



**Neovasc Inc.**  
**CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED  
DECEMBER 31, 2012 AND 2011**

**(Expressed in Canadian dollars)**

# CONTENTS

	<u>Page</u>
Auditor's Report	1 – 2
Consolidated Statements of Financial Position	3
Consolidated Statements of Comprehensive Loss	4
Consolidated Statements of Changes in Equity	5
Consolidated Statements of Cash Flows	6
Notes to the Consolidated Financial Statements	7 – 26



# Independent auditor's report

Grant Thornton LLP  
Suite 1600, Grant Thornton Place  
333 Seymour Street  
Vancouver, BC  
V6B 0A4

T +1 604 687 2711  
F +1 604 685 6569  
www.GrantThornton.ca

To the shareholders of Neovasc Inc.

We have audited the accompanying consolidated financial statements of Neovasc Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, and the consolidated statements of comprehensive loss, consolidated statements of changes in equity, and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

## Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Neovasc Inc. as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Vancouver, Canada

April 25, 2013



Chartered accountants

# NEOVASC INC.

## Consolidated Statements of Financial Position

(Expressed in Canadian dollars)

	Notes	December 31, 2012	December 31, 2011
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	6	\$ 5,861,120	\$ 2,404,510
Investments	7	-	1,504,290
Accounts receivable	8	1,248,271	735,680
Inventory	9	191,942	300,773
Prepaid expenses and other assets		29,891	23,372
<b>Total current assets</b>		<b>7,331,224</b>	<b>4,968,625</b>
<b>Non-current assets</b>			
Property, plant and equipment	10	1,467,372	1,290,651
Restricted cash and cash equivalents	12	-	40,840
<b>Total non-current assets</b>		<b>1,467,372</b>	<b>1,331,491</b>
<b>Total assets</b>		<b>\$ 8,798,596</b>	<b>\$ 6,300,116</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	11	\$ 1,067,283	\$ 591,476
Current portion of long-term debt	12	42,540	41,568
<b>Total current liabilities</b>		<b>1,109,823</b>	<b>633,044</b>
<b>Non-current liabilities</b>			
Long-term debt	12	241,083	280,642
<b>Total non-current liabilities</b>		<b>241,083</b>	<b>280,642</b>
<b>Total liabilities</b>		<b>1,350,906</b>	<b>913,686</b>
<b>Equity</b>			
Share capital	14	70,421,185	70,220,381
Contributed surplus	14	8,370,258	6,158,434
Deficit		(71,343,753)	(70,992,385)
<b>Total equity</b>		<b>7,447,690</b>	<b>5,386,430</b>
<b>Total liabilities and equity</b>		<b>\$ 8,798,596</b>	<b>\$ 6,300,116</b>

See Accompanying Notes to the Consolidated Financial Statements

# NEOVASC INC.

## Consolidated Statements of Comprehensive Loss

For the years ended December 31,  
(Expressed in Canadian dollars)

	Notes	2012	2011
<b>REVENUE</b>			
Product sales		\$ 3,264,851	\$ 1,785,324
Contract manufacturing		2,005,058	1,809,448
Consulting services		2,549,245	1,660,989
	16	<u>7,819,154</u>	<u>5,255,761</u>
<b>COST OF GOODS SOLD</b>	17	<u>4,640,302</u>	<u>3,192,976</u>
<b>GROSS PROFIT</b>		<u>3,178,852</u>	<u>2,062,785</u>
<b>EXPENSES</b>			
Selling expenses	17	169,073	192,355
General and administrative expenses	17	3,957,950	3,128,721
Product development and clinical trials expenses	17	3,980,056	2,624,768
		<u>8,107,079</u>	<u>5,945,844</u>
<b>OPERATING LOSS</b>		<u>(4,928,227)</u>	<u>(3,883,059)</u>
<b>OTHER INCOME/(EXPENSE)</b>			
Interest income		28,646	7,075
Interest expense		(10,553)	(11,848)
Gain on sale of license	19	4,598,160	-
(Loss)/gain on foreign exchange		(39,394)	27,656
		<u>4,576,859</u>	<u>22,883</u>
<b>LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>		<u>\$ (351,368)</u>	<u>\$ (3,860,176)</u>
<b>LOSS PER SHARE</b>			
Basic and diluted loss per share	20	\$ (0.01)	\$ (0.09)

See Accompanying Notes to the Consolidated Financial Statements

# NEOVASC INC.

## Consolidated Statements of Changes in Equity

(Expressed in Canadian dollars)

	Notes	Share Capital	Contributed Surplus	Deficit	Total Equity
<b>Balance at January 1, 2011</b>		<b>\$ 64,841,468</b>	<b>\$ 4,999,062</b>	<b>\$ (67,132,209)</b>	<b>\$ 2,708,321</b>
Issue of share capital pursuant to a private placement	14(b)(ii)	4,677,636	-	-	4,677,636
Issue of share capital on exercise of warrants	14(b)(i)	130,517	-	-	130,517
Issue of share capital on exercise of options	14(b)	570,760	(539,774)	-	30,986
Share-based payments	14(b)	-	1,699,146	-	1,699,146
<b>Transaction with owners during the year</b>		<b>5,378,913</b>	<b>1,159,372</b>	<b>-</b>	<b>6,538,285</b>
<b>Loss and comprehensive loss for the year</b>		<b>-</b>	<b>-</b>	<b>(3,860,176)</b>	<b>(3,860,176)</b>
<b>Balance at December 31, 2011</b>		<b>\$ 70,220,381</b>	<b>\$ 6,158,434</b>	<b>\$ (70,992,385)</b>	<b>\$ 5,386,430</b>
Issue of share capital on exercise of warrants	14(b)(iii)	31,250	-	-	31,250
Issue of share capital on exercise of options	14(b)	169,554	(154,009)	-	15,545
Share-based payments	14(b)	-	2,365,833	-	2,365,833
<b>Transaction with owners during the year</b>		<b>200,804</b>	<b>2,211,824</b>	<b>-</b>	<b>2,412,628</b>
<b>Loss and comprehensive loss for the year</b>		<b>-</b>	<b>-</b>	<b>(351,368)</b>	<b>(351,368)</b>
<b>Balance at December 31, 2012</b>		<b>\$ 70,421,185</b>	<b>\$ 8,370,258</b>	<b>\$ (71,343,753)</b>	<b>\$ 7,447,690</b>

See Accompanying Notes to the Consolidated Financial Statements

# NEOVASC INC.

## Consolidated Statements of Cash Flows

For the years ended December 31,  
(Expressed in Canadian dollars)

	Notes	2012	2011
<b>OPERATING ACTIVITIES</b>			
Loss for the year		\$ (351,368)	\$ (3,860,176)
Adjustments for:			
Depreciation	17	135,865	99,375
Share-based payments	17	2,365,833	1,699,146
Gain on sale of license		(4,598,160)	-
Interest income		(28,646)	(7,075)
Interest expense		10,553	11,848
		<u>(2,465,923)</u>	<u>(2,056,882)</u>
Net change in non-cash working capital items:			
Accounts receivable		(167,729)	(73,681)
Inventory		108,831	168,971
Prepaid expenses and other assets		(6,519)	10,357
Accounts payable and accrued liabilities		475,807	(56,401)
		<u>410,390</u>	<u>49,246</u>
Interest paid and received:			
Interest received		28,646	7,075
Interest paid		(10,553)	(11,848)
		<u>18,093</u>	<u>(4,773)</u>
		<u>(2,037,440)</u>	<u>(2,012,409)</u>
<b>INVESTING ACTIVITIES</b>			
Decrease/(Increase) in investments in guaranteed investment certificates		1,504,290	(1,504,290)
Proceeds from sale of license		4,253,298	-
Purchase of property, plant and equipment		(312,586)	(165,545)
		<u>5,445,002</u>	<u>(1,669,835)</u>
<b>FINANCING ACTIVITIES</b>			
Decrease in bank overdraft		-	(213,280)
Decrease in restricted cash & cash equivalents		40,840	9,160
Repayment of long-term debt		(38,587)	(37,292)
Proceeds from issue of shares, net of costs of \$42,864		-	4,677,636
Proceeds from exercise of warrants		31,250	130,517
Proceeds from exercise of options		15,545	30,986
		<u>49,048</u>	<u>4,597,727</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>		<b>3,456,610</b>	<b>915,483</b>
<b>CASH AND CASH EQUIVALENTS</b>			
Beginning of the year		2,404,510	1,489,027
End of the year		<u>\$ 5,861,120</u>	<u>\$ 2,404,510</u>
Represented by:			
Cash	6	5,861,120	901,964
Cashable high interest savings accounts	6	-	1,201,688
Cashable guaranteed investment certificates	6	-	300,858
		<u>\$ 5,861,120</u>	<u>\$ 2,404,510</u>

See Accompanying Notes to the Consolidated Financial Statements



# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 1. INCORPORATION AND NATURE OF BUSINESS

Neovasc Inc. ("Neovasc" or the "Company") is a limited liability company incorporated and domiciled in Canada. The Company was incorporated as Medical Ventures Corp. under the Company Act (British Columbia) on November 2, 2000 and was continued under the Canada Business Corporations Act on April 19, 2002. On July 1, 2008, the Company changed its name to Neovasc Inc.

Neovasc is the parent company. The consolidated financial statements of the Company as at December 31, 2012 and December 31, 2011 and for the years ended December 31, 2012 and 2011 comprise the Company and its subsidiaries, all of which are wholly owned. Neovasc's registered office and its principal place of business is Suite 2135, 13700 Mayfield Place, Richmond, British Columbia, Canada, V6V 2E4. The Company's shares are listed on the TSX Venture Exchange.

Neovasc is a specialty medical device company that develops, manufactures and markets products for the rapidly growing cardiovascular marketplace. Its products include the Neovasc Reducer™ for the treatment of refractory angina, the Tiara™ technology in development for the transcatheter treatment of mitral valve disease and a line of advanced biological tissue products that are used as key components in a variety of third-party medical products, such as transcatheter heart valves.

### 2. BASIS OF PREPARATION

#### (a) Statement of compliance with IFRS

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

#### (b) Basis of measurement

The Company's consolidated financial statements have been prepared on the historical cost basis except for accounts receivable measured at amortized cost and inventory measured at net realizable value, as explained in the accounting policies set out in Notes 3(b) and 3(e), respectively.

#### (c) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiaries, Neovasc Medical Inc., Angiometrx Inc., Neovasc Medical Ltd., B-Balloon Ltd. and Neovasc (US) Inc. All intercompany balances and transactions have been eliminated upon consolidation.

#### (d) Presentation of financial statements

The Company has elected to present the 'Statement of Comprehensive Income' in a single statement.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 2. BASIS OF PREPARATION (continued)

#### (e) Use of estimates and management judgment

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Significant areas requiring the use of estimates relate to the determination of the net realizable value of inventory (obsolescence provisions), allowance for doubtful accounts receivable, impairment of non-financial assets, useful lives of depreciable assets and expected life, volatility and forfeiture rates for share-based payments.

##### *Inventories*

The Company estimates the net realizable values of inventories, taking into account the most reliable evidence available at each reporting date. The future realization of these inventories may be affected by future technology or other market-driven changes that may reduce future selling prices.

##### *Allowance for doubtful accounts receivable*

The Company provides for bad debt by setting aside accounts receivable past due more than 121 days. Actual collectability of customer balances can vary from the Company's estimation.

##### *Impairment of long-lived assets*

In assessing impairment, the Company estimates the recoverable amount of each asset or cash generating unit based on expected future cash flows and uses an interest rate to discount them. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate.

##### *Useful lives of depreciable assets*

The Company reviews its estimate of the useful lives of depreciable assets at each reporting date, based on the expected utilization of the assets.

##### *Share-based payment*

The Company measures the cost of equity-settled transactions by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility and forfeiture rates and making assumptions about them.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

#### (a) Foreign currency translation

The functional currency of Neovasc and each of its subsidiaries is the Canadian dollar. The presentation currency of the consolidated financial statements is the Canadian dollar.

Foreign currency denominated monetary assets and liabilities are translated into Canadian dollars at the period end rate of exchange. Foreign currency denominated non-monetary assets and liabilities are translated at the historical rates of exchange in effect on the date the asset was acquired or liability incurred. Foreign currency denominated revenues and expenses are translated at the rate of exchange on the date on which such transactions occur. Foreign currency gains or losses arising on the settlement of foreign-currency denominated monetary assets and liabilities are recognized in profit or loss in the period in which they arise.

#### (b) Financial instruments

Financial assets and financial liabilities are recognized on the Company's consolidated statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognized when the contractual rights to the cash flows from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are de-recognized when the obligation specified in the contract is discharged, cancelled or expired.

The Company classifies its cash and cash equivalents, restricted cash and cash equivalents and accounts receivable as loans and receivables. Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method.

The Company classifies its long-term debt and accounts payable and accrued liabilities as other financial liabilities. These financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

#### (c) Cash and cash equivalents

Cash and cash equivalents include cash on hand and short-term, highly liquid investments that are readily convertible to known amounts of cash within 90 days of purchase.

#### (d) Investments

Investments include investments in high interest savings accounts ("HISAs") and guaranteed investment certificates ("GICs") that are readily convertible to known amounts of cash after 90 days of purchase.

#### (e) Inventory

Inventory is valued at the lower of cost and net realizable value for finished goods, work in progress and raw materials. Cost is determined on a first-in, first-out basis. Cost of finished goods and work in progress includes direct material and labor costs and an allocation of manufacturing overhead and applicable shipping and handling costs. In determining net realizable value, the Company considers factors such as obsolescence, future demand for inventory and contractual arrangements with customers.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (f) Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

As no finite useful life for land can be determined, related carrying amounts are not depreciated.

Depreciation of property, plant and equipment is recognized in profit or loss over the estimated useful lives using the following rates and methods:

Building	4% declining balance
Production equipment	30% declining balance
Computer hardware	30% declining balance
Computer software	100% declining balance
Office equipment	20% declining balance

Gains or losses arising on the disposal of property, plant and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss.

#### (g) Impairment of assets

##### Financial assets (including accounts receivable)

The Company reviews its accounts receivable at least at each reporting date to determine whether there is objective evidence that it is impaired.

The Company considers evidence of impairment for accounts receivable when the amounts are past due or when other objective information is received that a specific counterparty may default. Accounts receivable that are not considered to be individually impaired are reviewed for impairment in groups, using historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against receivables. When subsequent events cause the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

##### Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, if it is not possible to estimate the recoverable amount of an individual asset, the asset is included in the cash-generating unit to which it belongs and the recoverable amount of the cash-generating unit is estimated. As a result, some assets are tested individually for impairment and some are tested at the cash-generating unit level. A cash-generating unit is the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit on a pro-rata basis.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (h) Employee benefits

The Company provides short-term employee benefits and post-employment benefits to current employees. The short-term employee benefits includes wages, salaries, social security contributions, paid annual leave, paid sick leave and medical care. Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The Company provides post-employment benefits through defined contribution plans, including contributions to the Canadian Pension Plan and individual Registered Retirement Savings Plans of qualified employees. Contributions to defined contribution pension plans are recognized as an employee benefit expense in the years during which services are rendered by employees.

#### (i) Revenue recognition

Revenue from the sale of goods and services is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company earns revenue from three sources: product sales, contract manufacturing and consulting services. Revenues from these three sources are recognized as follows:

##### **Product sales**

For product sales, these criteria are met upon shipment of product.

##### **Contract manufacturing**

For contract manufacturing, these criteria are met upon shipment of product.

##### **Consulting services**

For consulting services, these criteria are met as the services are delivered under the terms of the related consulting services contract.

#### (j) Research and development

The Company is engaged in research and development. Research costs are expensed as incurred. Development costs are expensed in the period incurred, unless they meet the criteria for capitalization. The criteria include that development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Other development expenditure is recognized in profit or loss as incurred. Management reviews the applicable criteria on a regular basis and if the criteria are no longer met, any remaining unamortized balance is written off as a charge to profit or loss. Research and development costs are reduced by any scientific research and experimental development tax credits to which the Company is entitled.

#### (k) Government assistance

Government assistance, consisting of grants and scientific research and experimental development tax credits, is recorded as a reduction of either the related expense or the cost of the asset to which it relates. The assistance is recorded in the accounts when reasonable assurance exists that the Company has complied with the terms and conditions of the approved government assistance program and when there is reasonable assurance that the assistance will be realized.

#### (l) Interest income and interest expense

Interest income comprises interest income on the GICs and HISAs. Interest income is recognized in profit or loss, using the effective interest method.

Interest expense comprises interest expense on the long-term debt. Interest expense is recognized in profit or loss using the effective interest method.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (m) Operating lease

Leases where the Company does not assume substantially all the risks and rewards of ownership are classified as operating leases. Payments on operating lease are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

#### (n) Income taxes

Tax expense represents current tax and deferred tax. Tax is recognized in profit or loss except to the extent it relates to items recognized in other comprehensive income or directly in equity. Current tax is based on the taxable profits for the year, and is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their respective carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting profit nor taxable profit. Deferred tax assets are recognized to the extent that it is probable that the future taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized.

Deferred tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability settled.

#### (o) Equity

Share capital represents the value of shares that have been issued. Any transaction costs associated with the issuing of shares are deducted from share capital.

From time to time the Company issues units consisting of common shares and common share purchase warrants. The Company estimates the fair value of the common shares based on their market price on the date of the issuance of the units. The residual difference, if any, between the unit price and the fair value of each common share represents the fair value attributable to each warrant. Any transaction costs associated with the issuance of units are apportioned between the common shares and warrants based on their relative fair values.

Professional, consulting, regulatory fees and other costs that are directly attributable to financing transactions are deferred until such time as the transactions are completed. Share issue costs are charged to share capital when the related shares are issued. Costs relating to financing transactions that are abandoned are charged to profit and loss.

Contributed surplus includes the fair value of vested stock options (see Note 3(p)).

Deficit includes all current and prior period losses.

#### (p) Share-based payments

The Company has an equity-settled share-based stock option plan. The Company grants stock options to buy common shares of the Company to directors, officers, employees and consultants (see Note 14(c)).

The fair value of the stock options awarded to employees, directors, officers and service providers is measured at grant date, using the Black-Scholes Option Pricing Model with assumptions for risk-free interest rates, dividend yields, volatility factors of the expected market price of the Company's common shares and an expected life of the options. The fair value of the options is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the options. The amount recognized as expense is adjusted to reflect the number of stock options expected to vest.

For stock options with non-vesting conditions, the grant date fair value of the options is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (q) Loss per share

Loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed using the weighted average number of common shares outstanding during the period on a diluted basis using the treasury stock method.

#### (r) Operating segment

The Company operates its business in one segment. The Company reports information about revenues from customers for products sales, contract manufacturing and consulting services, from geographical areas, and from major customers (see Note 16).

#### (s) Future accounting pronouncements

The following new accounting pronouncements have been issued but are not effective and may have an impact on the Company:

Effective for annual periods beginning on or after January 1, 2013:

The International Accounting Standards Board (IASB) has issued Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities). The amendments clarify the transition guidance in IFRS 10 Consolidated Financial Statements. The effective date of the amendments is annual periods beginning on or after January 1, 2013, which is aligned with the effective date of IFRS 10, 11 and 12.

IFRS 10 Consolidated Financial Statements builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 10 Consolidated Financial Statements replaces SIC-12 Consolidation-Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements. Based on current facts and circumstances, the Company does not expect to be materially affected by the application of this standard.

IFRS 11 Joint Arrangements provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities. IFRS 11 supersedes IAS 31 Interests in Joint Ventures and SIC-13 Jointly Controlled Entities-Non-monetary Contributions by Venturers. Based on current facts and circumstances, the Company does not have any joint arrangements as defined by IFRS 11, and hence, does not expect to be affected by the application of this standard.

IFRS 12 Disclosure of Interests in Other Entities is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates, special purpose vehicles and other off-balance sheet vehicles. The effective date is annual periods beginning on or after January 1, 2013. Based on current facts and circumstances, the Company does not expect to be materially affected by the application of this standard.

IFRS 13 Fair Value Measurements explains how to measure fair value by providing a clear definition and introducing a single set of guidance for (almost) all fair value measurements. It clarifies how to measure fair value when a market becomes less active and improves transparency through additional disclosures. The effective date is annual periods beginning on or after January 1, 2013. Based on current facts and circumstances, the Company does not expect to be materially affected by the application of this standard.

The amendments to IAS 1 Presentation of Financial Statements require companies to group together items within Other Comprehensive Income ("OCI") that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendments to this standard do not change the nature of the items that are currently recognized in OCI. The effective date is annual periods beginning on or after July 1, 2012. Based on current facts and circumstances, the Company does not expect to be materially affected by the application of this standard.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (s) Future accounting pronouncements (continued)

Effective for annual periods beginning on or after January 1, 2015:

IFRS 9 Financial Instruments will replace IAS 39 Financial Instruments: Recognition and Measurement, and is currently being developed in stages by the IASB. The IASB has decided to delay implementation until periods beginning on or after January 1, 2015, with early application permitted. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. IFRS 9 has also been amended not to require the restatement of comparative period financial statements for the initial application of the classification and measuring requirements of IFRS 9, but instead requires modified disclosures on transition to IFRS 9. The Company has not early adopted this standard and is currently assessing the impact that this standard will have on the consolidated financial statements.

### 4. MANAGING CAPITAL

The Company's objectives, when managing capital, are to safeguard cash as well as maintain financial liquidity and flexibility in order to preserve its ability to meet financial obligations and deploy capital to grow its business. In the definition of capital, the Company includes equity and long-term debt. There has been no change in the definition since the prior period.

The Company's financial strategy is designed to maintain a flexible capital structure consistent with the objectives stated above and to respond to business growth opportunities and changes in economic conditions. In order to maintain or adjust its capital structure, the Company may issue new shares, or new debt (secured, unsecured, convertible and/or other types of available debt instruments).

The capital of the Company is comprised of:

	<b>December 31, 2012</b>	December 31, 2011
Equity	<b>\$ 7,447,690</b>	\$ 5,386,430
Long-term debt	<b>283,623</b>	322,210
	<b><u>\$ 7,731,313</u></b>	<u>\$ 5,708,640</u>

The Company is subject to certain financial covenants in connection with its long-term debt, including a requirement to limit the amount of total debt in relation to total equity. As at December 31, 2012 and 2011, the Company was in compliance with all financial covenants associated with its long-term debt.

For the years ended December 31, 2012 and 2011 there were no changes in the Company's capital management policy.



# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

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### 5. FINANCIAL RISK MANAGEMENT

#### (a) Foreign exchange risk

The majority of the Company's revenues are derived from product sales in the United States and Europe, primarily denominated in United States and European Union currencies. Management has considered the stability of the foreign currency and the impact a change in the exchange rate may have on future earnings during the forecasting process. United States and European Union currency represents approximately 65% and 31% of the revenue for year ended December 31, 2012 (year ended December 31, 2011: 63% and 33% respectively). A 5% change in the foreign exchange rates for United States and European Union currencies will result in a change in revenues of approximately \$255,000 and \$120,000 respectively. A 5% change in the foreign exchange rates for the United States and European Union currencies will result in a change in foreign currency denominated accounts receivable of approximately \$26,000 and \$14,000 respectively and a change in foreign currency denominated accounts payable of approximately \$11,000 and \$9,600 respectively.

#### (b) Interest rate risk

The Company makes fixed repayments on its long-term debt (see Note 12). Included in the repayments is an interest payment with an interest rate floating at prime rate plus 0.500% per annum. Management has considered the risks to cash flows from this variable interest portion and considers it unlikely that the interest rates will increase sufficiently to exceed the fixed monthly payment due on the bank loan. A 1% change in the interest rate on the bank loan will change the interest rate expense for the year by approximately \$2,860 (2011: \$3,200) and inversely change the amount of principal repaid by the same amount.

#### (c) Liquidity risk

As at December 31, 2012 the Company had \$5,861,120 cash. The cash use in operations during the year ended December 31, 2012 was \$2,037,440.

As at December 31, 2012 the Company had working capital of \$6,221,401 as compared to working capital of \$4,335,581 at December 31, 2011.

#### (d) Credit risk

Credit risk arises from the possibility that the entities to which the Company sells products may experience financial difficulty and be unable to fulfill their contractual obligations. This risk is mitigated by proactive credit management policies that include regular monitoring of the debtor's payment history and performance. The Company does not require collateral from its customers as security for trade accounts receivable but may require certain customers to pay in advance of any work being performed or product being shipped. The maximum exposure, if all of the Company's customers were to default at the same time is the full carrying value of the trade accounts receivable at December 31, 2012: \$844,850 (December 31, 2011: \$700,411).

As at December 31, 2012, the Company had \$8,706 (December 31, 2011: \$21,998) of trade accounts receivable that was overdue, according to the customers' credit terms. Of these the Company has provided for \$nil of trade accounts receivable which management believes may be impaired (December 31, 2011: \$3,868). During the years ended December 31, 2012 and 2011 the Company wrote down \$nil of accounts receivable owed by customers.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 6. CASH AND CASH EQUIVALENTS

	December 31, 2012	December 31, 2011
Canadian dollars	\$ 293,409	\$ 445,563
United States dollars	5,287,649	456,052
European euros	280,062	349
Deposits held in High Interest Savings Accounts ("HISAs")	-	1,201,688
Deposits held as a Guaranteed Investments Certificate ("GIC")	-	300,000
Accrued interest on GIC	-	858
	<b>\$ 5,861,120</b>	<b>\$ 2,404,510</b>

The HISAs were fully cashable at any time and had a variable interest rate. The GIC was fully cashable, had a 90-day term, matured on January 18, 2012 and had a fixed interest of 1.45% per annum.

### 7. INVESTMENTS

	December 31, 2012	December 31, 2011
Deposits held as Guaranteed Investments Certificates ("GICs")	\$ -	\$ 1,500,000
Accrued Interest on GICs	-	4,290
	<b>\$ -</b>	<b>\$ 1,504,290</b>

The GICs issued by major Canadian Chartered Banks were non-cashable, had a 180-day term, matured on April 17, 2012 and had a fixed interest rate of 1.50% per annum.

### 8. ACCOUNTS RECEIVABLE

	December 31, 2012	December 31, 2011
Trade receivables	\$ 844,850	\$ 704,279
Allowance for doubtful accounts	-	(3,868)
Net trade receivables	844,850	700,411
Receivable from LeMaitre	344,862	-
Other receivables	58,559	35,269
	<b>\$ 1,248,271</b>	<b>\$ 735,680</b>

At December 31, 2012, the Receivable from LeMaitre Vascular Inc. ("LeMaitre") represents amounts due one year after from the sale of a license to LeMaitre. (see Note 19).

All amounts are short-term. The net carrying value of trade receivables is considered a reasonable approximation of fair value. The aging analysis of receivables is as follows:

	December 31, 2012	December 31, 2011
Not past due	\$ 836,144	\$ 682,281
Past due 0 - 30 days	-	18,130
Past due 31 - 60 days	8,706	-
Past due 61 - 90 days	-	-
Past due 91 - 120 days	-	-
Past due more than 121 days	-	3,868
	<b>\$ 844,850</b>	<b>\$ 704,279</b>

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 8. ACCOUNTS RECEIVABLE (continued)

All of the Company's trade and other receivables have been reviewed for impairment. No impairment was found. The movement in the allowance for doubtful accounts is as follows:

	<b>December 31, 2012</b>	December 31, 2011
Balance January 1,	\$ 3,868	\$ 781
Amounts recorded during period	<b>(3,868)</b>	3,087
	<b>\$ -</b>	<b>\$ 3,868</b>

### 9. INVENTORY

	<b>December 31, 2012</b>	December 31, 2011
Raw materials	\$ 95,061	\$ 180,544
Work in progress	<b>49,567</b>	9,220
Finished goods	<b>47,314</b>	111,009
	<b>\$ 191,942</b>	<b>\$ 300,773</b>

During the year ended December 31, 2012 \$3,234,927 (2011: \$2,284,761) of inventory was expensed in cost of goods sold, and \$227,986 (2011: \$62,734) of inventory was used in internal development projects and expensed in product development and clinical trial expenses. All the inventories are pledged as security for the long-term debt of the Company (see Note 12).

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 10. PROPERTY, PLANT AND EQUIPMENT

	Land	Building	Production equipment	Computer hardware	Computer software	Office equipment	Total
<b>COST</b>							
Balance at January 1, 2011	\$ 207,347	\$ 1,081,177	\$ 528,561	\$ 170,279	\$ 216,739	\$ 162,024	\$ 2,366,127
Additions	-	94,801	38,751	6,914	25,079	-	165,545
<b>Balance at December 31, 2011</b>	<b>\$ 207,347</b>	<b>\$ 1,175,978</b>	<b>\$ 567,312</b>	<b>\$ 177,193</b>	<b>\$ 241,818</b>	<b>\$ 162,024</b>	<b>\$ 2,531,672</b>
Additions	-	123,664	111,049	39,918	29,846	8,109	312,586
<b>Balance at December 31, 2012</b>	<b>\$ 207,347</b>	<b>\$ 1,299,642</b>	<b>\$ 678,361</b>	<b>\$ 217,111</b>	<b>\$ 271,664</b>	<b>\$ 170,133</b>	<b>\$ 2,844,258</b>
<b>ACCUMULATED DEPRECIATION</b>							
Balance at January 1, 2011	\$ -	\$ 224,832	\$ 440,725	\$ 136,740	\$ 213,635	\$ 125,714	\$ 1,141,646
Depreciation for the year	-	36,478	34,014	11,660	9,961	7,262	99,375
<b>Balance at December 31, 2011</b>	<b>\$ -</b>	<b>\$ 261,310</b>	<b>\$ 474,739</b>	<b>\$ 148,400</b>	<b>\$ 223,596</b>	<b>\$ 132,976</b>	<b>\$ 1,241,021</b>
Depreciation for the year	-	39,743	34,811	12,821	42,029	6,461	135,865
<b>Balance at December 31, 2012</b>	<b>\$ -</b>	<b>\$ 301,053</b>	<b>\$ 509,550</b>	<b>\$ 161,221</b>	<b>\$ 265,625</b>	<b>\$ 139,437</b>	<b>\$ 1,376,886</b>
<b>CARRYING AMOUNTS</b>							
At December 31, 2011	<b>\$ 207,347</b>	<b>\$ 914,668</b>	<b>\$ 92,573</b>	<b>\$ 28,793</b>	<b>\$ 18,222</b>	<b>\$ 29,048</b>	<b>\$ 1,290,651</b>
At December 31, 2012	<b>\$ 207,347</b>	<b>\$ 998,589</b>	<b>\$ 168,811</b>	<b>\$ 55,890</b>	<b>\$ 6,039</b>	<b>\$ 30,696</b>	<b>\$ 1,467,372</b>

As at December 31, 2012, all property, plant and equipment were pledged as security for the long-term debt of the Company (see Note 12).

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31, 2012	December 31, 2011
Trade payables	\$ 646,042	\$ 339,534
Accrued liabilities	403,818	236,618
Other payables	17,423	15,324
	<u>\$ 1,067,283</u>	<u>\$ 591,476</u>

All amounts are short-term. The net carrying value of trade payables is considered a reasonable approximation of fair value.

### 12. LONG-TERM DEBT

	December 31, 2012	December 31, 2011
Bank installment loan	\$ 283,623	\$ 322,210
Less current portion	(42,540)	(41,568)
	<u>\$ 241,083</u>	<u>\$ 280,642</u>

Repayments consist of 180 regular blended payments of \$4,095 each month, including interest and principal, commencing on September 1, 2007 and ending on or before August 1, 2022. The loan agreement as amended on July 18, 2012, is collateralized by a first charge over the Company's land and buildings and a general security agreement over all personal property of the business now owned and all personal property acquired in the future. The liquid security agreement of US\$40,000 to be held in cash was removed in the 2012 loan agreement. The loan bears interest at prime plus 0.500% per annum.

Principal maturities in the next five years and thereafter are approximately as follows:

	December 31, 2012	December 31, 2011
Year 1	\$ 42,540	\$ 41,568
Year 2	43,855	42,897
Year 3	44,919	43,938
Year 4	46,009	45,005
Year 5	47,125	46,097
Thereafter	59,175	102,705
	<u>\$ 283,623</u>	<u>\$ 322,210</u>

More information about the Company's exposure to interest rate and liquidity risk is given in Notes 5(b) and 5(c).

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 13. INCOME TAXES

The relationship between the expected tax expense based on the combined federal and provincial income tax rate in Canada and the reported tax expense in the consolidated statement of comprehensive income can be reconciled as follows:

	For the years ended December 31,	
	2012	2011
Loss before income taxes	\$ (351,368)	\$ (3,860,176)
Statutory tax rate	25.0%	26.5%
Recovery of income taxes based on the combined Canadian federal and provincial statutory rates	(87,842)	(1,022,947)
Difference in tax rates between foreign jurisdictions and Canada	-	22,528
Share-based remuneration	591,458	450,274
Effect of rate change	-	7,015
Foreign exchange adjustment	7,712	(13,204)
Non-Taxable differences	(575,121)	
Other differences	48,924	(55,554)
Expired tax losses	-	278,703
Unrecognized deferred tax benefits	14,924	333,185
Income tax expense	\$ -	\$ -

The Company recorded no deferred tax assets in the consolidated statement of financial position. The unrecognized deferred tax assets include tax losses, research and development pools and differences between the carrying amount and the tax basis of the following items:

	For the years ended December 31,	
	2012	2011
Deferred tax assets		
Investment tax credits	\$ 2,330,768	\$ 1,613,026
Capital assets	363,667	329,700
Share issue expenses	10,006	19,141
Non-capital loss carry forwards	10,720,634	10,688,665
Research and development expenditures	1,770,412	1,332,249
	\$ 15,195,487	\$ 13,982,781

As at December 31, 2012, the Company has approximately \$7,100,000 of research and development expenditures available to reduce income taxes in the future periods, with no expiry date. The Company has loss carry forward balances for income tax purposes of approximately \$29,000,000 that are available to reduce income taxes in the future periods, if any, expiring at various times through to the year 2032. The Company also has investment tax credits of approximately \$2,800,000 available to reduce income taxes in the future periods, if any, expiring at various times through to the year 2032.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 14. SHARE CAPITAL

All shares are equally eligible to receive dividends and the repayment of capital and represent one vote at the shareholders' meeting.

#### (a) Authorized

Unlimited number of common shares without par value.

Unlimited number of preferred shares without par value.

#### (b) Issued and outstanding

	Common Shares		Contributed
	Number	Amount	Surplus
<b>Balance, December 31, 2010</b>	<b>40,364,334</b>	<b>\$ 64,841,468</b>	<b>\$ 4,999,062</b>
Issued for cash on exercise of warrants (i)	326,293	130,517	
Issued for cash pursuant to a private placement (ii)	4,720,500	4,720,500	
Share issue costs (ii)		(42,864)	
Issued for cash on exercise of options	301,522	570,760	(539,774)
Share-based payments			1,699,146
<b>Balance, December 31, 2011</b>	<b>45,712,649</b>	<b>\$ 70,220,381</b>	<b>\$ 6,158,434</b>
Issued for cash on exercise of warrants (iii)	25,000	31,250	
Issued for cash on exercise of options	89,391	169,554	(154,009)
Share-based payments			2,365,833
<b>Balance, December 31, 2012</b>	<b>45,827,040</b>	<b>\$ 70,421,185</b>	<b>\$ 8,370,258</b>

- (i) 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.
- (ii) On August 16, 2011, the Company completed a non-brokered private placement of 4,720,500 equity units at the price of \$1.00 per unit for aggregate gross proceeds of approximately \$4,720,500. 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 entitles the holder thereof to purchase one common share of Neovasc stock at the exercise price of \$1.25 per share for a period of two years after the closing date of the offering. Share issue costs were \$42,864.
- (iii) On December 12, 2012, the Company issued 25,000 common shares upon the exercise of warrants issued as part of the Company's August 2011 financing (see Note 14(b)(ii)). Proceeds received from the exercise of the 25,000 warrants amounted to \$31,250.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 14. SHARE CAPITAL (continued)

#### (c) Stock options

The Company adopted an equity-settled stock option plan under which the directors of the Company may grant options to purchase common shares to directors, officers, employees and service providers (the "optionees") of the Company on terms that the directors of the Company may determine within the limitations set forth in the stock option plan. Effective June 8, 2011, at the Annual General Meeting ("AGM"), the board of directors of the Company approved an amendment to the Company's incentive stock option plan to increase the number of options available for grant under the plan to 8,023,515, representing 20% of the number of common shares of the Company outstanding on June 8, 2011.

Options under the Company's stock option plan granted to directors may vest immediately and options granted to employees and officers vest 20% immediately on the grant date, and 20% on each of the next four anniversaries of the grant date. The directors of the Company have discretion within the limitations set forth in the stock option plan to determine other vesting terms on options granted to directors, officers, employees and others. The minimum exercise price of a stock option cannot be less than the applicable market price of the common shares on the date of the grant and the options have a maximum life of five years from the date of grant. The Company also assumed options from the acquisition of Neovasc Medical Ltd. and B-Balloon Ltd which are not the part of the Company's stock option plan. The following table summarizes stock option activity for the respective periods as follows:

	Number of options	Weighted average exercise price	Average remaining contractual life (years)
<b>Options outstanding, December 31, 2010</b>	<b>4,136,302</b>	<b>\$ 0.46</b>	<b>4.04</b>
Granted	2,468,250	1.00	
Exercised	(301,522)	0.10	
Forfeited	(7,550)	0.84	
Expired	(442)	0.20	
<b>Options outstanding, December 31, 2011</b>	<b>6,295,038</b>	<b>\$ 0.67</b>	<b>3.49</b>
Granted	1,609,850	1.44	
Exercised	(89,391)	0.17	
Forfeited	(46,000)	0.89	
Expired	(1,710)	0.20	
<b>Options outstanding, December 31, 2012</b>	<b>7,767,787</b>	<b>\$ 0.85</b>	<b>2.91</b>
<b>Options exercisable, December 31, 2012</b>	<b>6,589,512</b>	<b>\$ 0.85</b>	<b>2.86</b>
Weighted average measurement date fair value of stock options awarded during the year.		\$ 1.30	

The following table lists the options outstanding at December 31, 2012 by exercise price:

Exercise price	Options outstanding	Weighted average remaining term (yrs)	Options exercisable	Weighted average remaining term (yrs)
\$ 0.01	515,824	4.18	515,824	4.18
\$ 0.20-0.40	2,349,113	1.98	1,970,563	1.98
\$ 0.97-1.15	4,902,850	3.22	4,103,125	3.12
	<b>7,767,787</b>		<b>6,589,512</b>	

The weighted average share price at the date of exercise for share options exercised for the year ended December 31, 2012 was \$0.17 (2011: \$0.10). During the year ended December 31, 2012, the Company recorded \$2,365,833 as compensation expense for share-based compensation awarded to eligible optionees (2011: \$1,699,146). The Company used the Black-Scholes Option Pricing Model to estimate the fair value of the options at each measurement date using the following weighted average assumptions:

	2012	2011
Weighted average fair value	\$ 1.30	\$ 0.89
Dividend yield	nil	nil
Volatility	144%	141%
Risk-free interest rate	1.50%	2.75%
Expected life	5 years	5 years



# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 14. SHARE CAPITAL (continued)

#### (d) Warrants

	<u>Number of warrants</u>
<b>Balance, December 31, 2010</b>	<b>326,293</b>
Exercised (i)	(326,293)
Issued pursuant to a private placement (ii)	2,360,250
<b>Balance, December 31, 2011</b>	<b>2,360,250</b>
Exercised (iii)	(25,000)
<b>Balance, December 31, 2012</b>	<b>2,335,250</b>

- (i) On January 17, 2011, and February 15, 2011, 197,922 and 128,371 warrants issued as part of the Company's February 2010 financing (see Note 14(b)(i)) were exercised. Proceeds from the exercise of the 326,293 warrants amounted to \$130,517.
- (ii) On August 16, 2011, 2,360,250 warrants issued as part of the Company's August 2011 financing (see Note 14(b)(ii)). Each whole warrant entitled the holder thereof to purchase one common share of Neovasc stock at the exercise price of \$1.25 per share for a period of two years after the closing date of the offering.
- (iii) On December 12, 2012, 25,000 warrants issued as part of the Company's August 2011 financing (see Note 14(b)(i)) were exercised. Proceeds received from the exercise of the 25,000 warrants amounted to \$31,250.

There were no performance conditions attached to the warrants and all the warrants vested upon issuance.

### 15. EMPLOYEE BENEFITS EXPENSE

	For the years ended December 31,	
	<u>2012</u>	<u>2011</u>
Salaries and wages	<b>\$ 3,246,687</b>	\$ 2,645,287
Canadian pension plan and employment insurance	<b>162,287</b>	137,551
Contribution to defined contribution pension plan	<b>78,584</b>	64,676
Share-based payments	<b>2,365,833</b>	1,699,146
	<b>\$ 5,853,391</b>	<b>\$ 4,546,660</b>

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 16. SEGMENT INFORMATION

The Company's operations are in one business segment; the development, manufacture and marketing of medical devices. Each of the Company's product lines has similar characteristics, customers, distribution and marketing strategies, and are subject to similar regulatory requirements. Substantially all of the Company's long-lived assets are located in Canada. The Company carries on business in Canada. The Company earns revenue from sales to customers in the following geographic locations:

	For the years ended December 31,	
	2012	2011
<b>REVENUE</b>		
United States	\$ 4,039,667	\$ 2,298,201
Europe	3,665,049	1,958,583
Israel	103,181	809,002
Canada	11,257	189,975
	<b>\$ 7,819,154</b>	<b>\$ 5,255,761</b>

Sales to the Company's four largest customers accounted for approximately 39%, 21%, 18% and 10% of the Company's sales for the year ended December 31, 2012. Comparatively, sales to the Company's four largest customers accounted for approximately 27%, 27%, 19% and 13% of the Company's sales for the year ended December 31, 2011.

### 17. DEPRECIATION AND SHARE-BASED PAYMENTS

	For the years ended December 31,	
	2012	2011
<b>COST OF GOODS SOLD</b>		
Depreciation	\$ 18,278	\$ 14,374
Share-based payments	70,120	27,005
Other costs	4,551,904	3,151,597
<b>TOTAL COST OF GOODS SOLD</b>	<b>\$ 4,640,302</b>	<b>\$ 3,192,976</b>
<b>EXPENSES</b>		
<b>Selling expenses</b>		
Depreciation	\$ 532	\$ -
Share-based payments	14,395	12,055
Other costs	154,146	180,300
	<b>169,073</b>	<b>192,355</b>
<b>General and administrative expenses</b>		
Depreciation	88,600	57,730
Share-based payments	1,759,037	1,264,369
Other costs	2,110,313	1,806,622
	<b>3,957,950</b>	<b>3,128,721</b>
<b>Product development and clinical trials expenses</b>		
Depreciation	28,455	27,271
Share-based payments	522,281	395,717
Other costs	3,429,320	2,201,780
	<b>3,980,056</b>	<b>2,624,768</b>
<b>TOTAL EXPENSES</b>	<b>\$ 8,107,079</b>	<b>\$ 5,945,844</b>
Depreciation per Statements of Cash Flows	<b>\$ 135,865</b>	<b>\$ 99,375</b>
Share-based payments per Statements of Cash Flows	<b>\$ 2,365,833</b>	<b>\$ 1,699,146</b>

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 18. OPERATING LEASES

The Company entered into an agreement for additional office space. The agreement does not contain any contingent rent clauses, renewal or purchase options or escalation clauses. The term of the lease is 24 months commenced from October 1, 2012. The future minimum operating lease payments due over the next two years are as follows:

	For the year ended December 31,	
	2012	2011
Year 1	\$ 15,839	\$ -
Year 2	20,660	-
	<u>\$ 36,499</u>	<u>\$ -</u>

Lease payments recognized as an expense during the year amount to \$4,821.

### 19. GAIN ON SALE OF LICENSE

On October 31, 2012, the Company finalized its agreement with LeMaitre allowing LeMaitre to exercise its option to purchase certain specific rights to Neovasc's biological vascular surgical patch product technology on an accelerated basis, at an agreed price of US\$4.6 million. Under the terms of the amended agreement, Neovasc has received US \$4.255 million from LeMaitre, with the balance of US\$345,000 due one year after closing.

The total gain from the sale of license is \$4,598,160 (US\$4.6 million).

### 20. LOSS PER SHARE

Both the basic and diluted loss per share have been calculated using the loss attributable to shareholders of the Company as the numerator. The weighted average number of common shares outstanding used for basic loss per share for the year ended December 31, 2012 amounted to 45,780,690 shares (2011: 42,613,770 shares).

	For the years ended December 31,	
	2012	2011
Weighted average number of common shares	45,780,690	42,613,770
Loss for the period	(351,368)	(3,860,176)
Basic loss per share	<u>\$ (0.01)</u>	<u>\$ (0.09)</u>

As the Company is currently operating at a loss no dilutive potential ordinary shares have been identified as the conversion would lead to a decrease in loss per share.

# NEOVASC INC.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

### 21. RELATED PARTY TRANSACTIONS

The Company's key management personnel include members of the board of directors and executive officers. The Company provides salaries or cash compensation, and other non-cash benefits to directors and executive officers.

	For the years ended December 31,	
	2012	2011
<b>Short-term employee benefits</b>		
Employee salaries	\$ 670,000	\$ 607,500
Directors fees	59,421	60,370
Social security and medical care costs	20,791	20,452
	<u>750,212</u>	<u>688,322</u>
<b>Post-employment benefits</b>		
Contributions to defined contribution pension plan	25,125	20,883
	<u>25,125</u>	<u>20,883</u>
<b>Share-based payments</b>		
	1,277,708	930,750
	<u>1,277,708</u>	<u>930,750</u>
<b>Total key management remuneration</b>	<u>\$ 2,053,045</u>	<u>\$ 1,639,955</u>

### 22. SUBSEQUENT EVENTS

On February 27, 2013, the Company approved amendments to the company's stock option plan that, among other matters, increase the number of options exercisable into common shares available for grant by 1,148,081. These amendments remain subject to the approval of Neovasc shareholders at the next annual general meeting, as well as to the approval of the TSX Venture Exchange.

Also on February 27, 2013 Neovasc granted a total of 855,250 stock options (the "Options") to Neovasc directors, management and staff. The Options have an exercise price of \$2.49, the equivalent to Neovasc's closing market price of \$2.49 on the date of the grant. The Options will vest as follows: (i) 350,000 immediately on the date of the grant; (ii) 152,000 on December 31, 2013, contingent upon management achieving certain performance milestones established by the board of directors; and (iii) 353,250 of which 20% vest immediately and 20% will vest on each of the next four anniversaries of the date of grant. Of the 855,250 newly granted Options, 502,000 have been drawn from the increased option pool created as a result of the new stock option plan amendments and as such, remain subject to Neovasc receiving shareholder and TSX Venture Exchange approval prior to their exercise.

On April 24, 2013 warrant holders exercised 1,835,000 common share purchase warrants issued as part of the Company's August 2011 financing, resulting in proceeds of \$2,293,750 to Neovasc. In that financing, Neovasc issued units that included 2,360,250 whole warrants entitling the holders to purchase one common share of Neovasc stock at a price of \$1.25 for a period of up to two years after the close of the financing. Of the total available warrants from the August 2011 financing, 81% have been exercised by their holders. The remaining 457,750 warrants will expire on August 16, 2013, if they are not exercised before that date.

### 23. AUTHORIZATION OF FINANCIAL STATEMENTS

The consolidated financial statements for the year ended December 31, 2012 (including comparatives) were approved by the board of directors on April 25, 2013.

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Alexei Marko, Director

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Steven Rubin, Director