products in a cost-effective manner, the ability to integrate newly-acquired businesses and the ability to protect Neovasc's intellectual property (IP).

Neovasc disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements or information contained herein to reflect future results, events or developments, except as required by law.

All financial information is prepared in accordance with International Financial Reporting Standards ("IFRS") and is expressed in Canadian dollars.

Date: June 20, 2011

## OVERVIEW

### Description of the Business

Neovasc Inc. is a specialty vascular device company that develops, manufactures and markets medical devices for the rapidly growing vascular and surgical marketplace. Current products include the NeovascReducer™, a novel product in development to treat refractory angina, and a line of advanced biological tissue technologies that are used to enhance surgical outcomes and as key components in a variety of third-party medical products, including transcatheter heart valves.

Neovasc's business operations started in March 2002, with the acquisition of Neovasc Medical Inc. ("NMI") (formerly PM Devices Inc. ("PMD")), NMI manufactures a line of collagen based surgical patch products made for use in cardiac reconstruction and vascular repair procedures as well as other surgeries. The products are made from chemically treated bovine and equine pericardial tissue.

In May 2003, Neovasc acquired Angiometrx Inc. ("ANG"). ANG developed a technology called the "Metricath® System," a catheter-based device that allows clinicians to measure artery and stent size and confirm stent deployment during interventional treatment of coronary and peripheral artery disease. In 2009, Neovasc ceased all activities related to the Metricath.

In July 2008, Neovasc acquired two pre-commercial vascular device companies based in Israel: Neovasc Medical Ltd. ("Neovasc Medical") and B-Balloon Ltd. ("B-Balloon") (the "Acquisitions"). Neovasc Medical had developed and owned IP related to a novel catheter-based treatment for refractory angina, a debilitating condition resulting from inadequate blood flow to the heart muscle. Refractory angina affects millions of patients and at present there is no effective cure. B-Balloon had developed certain products intended to solve problems encountered by physicians when attempting to place vascular stents at locations where an artery branches from the aorta (the "ostium") or where an artery splits into multiple branches (a "bifurcation"). Currently Neovasc is not developing any of the B-Balloon technologies and is focusing its efforts on the Neovasc Medical treatment for refractory angina.

### Product Portfolio

#### Peripatch Products

Neovasc manufactures the *PeriPatch™* ("PeriPatch") line of advanced biological tissue products that are manufactured from pericardium, which is the protective sac that surrounds the heart of an animal. Neovasc uses its proprietary processes to convert raw pericardial tissue from animal sources into sheets of implantable tissue that can be used as a reinforcement during surgery (for example, to patch a hole in an artery or to help repair a hernia) or that can be incorporated into third party medical devices (for example, for use as the material for artificial heart valve leaflets or as a covering on a vascular stent). Peripatch tissue retains the mechanical characteristics of natural tissue and is readily incorporated into the body without rejection. Neovasc's Peripatch material was originally developed to fabricate artificial heart valves and has a 20-year history of successful implantation for heart valve and other surgical applications. Peripatch tissue can be manufactured to meet the mechanical and biological characteristics required for a wide variety of applications, such as surgical reinforcement patches or aortic heart valve leaflets.

The product line includes: the *PeriPatch™ Sheet*, and *PeriPatch™ EQ Sheet*, which are rectangular patches made from bovine (cow) or equine (horse) tissue, applied as internal bandages to repair weak or damaged organs or vessels. These are typically supplied sterile to customers who then use the sheets in surgical procedures.

The Company also provides a range of custom Peripatch products to industry customers for incorporation into their own products. These include Peripatch tissues fabricated from bovine, equine and porcine sources and offered in a wide variety of shapes and sizes. Neovasc works closely with these industry customers to develop and supply tissue to meet their specific needs. This often includes providing tissue in custom shapes or molded to 3-D configurations. The Company also provides product development and specialized manufacturing services related to Peripatch tissue-based products.

### *Regulatory Status*

The Peripatch Sheets made from bovine tissue are cleared for sale in the United States, Canada and Mexico. Peripatch Sheets made from bovine pericardium sourced from Australia are cleared for sale in Europe. The Peripatch EQ Sheets made from equine tissue are approved for sale in the European Union and in Canada. A number of third-party products which incorporate Peripatch tissue are approved for sale or have pending approvals in various markets. There is no assurance that these approvals for third-party products will be obtained.

### *Distribution*

Certain sizes of sterile Peripatch and Peripatch EQ Sheets for surgical repair, specifically “strips” which are used primarily for vascular reconstruction procedures, are distributed exclusively by LeMaitre Vascular (Boston, MA) in the United States and Europe. Non-strip sizes of Peripatch Sheets for surgical repair are distributed by LeMaitre Vascular as well as a number of other independent distributors in Europe and elsewhere. The Company’s goal is to steadily increase its distribution reach in new target markets, while increasing market share in current markets and in particular in the United States.

Distribution of custom Peripatch tissue products to industry customers is handled directly by Neovasc through its business and product development group.

### **Neovasc Reducer**

The Neovasc Reducer™ (the “Reducer”) is a treatment for patients with refractory angina. Refractory angina patients have severe, debilitating chest pain due to insufficient blood supply to the heart muscle, or myocardium, which is not amenable to revascularization. Using a simple catheter-based procedure, the Reducer is implanted in the coronary sinus, the major blood vessel that sends de-oxygenated blood from the heart back to the systemic circulation. The Reducer has been clinically demonstrated to provide significant relief of chest pain in refractory angina patients. There are approximately 1,000,000 new patients each year in the United States and Europe with recurrent angina who are potential candidates for the Reducer, either because they cannot be revascularized or because they are otherwise poorly managed using conventional medical therapies. These patients represent an annual market opportunity of over \$3 billion for the Reducer product. The initial target market for the Reducer product is patients presenting with refractory angina with no other available treatment options. Once physicians have adopted Reducer for use in these refractory patients, it is expected that there will be a natural spillover into the broader recurrent angina market, which represents a substantially larger patient population.

The Reducer is an hourglass-shaped, balloon-expandable, stainless steel “stent-like” device, which is implanted in the coronary sinus, creating a restriction in venous outflow from the myocardium. It is implanted using conventional percutaneous techniques. The Reducer is provided sterile and pre-loaded on a balloon catheter system. The system is 9F sheath compatible and operates over a .035” guidewire. The implantation procedure is quick and requires minimal training. Once guidewire access to the coronary sinus is achieved, implantation typically takes less than 10 minutes.

Following implantation, the bare metal Reducer is incorporated into the endothelial tissue and creates a permanent (but reversible) narrowing in the coronary sinus. The coronary sinus is narrowed from a typical diameter of 10-12mm to approximately 3mm at the site of implantation. This narrowing slightly elevates the venous outflow pressure that restores a more normal ratio of epicardial/endocardial blood flow between the outer and inner layers of the ischemic areas of the heart muscle. This results in improved perfusion of the endocardium, which helps relieve ischemia. The physiological mechanism behind this effect is well documented in medical literature.

The clinical utility of this approach is demonstrated by a number of analogous approaches used in the past that achieved excellent clinical outcomes for angina patients by constricting or intermittently blocking the coronary sinus to improve perfusion to the heart muscle. However, these therapies required the use of highly invasive surgery or leaving a catheter in the heart for a prolonged period, making them impractical or clinically unacceptable for use in modern medical practice. Reducer was developed to

deliver this therapy in a safe, simple and effective manner via a catheter that is consistent with modern medical practice.

The Reducer has demonstrated excellent results in multiple animal studies and in a clinical trial of 15 patients suffering from chronic refractory angina who were followed for three years after implantation. The six-month results from this clinical trial were published in the *Journal of the American College of Cardiology* and three-year data was presented at the ACC annual scientific meeting in March 2010. In this clinical trial, implantation of the Reducer resulted in significant clinical improvements in stress test and perfusion measurements, as well as an overall quality of life improvement in the majority of the patients.

#### *Regulatory Status*

The Reducer is not yet approved for sale. Neovasc has completed development of the commercial-generation Reducer and the product has been transferred to pilot manufacture. The Company is presently conducting a clinical trial named "COSIRA" (**C**oronary **S**inus Reducer for Treatment of **R**efractory **A**ngina) which will provide data to support CE mark of the product. CE mark will enable the Company to begin marketing Reducer for use in Europe. COSIRA is a double-blinded, randomized, sham controlled, multicentre trial of approximately 124 patients with an expected eight to ten investigation sites. Enrollment of patients at the first center began in September 2010. Enrollment is expected to be complete around the end of the third quarter of 2011 with the required six-month follow-up completed on all patients in the first half of 2012. There is no assurance that the CE mark will be granted in the time frame anticipated by management, or granted at any time in the future. Neovasc is presently developing a US regulatory approval strategy that will address the requirement for a larger randomized clinical trial that is mandatory in the US. US approval is expected in about four to five years. There is no assurance that US regulatory approval will be granted in the time frame anticipated by management, or granted at any time in the future.

#### **Additional Products and Third Party Sales**

Neovasc provides consulting and original equipment manufacturing services to other medical device companies when these services fall within the scope of its expertise and capabilities. These activities are substantially focused on providing specialized development and manufacturing services for industry customers who incorporate the Company's Peripatch tissue materials into their vascular device products such as heart valves. The goal of these activities is to drive near-term revenues as well as support development of a long-term revenue stream through the ongoing provision of tissue and manufacturing services to customers with commercially successful device products that incorporate Neovasc tissue. Revenue earned from various contract agreements varies throughout the year depending on customer needs.

#### **Regulatory Affairs and Clinical Trials**

The Company is presently in the process of obtaining the clinical trial data required to support European regulatory approval for the Reducer product. The COSIRA trial which commenced in September 2010 is expected to support this and other regulatory applications.

#### **Product Development**

Product development at the Company is presently focused on completing the development and commercialization of the Reducer product. The Company is also undertaking a substantial volume of product development work under contract for third parties. These third party projects are typically focused on supporting the development of products that incorporate Neovasc's PeriPatch tissue. These activities generate both near-term revenues from consulting activities for Neovasc and also are expected to drive longer-term growth as a result of the revenues that will result from future sales of new PeriPatch tissue products as well as the related manufacturing services the Company will provide for these customers once their products reach the market. The Company is also investigating potential new internal projects which leverage the Company's existing technologies, infrastructure and expertise. These new internal projects are at the proof-of-concept stage.

## **Sales & Marketing**

The Company's sales and marketing activities are currently focused on reaching tissue product customers and distributors, and contract manufacturing clients.

## **TRENDS, RISKS AND UNCERTAINTIES**

The Company has incurred operating losses of \$973,454 for the three months ended March 31, 2011(2010: \$472,236) and has a deficit of \$67,968,691 at March 31, 2011 compared to a deficit of 66,995,237 as at December 31, 2010. The Company's ability to continue as a going concern is dependent on the profitable commercialization of its products or obtaining additional debt or equity financing to fund ongoing operations until profitability is achieved. The current economic crisis which has significantly tightened the credit and equity markets may result in required funds not being available to the Company at the time required or on terms acceptable to the Company and may also reduce demand for the Company's products.

Neovasc has a limited operating history which makes it difficult to predict how its business will develop or of its future operating results. The Company has a history of fiscal losses since its inception and will need to generate significantly greater revenues than it has to date to achieve and maintain profitability. There is no certainty of future profitability, and results of operations in future periods cannot be predicted based on results of operations in past periods. Generally, the securities of the Company should be considered a highly speculative investment.

Neovasc is subject to risks and uncertainties associated with operating in the life sciences industry and as a company engaged in significant development, regulatory, production and commercialization activity. Neovasc cannot anticipate or prevent all of the potential risks to its success, nor predict the impact of any such risk. To the extent possible, management implements strategies aimed at reducing or mitigating risks and uncertainties associated with its business.

Operating risks include but are not limited to: market acceptance of the Company's technology and products; the Company's ability to obtain and enforce timely patent protection of its technology and products; the Company's ability to develop, manufacture and commercialize its products cost-effectively and according to the regulatory standards of numerous governments; the competitive environment and impact of technological change and/or product obsolescence; the continued availability of capital to finance the Company's activities; the Company's ability to conduct and complete successful clinical trials; the Company's ability to garner regulatory approvals for its products in a timely fashion; the Company's ability to attract and retain key personnel, effectively manage growth, and smoothly integrate newly acquired businesses or technologies; limitations on third-party reimbursement; instances of product or third-party liability; dependence on a single supplier for some products; animal disease or other factors affecting the quality and availability of raw materials; conflicts of interest among the Company's Directors, Officers, promoters and members of management; fluctuations in the values of relative foreign currencies; volatility of the Company's share price; fluctuations in quarterly financial results; unanticipated expenses; changes in business strategy; impact of any negative publicity; general political and economic conditions; and Acts of God and other unforeseeable events, natural or human-caused.

## **FOREIGN OPERATIONS**

The majority of the Company's revenues are derived from product sales in the United States and Europe, primarily denominated in United States dollars and Euros, while the majority of the Company's costs are denominated in Canadian dollars. The Company expects that foreign currency denominated international sales will continue to account for a significant portion of its revenues. Consequently, a decrease in the value of a relevant foreign currency in relation to the Canadian dollar will have an adverse effect on the Company's results of operations, with lower than expected revenue amounts and gross margins being reported in the Company's Canadian dollar financial statements. In addition, any decrease in the value of the United States dollar or Euro occurring in between the time a sale is consummated and the time payment is received by Neovasc will lead to a foreign exchange loss being recognized on the foreign-currency denominated trade account receivable. The fluctuation of foreign exchange may impose an

adverse effect on the Company's results of operations and cash flows in the future. Additionally, Neovasc may be materially and adversely affected by increases in duty rates, exchange or price controls, repatriation restrictions, or other restrictions on foreign currencies. The Company's international operations are subject to certain other risks common to international operations, including, without limitation: government regulations; import restrictions and, in certain jurisdictions, reduced protection for the Company's intellectual property rights.

Foreign currency translation gains and losses arising from normal business operations are credited to or charged to operations in the period incurred. To date, Neovasc has not entered into any foreign exchange forward contracts.

## **SELECTED QUARTER FINANCIAL INFORMATION**

The Company has adopted International Financial Reporting Standards ('IFRS') from January 1, 2011. The unaudited interim consolidated financial statements for the three months ended March 31, 2011 are Neovasc's first financial statements prepared under IFRS. The section "FIRST-TIME ADOPTION OF IFRS" includes the significant accounting policies that the Company adopted under IFRS and a reconciliation of the January 1, 2010 Canadian GAAP statement of financial position to IFRS. The comparative data has been retroactively changed in accordance with the transition rules.

The following discussion should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended March 31, 2011 and 2010.

## **DISCUSSION OF OPERATIONS AND FINANCIAL CONDITION**

This section analyzes the significant changes in the unaudited interim consolidated financial statements of comprehensive loss and cash flows for the three months ended March 31, 2011, compared to those for the same year-ended March 31, 2010 and compares the financial position at March 31, 2011 to that at December 31, 2010.

### **Loss**

The loss for the three months ended March 31, 2011 was \$973,454 or \$0.02 basic loss per share, as compared with a loss of \$472,236 or \$0.02 basic loss per share for the comparable period in 2010. The significant increase in the loss incurred in 2011 as compared to 2010 can be substantially explained by an increase in product development and clinical trial activities of \$99,683 and an increase in non-cash share-based payments for the quarter of \$410,036. While the actual number of share-based awards was similar in the first three months of 2010 and 2011, the valuation of those awards has increased as a result of an increase in the Company's share price.

### **Revenues**

Revenues increased 10% year-over-year to \$1,169,920 for the three months ended March 31, 2011 from \$1,065,841 for the same period in 2010.

Product sales for the three months ended March 31, 2011 were \$550,681, compared to \$377,476 in the same period of 2010, representing an increase of 46% as sales of Neovasc's tissue products continued to grow at a steady rate.

Contract manufacturing revenues decreased from \$360,486 in the first three months of 2010 to \$290,251 in the comparable period in 2011, a decrease of 19%. The company anticipates this revenue stream may increase in the future as customers' products are commercialized, but also expects that it will continue to be unpredictable due to the uncertainty of customers' product development timelines.

Revenue from consulting services for the three months ended March 31, 2011 were essentially flat at \$328,988, compared to \$327,879 in the same period in 2010. Because consulting service revenues are contract-driven, they can fluctuate from quarter to quarter as current projects are completed and new

projects start. The Company believes that the underlying trend is for moderate year-over-year growth in its consulting service business.

### **Cost of Sales**

The cost of sales for the three months ended March 31, 2011 was \$665,776, as compared to \$587,359 in the comparable period in 2010. The overall gross margin for the first quarter of 2011 was 43% compared to the 45% gross margin in the same period in 2010.

The decline in gross margins for the first quarter of 2011 can be substantially explained by the impact of exchange rates. In the three months ended March 31, 2011, 35% of the Company's sales were set in U.S. and European Union currencies. A strengthening Canadian dollar has impacted the revenues and margins generated from these foreign currency-denominated sales. Neovasc is exploring a number of initiatives aimed at strengthening margins going forward, including implementing further manufacturing efficiencies, reviewing pricing strategies for certain products and focusing on expanding sales of higher margin product lines such as custom tissue for transcatheter heart valves and related manufacturing services.

### **Expenses**

Total expenses for the three months ended March 31, 2011 were \$1,443,840, as compared to \$909,365 for the same period in 2010, representing an increase of \$534,475 or 59%. Of this increase, \$413,661, or 77%, can be explained by an increase in non-cash share-based payments, as discussed in the "Loss" section above. Net of these non-cash share-based payments, total expenses increased \$120,814 between the comparable periods in 2010 and 2011.

Sales and marketing expenses were \$47,246 for the three months ended March 31, 2011, as compared to \$44,891 for the same period in 2010, representing a small increase of 5%. The Company maintains relatively constant and minimal sales and marketing costs while it focuses on growing its business-to-business revenue streams.

General and administrative expenses were \$938,730 for the three months ended March 31, 2011 as compared to \$506,293 for the same period of 2010, representing an increase of 85%. The \$432,437 increase in general and administrative expenses in the first quarter was principally due to an increase non-cash share-based payments of \$402,079, as discussed in the "Loss" section above.

Product development and clinical trial expenses were \$457,864 for the three months ended March 31, 2011 as compared to \$358,181 for the same period of 2010, representing an increase of 28%. The increase in year-over-year research and development costs is principally due to increased investment in the COSIRA clinical trial.

## Quarterly Information

The following is a summary of selected unaudited financial information for the eight fiscal quarters to March 31, 2011:

	March 31, 2011	December 31, 2010	September 30, 2010	June 30, 2010
<b>SALES</b>				
Product sales	\$ 550,681	\$ 657,417	\$ 539,478	\$ 575,320
Contract manufacturing	290,251	318,834	99,878	71,415
Consulting services	328,988	342,313	375,144	313,185
	<u>1,169,920</u>	<u>1,318,564</u>	<u>1,014,500</u>	<u>959,920</u>
<b>COST OF GOODS SOLD</b>	<u>665,776</u>	<u>860,053</u>	<u>568,536</u>	<u>617,040</u>
<b>GROSS PROFIT</b>	<u>504,144</u>	<u>458,511</u>	<u>445,964</u>	<u>342,880</u>
<b>EXPENSES</b>				
Selling expenses	47,246	55,731	40,763	49,358
General and administration expenses	938,730	543,700	482,775	715,013
Product development and clinical trials expenses	457,864	614,889	330,393	538,680
	<u>1,443,840</u>	<u>1,214,320</u>	<u>853,931</u>	<u>1,303,051</u>
<b>Operating Loss</b>	<u>(939,696)</u>	<u>(755,809)</u>	<u>(407,967)</u>	<u>(960,171)</u>
<b>OTHER INCOME (EXPENSES)</b>	<u>(33,758)</u>	<u>(61,279)</u>	<u>1,023</u>	<u>26,437</u>
<b>LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD</b>	<u>\$ (973,454)</u>	<u>\$ (817,088)</u>	<u>\$ (406,944)</u>	<u>\$ (960,171)</u>
<b>LOSS PER SHARE</b>				
Basic and diluted loss per share	\$ (0.02)	\$ (0.02)	\$ (0.01)	\$ (0.03)
	March 31 , 2010	December 31, 2009	September 30, 2009	June 30, 2009
<b>SALES</b>				
Product sales	\$ 377,476	\$ 665,100	\$ 436,272	\$ 446,018
Contract manufacturing	360,486	54,456	137,505	83,751
Consulting services	327,879	324,316	426,590	70,555
	<u>1,065,841</u>	<u>1,043,872</u>	<u>1,000,367</u>	<u>600,324</u>
<b>COST OF GOODS SOLD</b>	<u>587,359</u>	<u>518,223</u>	<u>471,871</u>	<u>283,571</u>
<b>GROSS PROFIT</b>	<u>478,482</u>	<u>525,649</u>	<u>528,496</u>	<u>316,753</u>
<b>EXPENSES</b>				
Selling expenses	44,891	105,343	94,412	163,683
General and administration expenses	506,293	524,485	593,112	675,312
Product development and clinical trials expenses	358,181	432,950	606,259	873,191
	<u>909,365</u>	<u>1,062,778</u>	<u>1,293,783</u>	<u>1,712,186</u>
<b>Operating Loss</b>	<u>(430,883)</u>	<u>(537,129)</u>	<u>(765,287)</u>	<u>(1,395,433)</u>
<b>OTHER INCOME (EXPENSES)</b>	<u>(41,353)</u>	<u>(60,016)</u>	<u>(37,161)</u>	<u>64,982</u>
<b>LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD</b>	<u>\$ (472,236)</u>	<u>\$ (597,145)</u>	<u>\$ (802,448)</u>	<u>\$ (1,330,451)</u>
<b>LOSS PER SHARE</b>				
Basic and diluted loss per share	\$ (0.02)	\$ (0.02)	\$ (0.03)	\$ (0.05)

## **DISCUSSION OF LIQUIDITY AND CAPITAL RESOURCES**

The Company finances its operations and capital expenditures with cash generated from operations, lines of credit, long-term debt and equity financings. At March 31, 2011, the Company had cash and cash equivalents of \$1,252,497, as compared to cash and cash equivalents of \$1,489,027 at December 31, 2010. In addition, at March 31, 2011 the Company had restricted cash related to a security on long-term debt of \$50,000 (December 31, 2010: \$50,000) included in long-term assets and a bank overdraft facility of \$191,721 (December 31, 2010: \$213,280) included in current liabilities.

At March 31, 2011 the Company had working capital of \$1,391,805 as compared to working capital of \$1,752,712 at December 31, 2010. The decrease in working capital during the first quarter of 2011 was predominantly due to the net impact of a decrease in cash used to fund operations during the quarter; a decrease in accounts receivable, due to lower sales in the first quarter of 2011 as compared to the fourth quarter of 2010 and better than expected collections from customers during the quarter; an increase in inventory, as levels of tissue work-in-progress increased to more normal levels after the year-end; and a small increase in accounts payable and accrued liabilities.

Cash used in operating activities was \$274,918 for the three months ended March 31, 2011, as compared to \$826,476 for the same period in 2010. The decrease in the cash used during this period is principally due to the reduction in working capital requirements between the two periods. In the first quarter of 2010 working capital items absorbed cash of \$503,595, while in the first quarter of 2011 working capital items generated \$145,669 in cash.

Net cash invested in capital assets was \$87,892 for the three months ended March 31, 2011 compared to \$30,855 in 2010. In the first quarter of 2011 the Company invested capital to expand its clean room and manufacturing facilities to include a valve assembly room.

Net cash provided by financing activities was \$126,280 for the three months ended March 31, 2011, compared to cash provided of \$1,523,429 in the same period of 2010. On February 19, 2010, the Company completed a non-brokered private placement of 5,691,658 units at the price of \$0.27 per unit for aggregate gross proceeds of \$1,536,748. Each unit consists of one common share of Neovasc stock and one-half of one common share purchase warrant of Neovasc stock. Each whole warrant entitled the holder thereof to purchase one common share of Neovasc stock at the exercise price of \$0.40 per share for a period of one-year after the closing date of the offering. Share issue costs were \$22,015. On January 17, 2011 and February 15, 2011, the Company issued 197,922 and 128,371 common shares, respectively, upon the exercise of warrants issued as part of the Company's February 2010 financing. Proceeds from the exercise of the 326,293 warrants amounted to \$130,517. In addition, proceeds from the exercise of stock options amounted to \$26,598 for the first quarter of 2011.

## **SUBSEQUENT EVENTS**

There are no material events subsequent from March 31, 2011 to the date of this report.

## **OUTSTANDING SHARE DATA**

As at March 31, 2011, the Company had 40,771,576 common voting shares issued and outstanding. Further, the following securities are convertible into common shares of the Company: 5,347,303 stock options with a weighted average price of \$0.57. The fully diluted share capital of the Company at March 31, 2011 is 46,118,879.

## **OFF BALANCE SHEET ARRANGEMENTS**

The Company has no off balance sheet arrangements.

## **RELATED PARTY TRANSACTIONS**

There were no transactions with related parties, other than those compensation based payments disclosed in Note 17 of the financial statements, during the three months ended March 31, 2011 and 2010.

## **PROPOSED TRANSACTIONS**

The Company is not party to any transaction requiring additional disclosure.

## **CONTROLS AND PROCEDURES**

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO), in cooperation with the other members of senior management and Directors, are responsible for the Company's disclosure policy. The effectiveness of the Company's internal disclosure controls have been evaluated by the CEO and the CFO, and they have concluded that the Company's control procedure provides reasonable assurance that (i) information required to be disclosed by the Company in its annual and interim reports or other reports filed or submitted by it under applicable securities legislation is recorded, processed, summarized and reported within the prescribed time periods, and (ii) material information regarding the Company is accumulated and communicated to the Company's management, including its CEO and CFO, in a timely manner.

The CEO and CFO are responsible for the design of internal controls over financial reporting in order to provide reasonable assurance that the Company's financial reporting is reliable and that financial statements prepared for external purposes are prepared in accordance with Canadian GAAP and for the safeguarding of Company assets. The CEO and CFO are aware that internal controls relating to the accounting function could be strengthened by adhering to a strict policy of segregating the duties of accounting staff to reduce the risk of unauthorized journal entries being made or a misappropriation of cash. At the Company's current size, adoption of such a policy is impractical. To reduce these risks, the CFO reviews bank reconciliation statements and performs periodic reviews of non-standard entries after they have been recorded; all cheque payments require two signing authorities. The CEO periodically reviews recorded financial information. The CEO and CFO believe that these reviews are an adequate compensating control; accordingly, there are no plans to remediate this internal control weakness.

No material changes were made to the Company's system of internal controls relating to financial reporting during the three months ended March 31, 2011.

## **FIRST-TIME ADOPTION OF IFRS**

These are the Company's first consolidated financial statements prepared under IFRS. The date of transition to IFRS is January 1, 2010.

The accounting policies set out in the unaudited interim consolidated financial statements for the three months ended March 31, 2011 and 2010 note 3 have been applied in preparing the interim consolidated financial statements for the three months ended March 31, 2011, the comparative information presented in these interim consolidated financial statements for the three months ended March 31, 2010 and in the preparation of an opening IFRS consolidated statement of financial position at the date of transition.

In preparing its opening IFRS consolidated statement of financial position, the Company has applied IFRS 1 First-time Adoption of International Financial Reporting Standards (as revised in 2008). The Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian General Accepted Accounting Policies ("Canadian GAAP"). An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

First-time adoption exemption applied

Upon transition, IFRS 1 permits certain exemptions from full retrospective application. The Company has applied the mandatory exceptions and certain optional exemptions. The optional exemptions adopted by the Company include:

The Company has elected not to apply IFRS 3 retrospectively to business combinations that occurred before January 1, 2010.

The Company has elected not to apply IFRS 2 to awards that vested prior to January 1, 2010.

## Reconciliation of equity

	Notes	January 1, 2010			March 31, 2010			December 31, 2010		
		Previous	Effect of	IFRS	Previous	Effect of	IFRS	Previous	Effect of	IFRS
		Canadian GAAP	transition to IFRS		Canadian GAAP	transition to IFRS		Canadian GAAP	transition to IFRS	
<b>ASSETS</b>										
<b>Current assets</b>										
Cash and cash equivalents	(ii)	\$ 111,368	186,897	\$ 298,265	\$ 758,823	205,540	\$ 964,363	\$ 1,275,747	213,280	\$ 1,489,027
Accounts receivable		442,540	-	442,540	614,910	-	614,910	661,999	-	661,999
Inventory		404,309	-	404,309	516,196	-	516,196	469,744	-	469,744
Prepaid expenses and other assets		15,771	-	15,771	40,611	-	40,611	33,729	-	33,729
<b>Total current assets</b>		<b>973,988</b>	<b>186,897</b>	<b>1,160,885</b>	<b>1,930,540</b>	<b>205,540.00</b>	<b>2,136,080</b>	<b>2,441,219</b>	<b>213,280.00</b>	<b>2,654,499</b>
<b>Non-current assets</b>										
Property, plant and equipment		1,249,326	-	1,249,326	1,252,718	-	1,252,718	1,224,481	-	1,224,481
Restricted cash equivalents		50,000	-	50,000	50,000	-	50,000	50,000	-	50,000
<b>Total non-current assets</b>		<b>1,299,326</b>	<b>-</b>	<b>1,299,326</b>	<b>1,302,718</b>	<b>-</b>	<b>1,302,718</b>	<b>1,274,481</b>	<b>-</b>	<b>1,274,481</b>
<b>Total Assets</b>		<b>\$ 2,273,314</b>	<b>186,897</b>	<b>\$ 2,460,211</b>	<b>\$ 3,233,258</b>	<b>205,540.00</b>	<b>\$ 3,438,798</b>	<b>\$ 3,715,700</b>	<b>213,280.00</b>	<b>\$ 3,928,980</b>

## Reconciliation of equity (continued)

	Notes	January 1, 2010			March 31, 2010			December 31, 2010		
		Previous Canadian GAAP	Effect of transition to IFRS	IFRS	Previous Canadian GAAP	Effect of transition to IFRS	IFRS	Previous Canadian GAAP	Effect of transition to IFRS	IFRS
<b>LIABILITIES AND EQUITY</b>										
<b>Liabilities</b>										
<b>Current liabilities</b>										
Bank overdraft	(ii)	\$ -	186,897	\$ 186,897	\$ -	205,540	\$ 205,540	\$ -	213,280	\$ 213,280
Accounts payable and accrued liabilities		962,512	-	962,512	768,014	-	768,014	647,877	-	647,877
Current portion of long-term debt		39,978	-	39,978	40,309	-	40,309	40,630	-	40,630
<b>Total current liabilities</b>		<b>1,002,490</b>	<b>186,897</b>	<b>1,189,387</b>	<b>808,323</b>	<b>205,540</b>	<b>1,013,863</b>	<b>688,507</b>	<b>213,280</b>	<b>901,787</b>
<b>Non-current liabilities</b>										
Long-term debt		357,097	-	357,097	346,819	-	346,819	318,872	-	318,872
<b>Total non-current liabilities</b>		<b>357,097</b>	<b>-</b>	<b>357,097</b>	<b>346,819</b>	<b>-</b>	<b>346,819</b>	<b>318,872</b>	<b>-</b>	<b>318,872</b>
<b>Total liabilities</b>		<b>1,359,587</b>	<b>186,897</b>	<b>1,546,484</b>	<b>1,155,142</b>	<b>205,540</b>	<b>1,360,682</b>	<b>1,007,379</b>	<b>213,280</b>	<b>1,220,659</b>
<b>Equity</b>										
Share capital		60,648,625	-	60,648,625	62,163,358	-	62,163,358	64,841,468	-	64,841,468
Contributed surplus	(iii)	4,631,349	(1,012)	4,630,337	4,752,134	95	4,752,229	4,863,985	(1,895)	4,862,090
Deficit	(iii)	(64,366,247)	1,012	(64,365,235)	(64,837,376)	(95)	(64,837,471)	(66,997,132)	1,895	(66,995,237)
<b>Total equity</b>		<b>913,727</b>	<b>-</b>	<b>913,727</b>	<b>2,078,116</b>	<b>-</b>	<b>2,078,116</b>	<b>2,708,321</b>	<b>-</b>	<b>2,708,321</b>
<b>Total liabilities and equity</b>		<b>\$ 2,273,314</b>	<b>186,897</b>	<b>\$ 2,460,211</b>	<b>\$ 3,233,258</b>	<b>205,540</b>	<b>\$ 3,438,798</b>	<b>\$ 3,715,700</b>	<b>213,280</b>	<b>\$ 3,928,980</b>

## Reconciliation of equity (continued)

The Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian General Accepted Accounting Policies ("Canadian GAAP"). The balance sheet as at March 31, 2011 has only been reported under IFRS as Canadian GAAP does not exist for that reporting period. There are no material differences between the balance sheet as at March 31, 2011 as reported under IFRS and the balance sheet that would have been reported under Canadian GAAP applicable to fiscal 2010 if Canadian GAAP had continued to exist and been applied to the first interim reporting period of fiscal 2011.

## Reconciliation of comprehensive income for the three months ended March 31, 2010

	Notes	Previous Canadian GAAP	Effect of transition to IFRS	IFRS
<b>REVENUE</b>				
Product sales		\$ 2,149,691	-	\$ 2,149,691
Contract manufacturing		850,613	-	850,613
Consulting services		1,358,521	-	1,358,521
		<u>4,358,825</u>	-	<u>4,358,825</u>
<b>COST OF GOODS SOLD</b>	(v)	<u>2,614,919</u>	18,069	<u>2,632,988</u>
<b>GROSS PROFIT</b>		<u>1,743,906</u>	(18,069)	<u>1,725,837</u>
Selling expenses		190,743	-	190,743
General and administrative expenses	(iii & v)	2,165,070	82,711	2,247,781
Product development and clinical trials expenses	(v)	1,820,688	21,455	1,842,143
Amortization	(v)	123,118	(123,118)	-
		<u>4,299,619</u>	(18,952)	<u>4,280,667</u>
<b>OPERATING LOSS</b>		<u>(2,555,713)</u>	883	<u>(2,554,830)</u>
<b>OTHER INCOME (EXPENSES)</b>				
Interest income		466	-	466
Interest on long-term debt		(11,567)	-	(11,567)
Loss on disposal of property and equipment		(9,912)	-	(9,912)
Loss on foreign exchange		(54,159)	-	(54,159)
		<u>(75,172)</u>	-	<u>(75,172)</u>
<b>LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>		<u>\$ (2,630,885)</u>	\$ 883	<u>\$ (2,630,002)</u>
<b>LOSS PER SHARE</b>				
Basic and diluted loss per share	(vi)	\$ (0.07)	\$ 0.00	\$ (0.07)

## Reconciliation of comprehensive income for the year-ended December 31, 2010

	Notes	Previous Canadian GAAP	Effect of transition to IFRS	IFRS
<b>REVENUE</b>				
Product sales		\$ 2,149,691	-	\$ 2,149,691
Contract manufacturing		850,613	-	850,613
Consulting services		1,358,521	-	1,358,521
		<u>4,358,825</u>	-	<u>4,358,825</u>
<b>COST OF GOODS SOLD</b>	(v)	2,614,919	18,069	<b>2,632,988</b>
<b>GROSS PROFIT</b>		<u>1,743,906</u>	<u>(18,069)</u>	<u>1,725,837</u>
Selling expenses		190,743	-	190,743
General and administrative expenses	(iii & v)	2,165,070	82,711	2,247,781
Product development and clinical trials expenses	(v)	1,820,688	21,455	1,842,143
Amortization	(v)	123,118	(123,118)	-
		<u>4,299,619</u>	<u>(18,952)</u>	<u>4,280,667</u>
<b>OPERATING LOSS</b>		<u>(2,555,713)</u>	<u>883</u>	<u>(2,554,830)</u>
<b>OTHER INCOME (EXPENSES)</b>				
Interest income		466	-	466
Interest on long-term debt		(11,567)	-	(11,567)
Loss on disposal of property and equipment		(9,912)	-	(9,912)
Loss on foreign exchange		(54,159)	-	(54,159)
		<u>(75,172)</u>	-	<u>(75,172)</u>
<b>LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>		<u>\$ (2,630,885)</u>	<u>\$ 883</u>	<u>\$ (2,630,002)</u>
<b>LOSS PER SHARE</b>				
Basic and diluted loss per share	(vi)	\$ (0.07)	\$ 0.00	\$ (0.07)

### Material adjustments to the statement of cash flows for 2010

Consistent with the Company's accounting policy choice under IAS 7 Statement of Cash Flows, interest paid has moved into the body of the Statement of Cash Flows, whereas it was previously disclosed as supplementary information. There are no other material differences between the statement of cash flows presented under IFRSs and the statement of cash flows previously presented under Canadian GAAP.

### Notes to the reconciliations

#### (i) Presentation differences

Certain presentation differences between Canadian GAAP and IFRS have no impact on comprehensive loss or total equity. Please see Notes (f)(ii), (f)(iv) and (f)(v).

Under the "function of expense" presentation adopted for the Company's Statement of Comprehensive Loss under IFRS, depreciation expense is not presented as a separate line item, but is allocated to expense line items by function (see Note (f)(v)).

In addition, amounts previously reported under "Product sales" have been disaggregated into "Product sales" and "Contract manufacturing" under IFRS (see Note (f)(iv)).

Amounts previously reported under “Cash and cash equivalents” have been disaggregated into “Cash” and “Bank overdraft” under IFRS (see note (f)(ii)).

**(ii) Bank overdraft**

Amounts previously reported under “Cash and cash equivalents” have been disaggregated into “Cash” and “Bank overdraft” under IFRS. Consequently, amounts reported as “Cash and cash equivalents” increased by \$186,897 as at January 1, 2010 and by \$213,280 as at December 31, 2010 and amounts reported as “Bank overdraft” increased by \$186,897 as at January 1, 2010 and by \$213,280 as at December 31, 2010.

**(iii) Share-based payments**

Under Canadian GAAP, the fair value of share-based awards with graded vesting are calculated as one grant and the resulting fair value is recognized on a straight-line basis over the vesting period, with actual forfeitures recognized as they occur.

Under IFRS, each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is amortized over the vesting period of the respective tranches with forfeitures estimated at the date of grant, and updated at each subsequent reporting date.

As a result of applying the IFRS 2 to awards not yet vested at the date of transition to IFRS, contributed surplus was decreased by \$1,012 as at January 1, 2010 (March 31, 2010: increased by \$95; December 31, 2010: decreased by \$1,895), and deficit decreased by \$1,012 as at January 1, 2010 (March 31, 2010: increased by \$95, December 31, 2010: decreased by \$1,895); Share-based payment expenses in “General and administrative expenses” increased by \$1,107, and decreased by \$883 for the three months ended March 31, 2010 and for the year-ended December 31, 2010, respectively.

**(iv) Product sales**

Amounts previously reported under “Product sales” has been disaggregated into “Product sales” and “Contract manufacturing” under IFRS. Consequently, amounts reported as “Product sales” decreased by \$360,486 and amounts reported as “Contract manufacturing” increased by \$360,486 for the three months ended March 31, 2010.

**(v) Depreciation**

Under IFRS, the Company has chosen to present the expenses recognized in profit or loss by their function. As a result, depreciation expense in Canadian GAAP is allocated to as an element of “Cost of goods sold”, “General and administrative expenses” and “Product development and clinical trials expenses”. As a result, amounts previously reported for these captions increased by \$4,414, \$17,983, and \$5,066 respectively for the three months ended March 31, 2010, and increased by \$18,068, \$83,594, and \$21,455 respectively for the year-ended December 31, 2010.

**(vi) Basic and diluted loss per share**

Basic and diluted earnings per share in 2010 are the same under IFRS as reported under Canadian GAAP.