

**Consolidated Financial Statements**  
(unaudited)

**Prism Medical Ltd.**

**August 31, 2007**

*Prism Third Quarter Report 2007*

**Prism Medical Ltd.**

**CONSOLIDATED BALANCE SHEETS**

(unaudited)

	August 31 2007 \$	November 30 2006 \$
<i>(stated in thousands of Canadian dollars)</i>		
<b>ASSETS</b>		
<b>Current</b>		
Accounts receivable	8,226	8,949
Inventories	10,449	8,427
Prepaid expenses	575	325
Other receivables	368	300
Income taxes recoverable	567	741
<b>Total current assets</b>	<b>20,185</b>	<b>18,742</b>
Property, plant and equipment, net	3,081	2,757
Deferred charges, net	959	2,022
Goodwill	13,222	13,739
Intangible assets	372	384
Future income tax asset	3,816	3,579
	<b>41,635</b>	<b>41,223</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness	2,309	391
Accounts payable and accrued liabilities	6,091	6,534
Current portion of long-term debt	1,401	1,366
<b>Total current liabilities</b>	<b>9,801</b>	<b>8,291</b>
Long-term debt	12,823	14,323
Future tax liabilities	412	416
<b>Total liabilities</b>	<b>23,036</b>	<b>23,030</b>
<b>Total shareholders' equity [note 5]</b>	<b>18,599</b>	<b>18,193</b>
	<b>41,635</b>	<b>41,223</b>

*The accompanying notes are an integral part of these consolidated financial statements*

On behalf of the Board:  
Director

Director

**Prism Medical Ltd.**

**CONSOLIDATED STATEMENTS OF  
INCOME AND RETAINED EARNINGS**

(unaudited)

<i>(stated in thousands of Canadian dollars, except per share amounts)</i>	Three months ended		Nine months ended	
	August 31	August 31	August 31	August 31
	2007	2006	2007	2006
	\$	\$	\$	\$
Sales	10,726	9,992	31,833	31,360
Cost of goods sold	6,107	5,783	18,728	18,794
<b>Gross profit</b>	<b>4,619</b>	<b>4,209</b>	<b>13,105</b>	<b>12,566</b>
<b>Expenses</b>				
Selling and administrative	2,801	2,802	8,703	8,604
Severance and termination	-	-	-	246
Loss on foreign exchange	(28)	(9)	96	59
Research and development	3	14	23	74
Stock based compensation	29	34	86	112
Amortization	160	221	528	646
Interest	331	414	1,059	1,200
<b>Income before income taxes</b>	<b>1,323</b>	<b>733</b>	<b>2,610</b>	<b>1,625</b>
Provision for income taxes				
Current	362	(317)	564	100
Future	53	34	228	92
	<b>415</b>	<b>(283)</b>	<b>792</b>	<b>192</b>
<b>Net Income</b>	<b>908</b>	<b>1,016</b>	<b>1,818</b>	<b>1,433</b>
Retained earnings, beginning of period as previously reported	7,902	6,532	7,683	6,115
Transitional adjustment on adoption of new accounting policy [note 2]	-	-	(637)	-
Retained earnings, beginning of period restated	7,902	6,532	7,046	6,115
Net income for the period	908	1,016	1,818	1,433
Premium on share buy-back [note 8]	-	-	(54)	-
<b>Retained earnings, end of period</b>	<b>8,810</b>	<b>7,548</b>	<b>8,810</b>	<b>7,548</b>
<b>Earnings per share [note 5]</b>				
Basic	\$0.15	\$0.17	\$0.30	\$0.24
Diluted	\$0.12	\$0.13	\$0.26	\$0.22

*The accompanying notes are an integral part of these consolidated financial statements*

***Prism Third Quarter Report 2007***

**Prism Medical Ltd.**

**CONSOLIDATED STATEMENTS OF  
COMPREHENSIVE INCOME (LOSS)**

(unaudited)

*(stated in thousands of Canadian dollars)*

	Three months ended		Nine months ended	
	August 31 2007 \$	August 31 2006 \$	August 31 2007 \$	August 31 2006 \$
Net income for the period	908	1,016	1,818	1,433
Change in foreign currency translation gain (loss) on self-sustaining foreign operations	1	314	(755)	649
<b>Comprehensive income for the period [note 2]</b>	<b>909</b>	<b>1,330</b>	<b>1,063</b>	<b>2,082</b>
Accumulated comprehensive loss – beginning of period	(1,618)	(2,076)	(862)	(2,411)
Change in foreign currency translation gain (loss) on self-sustaining foreign operations	1	314	(755)	649
<b>Accumulated comprehensive loss – end of period [note 5]</b>	<b>(1,617)</b>	<b>(1,762)</b>	<b>(1,617)</b>	<b>(1,762)</b>

*The accompanying notes are an integral part of these consolidated financial statements*

**Prism Medical Ltd.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)

<i>(stated in thousands of Canadian dollars)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>August 31</b>	<b>August 31</b>	<b>August 31</b>	<b>August 31</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>OPERATING ACTIVITIES</b>				
Net income	908	1,016	1,818	1,433
Add (deduct) items not affecting cash				
Future income taxes	(14)	34	(101)	92
Stock based compensation	29	34	86	112
Amortization – cost of goods sold	192	144	545	412
Amortization – research and development	65	51	195	180
Amortization – operations	95	170	333	466
Interest accretion on convertible debt	37	40	107	119
	<b>1,312</b>	<b>1,489</b>	<b>2,983</b>	<b>2,814</b>
Net change in non-cash working capital balances <i>[note 7]</i>	(1,558)	58	(2,118)	(309)
<b>Cash provided by operating activities</b>	<b>(246)</b>	<b>1,547</b>	<b>865</b>	<b>2,505</b>
<b>INVESTING ACTIVITIES</b>				
Deferred charges	(77)	(105)	(196)	(341)
Intangible assets	(27)	-	(46)	-
Acquisition of subsidiary	-	(782)	-	(782)
Purchase of capital assets	(549)	(170)	(1,153)	(549)
Decrease in notes receivable net of repayment	-	6	-	25
<b>Cash used in investing activities</b>	<b>(653)</b>	<b>(1,051)</b>	<b>(1,395)</b>	<b>(1,647)</b>
<b>FINANCING ACTIVITIES</b>				
Increase (decrease) in bank indebtedness	1,280	(1,274)	1,918	(88)
Deferred financing charges	-	(27)	-	(52)
Repayment of long-term debt	(339)	(175)	(1,342)	(776)
Cancellation of share capital <i>[note 8]</i>	-	-	(106)	-
Issuance of share capital	-	346	-	483
<b>Cash provided by (used in) financing activities</b>	<b>941</b>	<b>(1,130)</b>	<b>470</b>	<b>(433)</b>
<b>Effect of exchange rate changes on cash</b>	<b>(42)</b>	<b>(10)</b>	<b>60</b>	<b>36</b>
<b>Net increase (decrease) in cash during period</b>	<b>-</b>	<b>(644)</b>	<b>-</b>	<b>461</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>-</b>	<b>1,797</b>	<b>-</b>	<b>692</b>
<b>Cash and cash equivalents, end of period</b>	<b>-</b>	<b>1,153</b>	<b>-</b>	<b>1,153</b>
<b>Supplemental cash flow information</b>				
Interest paid	518	605	1,188	1,365
Income taxes paid	62	264	347	415

*The accompanying notes are an integral part of these consolidated financial statements*

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## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

#### **1. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the most recent audited financial statements. These unaudited consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for the annual financial statements and therefore should be read in conjunction with the audited consolidated annual financial statements and notes included in the Company's Annual Report for the year ended November 30, 2006.

All dollar figures are expressed in thousands of Canadian dollars except for earnings per share or unless otherwise stated.

#### **2. CHANGE IN ACCOUNTING POLICY**

The Canadian Institute of Chartered Accountants issued three handbook sections that apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The Company adopted the new sections as follows:

Effective December 1, 2006 the Company adopted section 1530 of the CICA Handbook, *Comprehensive Income*, which describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in our net assets that results from transactions, events and circumstances from sources other than shareholders. It includes items that would not normally be included in net earnings, such as:

- Changes in the currency translation adjustment relating to self-sustaining foreign operations
- Unrealized gains or losses on available-for-sale investments
- Gains and losses on cash flow hedges.

Effective December 1, 2006 the Company adopted section 3855 of the CICA Handbook, *Financial Instruments – Recognition and Measurement*, which describes the standards for recognizing and measuring financial liabilities and derivatives. This section requires that:

- All financial assets be measured at fair value, with some exceptions for loans and investments that are classified as held-to maturity
- All financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes. Other financial liabilities are measured at their amortized cost.
- All derivative financial instruments are measured at fair value, even when they are part of a hedging relationship.

## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

Due to the adoption of Section 3855, a retained earnings adjustment of \$637 was recorded at December 1, 2006 consisting of a reclassification of unamortized deferred financing transaction costs of \$965, a future income tax asset of \$248 being created to reflect the unamortized tax value of the deferred financing costs and an \$80 adjustment to reflect the use of the effective interest method rather than the straight line method on the interest calculation of our convertible debenture.

Effective December 1, 2006 the Company adopted section 3865 of the CICA Handbook, *Hedges*, which describes how and when hedge accounting can be used. Hedging is an activity used to change an exposure to one or more risks by creating an offset between:

- Changes in the fair value of a hedged item and a hedging item, or
- Changes in the cash flows attributed to a hedged item and a hedging item, or
- Changes resulting from a risk exposure related to a hedged item and a hedging item.

The adoption of this section has not changed the first nine months of 2007 operating results from that which would have been otherwise reported.

### **3. CHANGE IN ACCOUNTING ESTIMATE**

The Company has operations in countries that have differing tax laws and rates. The provision for income taxes is based on a number of estimates and assumptions made by management including its understanding of domestic and international tax rules. Advice is also sought from professional tax advisors.

The annual tax provision made in the fourth fiscal quarter of 2005 included an additional provision of \$569 for potential tax liabilities related to the deductibility of interest and foreign exchange losses arising from inter-company loans made between the Company and its subsidiaries.

During the third fiscal quarter of 2006, the Company, in conjunction with its tax advisors, completed a study to determine the extent of the tax liability that may exist in respect to its 2005 and 2006 fiscal years. Based on the results of the study the Company reversed \$479 of the additional year end provision during the third fiscal quarter of 2006.

## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

#### **4. ACQUISITIONS**

##### **2006 Acquisition ErgoSafe Products, LLC**

On June 6, 2006, the Company acquired ErgoSafe Products, LLC ["ErgoSafe"], a privately owned United States based manufacturer and distributor of moving and handling products for the mobility impaired. The shares were acquired for \$765.

The purchase price was satisfied as follows:

	\$
Cash	392
Transaction costs	43
Value of common shares issued	330
<b>Total purchase consideration</b>	<b>765</b>

The allocation of the purchase price for the acquisition of ErgoSafe, based on management's estimate, is as follows:

	\$
Current assets	211
Capital assets	2
Intangible assets	363
Goodwill	261
Liabilities assumed	(72)
<b>Total purchase consideration</b>	<b>765</b>

The value of the 88,080 common shares issued was determined based on the average market price of the Company's common shares over the three-day period before the terms of the acquisition were announced on June 6, 2006.

The Company's consolidated results include the results of ErgoSafe from June 7, 2006.

A former minority indirect shareholder (9.9 percent) of ErgoSafe was a senior officer of a subsidiary of the Company at the time of acquisition and was an insider to this transaction. He received, at closing, approximately \$73 of the total transaction proceeds, 8,720 common shares of the Company and will be entitled to share in an earn-out.

The annual earn-out will be payable and calculated at 20 percent of the excess of the annual gross profit of the ErgoSafe products over the annual gross profit benchmark for the period up to and including December 31, 2011.

## Prism Medical Ltd.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007

#### 5. SHAREHOLDERS' EQUITY

Shareholders' equity consists of the following:

	August 31 2007 \$	November 30 2006 \$
Share capital	9,783	9,835
Other paid-in-capital	1,115	1,115
Accumulated other comprehensive loss [note 2]	(1,617)	(862)
Contributed surplus	508	422
Retained earnings as restated	8,810	7,683
<b>Total shareholders' equity</b>	<b>18,599</b>	<b>18,193</b>

The authorized and issued share capital consists of the following:

	August 31 2007 \$	November 30 2006 \$
<b>Authorized</b>		
Unlimited common shares		
Unlimited Class A shares, non-voting, redeemable, non-cumulative preferential dividends as determined from time to time, equal to 80% of the stated capital, multiplied by the Canadian Imperial Bank of Commerce's prime rate		
<b>Issued</b>		
6,014,930 [2006 – 6,046,430] common shares	9,783	9,835

During the first nine months of fiscal 2007, 31,500 common shares were purchased under the Normal Course Issuer Bid [Note 8] for an aggregate cost of \$106. For each share purchased for cancellation share capital was reduced by \$1.66. In aggregate share capital was reduced by \$52 [2006 – Nil].

#### Incentive stock option plan

The Company has an incentive stock option plan [the "Plan"], which provides for the granting of options to directors, officers, and key employees. The maximum number of shares that may be issued under the plan is 650,000 common shares of the Company at any point in time.

The exercise price of common shares subject to an option is determined at the time of grant and the price cannot be less than the closing market price of the common shares of the Company on the TSX-Venture Exchange on the day of the grant. Options generally expire three years after the grant date and are also subject to early expiry in the event of death, resignation, dismissal or retirement of an optionee. Options generally vest over three years, one-quarter on the day of grant, and one-quarter on each of the first, second and third anniversary of the grant date.

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**Prism Medical Ltd.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

The outstanding and exercisable options are as follows:

	<u>Nine Months ended</u> <u>August 31, 2007</u>		<u>Year ended</u> <u>November 30, 2006</u>	
	<u>Shares</u> <u>#</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u> <u>\$</u>	<u>Shares</u> <u>#</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u> <u>\$</u>
<b>Outstanding at beginning of period</b>	<b>230,000</b>	<b>4.45</b>	<b>508,672</b>	<b>3.49</b>
Exercised	-	-	(159,024)	2.36
Expired or forfeited during period	-	-	(119,648)	3.16
<b>Outstanding at end of period</b>	<b>230,000</b>	<b>4.45</b>	<b>230,000</b>	<b>4.45</b>
<b>Options exercisable at end of period</b>	<b>167,500</b>	<b>4.43</b>	<b>115,000</b>	<b>4.45</b>

The following table summarizes information on options outstanding at August 31, 2007:

<u>Exercise</u> <u>prices</u> <u>\$</u>	<u>Options outstanding</u>		
	<u>Number</u> <u>outstanding</u> <u>#</u>	<u>Weighted</u> <u>average</u> <u>remaining</u> <u>contractual life</u> <u>years</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u> <u>\$</u>
4.30	180,000	0.74	4.30
4.90	30,000	0.83	4.90
5.07	20,000	1.16	5.07
	<b>230,000</b>	<b>0.79</b>	<b>4.45</b>

<u>Exercise</u> <u>prices</u> <u>\$</u>	<u>Options exercisable</u>	
	<u>Number</u> <u>outstanding</u> <u>#</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u> <u>\$</u>
4.30	135,000	4.30
4.90	22,500	4.90
5.07	10,000	5.07
	<b>167,500</b>	<b>4.43</b>

## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

The Company accounts for stock options granted after December 1, 2003 under the fair value method. For the first nine months of fiscal 2007, Nil [2006 – Nil] stock options were granted and the Company recorded as compensation expense \$86 [2006 – \$112].

The fair value of stock options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

- |  |         |
|--|---------|
| • Risk-free interest rate              | 3.15%   |
| • Expected volatility                  | 68%     |
| • Expected average life of the options | 3 years |
| • Expected dividend yield              | n/a     |

The Black-Scholes option valuation model used by the Company to determine fair values was developed for use in estimating the fair value of freely traded options, which are fully transferable and have no vesting restrictions. The Company's employee stock options are not transferable, cannot be traded and are subject to vesting restrictions and exercise restrictions under the Company's blackout policy. Changes to the subjective input assumptions used in the model can cause a significant variation in the estimate of the fair value of the options.

## Prism Medical Ltd.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007

#### Earnings per share

The following is a reconciliation of the numerator and denominator of earnings per share computations:

	Three months ended		Nine months ended	
	August 31 2007	August 31 2006	August 31 2007	August 31 2006
	\$	\$	\$	\$
<b>Net income for period</b>	<b>908</b>	<b>1,016</b>	<b>1,818</b>	<b>1,433</b>
After-tax interest expense on convertible debentures	180	184	536	552
<b>Adjusted net income for fully diluted earnings per share</b>	<b>1,088</b>	<b>1,200</b>	<b>2,354</b>	<b>1,985</b>
<b>Weighted average number of common shares outstanding (in thousands)</b>	<b>6,015</b>	<b>6,035</b>	<b>6,018</b>	<b>5,961</b>
Effect of dilutive securities	2,910	2,889	2,910	2,944
<b>Diluted weighted average shares outstanding</b>	<b>8,925</b>	<b>8,924</b>	<b>8,928</b>	<b>8,905</b>
<b>Earnings per share</b>				
Basic	\$0.15	\$0.17	\$0.30	\$0.24
Diluted	\$0.12	\$0.13	\$0.26	\$0.22

## Prism Medical Ltd.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007

#### 6. INFORMATION BY SEGMENT

##### Industry segments

The Company's operations consist of only a medical products segment.

##### Geographic segments

	Three months ended		Nine months ended	
	August 31 2007 \$	August 31 2006 \$	August 31 2007 \$	August 31 2006 \$
<b>Sales</b>				
United States	743	1,070	2,557	2,376
Canada	2,511	2,336	7,516	10,999
United Kingdom	7,472	6,586	21,760	17,985
<b>Total</b>	<b>10,726</b>	<b>9,992</b>	<b>31,833</b>	<b>31,360</b>
			<b>August 31 2007 \$</b>	<b>August 31 2006 \$</b>
<b>Total assets</b>				
United States			1,070	1,238
Canada			15,172	13,642
United Kingdom			25,393	25,587
<b>Total</b>			<b>41,635</b>	<b>40,467</b>
<b>Goodwill</b>				
United States			243	272
Canada			327	327
United Kingdom			12,652	12,659
<b>Total</b>			<b>13,222</b>	<b>13,258</b>

Sales are attributed to countries based on the location of the subsidiary operations.

## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

#### **7. STATEMENTS OF CASH FLOWS**

The net change in non-cash working capital balances related to operations consists of the following:

	Three months ended		Nine months ended	
	August 31 2007	August 31 2006	August 31 2007	August 31 2006
	\$	\$	\$	\$
Accounts receivable	(1,342)	1,260	507	747
Inventories	-	(86)	(2,278)	112
Prepaid expenses	227	(9)	(261)	(335)
Other receivables	294	53	(72)	(86)
Income taxes recoverable	231	373	174	(37)
Accounts payable and accrued liabilities	(968)	(1,533)	(188)	(710)
	<u>(1,558)</u>	<u>58</u>	<u>(2,118)</u>	<u>(309)</u>

#### **8. NORMAL COURSE ISSUER BID**

The Company had a normal course issuer bid for up to 302,163 of its issued common shares, representing approximately 5% of the common shares outstanding. This bid commenced on August 1, 2006 and terminated on July 31, 2007. Purchases were made on the open market through the facilities of the TSX Venture Exchange at the market price. All common shares purchased under the normal course issuer bid were returned to treasury and cancelled. Shareholders can obtain a copy of the notice filed with the TSX Venture Exchange with respect to this bid, without charge, by contacting the Company.

During 2007, 31,500 (2006 – Nil) common shares were purchased under the normal course issuer bid for an aggregate cost of \$106, of which \$54 of the cost was applied as a reduction of retained earnings and \$52 as a reduction of share capital.

#### **9. SUBSTANTIAL ISSUER BID**

On September 25, 2007 the Company announced that its Board of Directors has authorized an offer to repurchase for cancellation up to \$4 million worth of its common shares, at a price range of \$3.25 to \$3.75 per share, through a substantial issuer bid. Up to a maximum of 1,230,769 common shares may be repurchased under the issuer bid, representing approximately 20% of the Company's outstanding common shares. The Company currently has approximately 6 million common shares issued and outstanding.

## **Prism Medical Ltd.**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED AUGUST 31, 2007**

An issuer bid circular containing full details of the offer and procedures for tendering common shares was mailed to shareholders on September 28, 2007. The offer, which is subject to regulatory approval, will expire on November 5, 2007 unless extended.

The share repurchase will be funded by a term loan from the Company's bankers, bearing interest at an annual rate of prime plus 1%, repayable interest only for first year and thereafter repayable in quarterly installments over the following four years.

#### **10. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS**

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2007 consolidated financial statements.