

predict > to prevent



Corporate Profile

PreMD's business is the development, commercialization and production of accurate, non-invasive and cost-effective tests for the early detection of cardiovascular disease and three types of cancer – diseases that can often be prevented or that may be curable when detected early.

PreMD's mission is to save lives while creating value for all of our stakeholders. We are committed to scientific and operational excellence, innovation and integrity in everything we do.

Our product pipeline includes:

- PREVU* Skin Cholesterol Test (point of care)
- PREVU* LT Skin Cholesterol Test (lab-processed format)
- PREVU* PT Skin Cholesterol Test (consumer-oriented format)
- LungAlert™
- ColorectAlert™
- Breast cancer test

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BRENT NORTON, MD, MBA
*President and
Chief Executive Officer*

2007 Outlook

- **Conclude new marketing partnership for PREVU***
- **Seek expanded regulatory claims for PREVU***
- **Conclude strategic partnership for cancer products**

Dear Shareholders:

In 2006 PreMD continued to make significant progress in its mission to reduce the human costs of cardiovascular disease and cancers, and to enhance the quality and quantity of life for patients. We do this by developing technologies and commercializing products that identify early markers of disease and thereby enable timely medical intervention. Rather than treating disease, our products are targeted at the early detection of disease. We advanced the communication of this concept last year when our company's name became PreMD, using the positioning phrase "predict to prevent" – a challenge to conventional thinking about disease management.

While 2006 was a year of significant medical and scientific progress, it was also a year that brought business developments the long-term impact of which was not always apparent at the time. I will address some of these business developments first.

MCNEIL DECISION

As you may know, in late September, McNeil Consumer Healthcare advised PreMD of its intention to terminate our worldwide license, development and supply agreements on the PREVU* Skin Cholesterol Test products, due to a change in its broader strategic direction. We had been working with McNeil over the last few years, and had received several million dollars in payments, as well as being positioned for further milestone payments and a royalty revenue stream on product sales.

While, in the short-term, this unforeseen development will deprive PreMD of the milestone payments associated with the continuing commercialization of the PREVU* Skin Cholesterol Test product line, we now believe that the net effect of McNeil's withdrawal will be positive for PreMD, for the following reasons. First, with the royalty payments from McNeil to be replaced by direct sales in some markets, and by revenues or royalties from a new partner in others, we will realize significantly improved revenues on a per-unit basis as sales grow. Second, with the completion of all the major clinical studies on the PREVU* Skin Cholesterol Test and related products and the completion of marketing plans, PreMD's future cash requirement has been minimized, while the value of our technology has been substantially enhanced.

Although one frustration caused by this decision is that PreMD did not become cash flow neutral by the end of 2006 as we expected, the opportunities we can now address in 2007 are enhanced, as a result of McNeil's contribution and the momentum it achieved for the PREVU* technology. We can now focus on capitalizing on the work that was done. PreMD is now assessing the markets we can address with PREVU* point of care (POC), laboratory format (LT) and home-use (PT) skin tests on our own, as well as those best addressed through partnerships.

Message to Shareholders

Second, our efforts to reinstate two lapsed U.S. patents on PreMD's Skin Cholesterol Test technology have not been successful. The lapse occurred due to failure to make maintenance payments when we transferred responsibility between Canadian and U.S. patent agents. Patent protection remains in place in all other jurisdictions. Our Skin Cholesterol Test technology results from years of proprietary research and development work and expertise that is exclusive to PreMD. A legal action for damages has been commenced against the law firm that was responsible.

Finally, as we announced shortly after the 2006 year end, PreMD has successfully resolved litigation related to a license for some of the intellectual property employed in our cancer tests. As part of the settlement, PreMD will pay \$175,000 in two equal installments during the first half of 2007 and provide a limited right to the licensor to utilize the patents. As a result, PreMD has retained exclusive right to the ColorectAlert™, LungAlert™, and breast cancer test technologies. In addition, new contractual arrangements reduce the royalty payable on products using the patented technology to 7.5 percent from 10 percent, and eliminate future milestone payments by PreMD amounting to US\$104,000.

While we were resolving the litigation, our oncology clinical trial program continued unaffected, and we expect to receive data from these studies during the first half of 2007. Further, the reduction in the royalty payment rate will enable PreMD to generate additional value from this promising product line.

SCIENTIFIC DEVELOPMENT AND MEDICAL PROGRESS

If 2006 presented more than a typical year's share of business challenges for PreMD, the year also represented a very strong period of accomplishment in the scientific development and medical side of our Company's activities.

At the start of 2006, PreMD had 12 clinical trials underway that eventually enrolled more than 16,000 patients in 2006 and that addressed both the cardiovascular and cancer product portfolios. Over the course of the year, we completed five of these studies and compiled data to support six regulatory applications for new or expanded approvals, five of which had been received by year end.

Our major clinical studies on cardiovascular disease testing included these:

PASA – expected to lead to an expanded claim for PREVU* Skin Cholesterol Test's use to predict heart attack and stroke; enrollment completed in 2006; anticipate U.S. filing for expanded approval in mid-2007.

PREPARE – insurance industry study completed in 2006 with more than 10,000 patients enrolled across North America, examined relationship between skin sterol measured by PREVU* LT and risk of cardiovascular disease as estimated by the Framingham score; the data was submitted to support our U.S. regulatory claim for the LT format test for use in the insurance industry.

ARISE – examined the relationship between skin sterol and heart attacks, sponsored by AtheroGenics Inc.; data analysis to be conducted in 2007.

MESA – examines correlation of skin sterol to markers of subclinical heart disease across different ethnic groups, sponsored by National Heart Lung and Blood Institute ("NHLBI"); 1,700 patients enrolled to date.

In summary, looking at the PREVU* Skin Cholesterol Tests for cardiovascular disease:

- The point of care (POC) format test is approved for sale to medical professionals in North America and select European markets;
- The new handheld reader for assessing the PREVU* Skin Cholesterol Test was approved for use in Europe (CE Mark) and Canada in August, and the U.S. in September 2006;
- The PREVU* laboratory-processed (LT) format test for use in the insurance industry and clinical labs received regulatory clearance for sale in Canada and was CE-marked in Europe in September 2006 and PreMD filed its FDA 510(k) pre-marketing notice for U.S. review in November 2006, with clearance anticipated by mid-2007;
- The consumer-oriented PREVU* (PT) format is progressing in product development and heading for first clinical trials in 2007.

Turning to the cancer test product portfolio – which follows the cardiovascular test product lineup in the product development pipeline – our scientific and development teams made solid progress during 2006, with the following major clinical studies:

ColorectAlert™ – continued a major validation study, including a variety of markers for colorectal cancer, with 600 patients enrolled at multiple sites, sponsored by U.S. National Cancer Institute’s Early Detection Research Network (EDRN). This study continues into 2008, with preliminary statistical analysis proceeding in parallel.

LungAlert™ – assessment of LungAlert™ values in 500 patients, including cancer patients, smokers and patients with benign lung disease, to determine whether LungAlert™ is effective as a screening test to detect early-stage disease; conducted at St. Joseph’s Hospital, Hamilton, Ontario. Data analysis continues through the first half of 2007.

International Early Lung Cancer Action Program (“I-ELCAP”) – expanding study from 1,000 to 2,500 patients to establish the relationship between LungAlert™ and results from CT scans. Conducted at Princess Margaret Hospital, Toronto, Ontario. Data analysis will be completed in the first half of 2007.

Pivotal breast cancer study – enrolled 78 patients to confirm and extend positive data obtained in the pilot study. The study is to be completed in early 2007 at the University of Louisville, Louisville, KY and followed by data analysis through much of the year.

In addition to the accomplishment of these externally oriented benchmarks, PreMD has benefited organizationally from the development, execution and completion of these major research and development projects. We have developed the skills in-house, including managing commercial-scale test production; managing multiple customer relationships; equipping, training and managing PREVU* operators and testers in the field; and establishing and maintaining logistics to enable submission and processing of completed tests.

Message to Shareholders

Outlook

In 2007 we expect PreMD to begin to benefit significantly from the accumulated progress of its scientific and medical development teams. We are anticipating the receipt of numerous clinical study results during the first half of 2007, which are expected to strengthen our position in discussions and negotiations with prospective marketing partners, enhance our regulatory applications leading to new and expanded market opportunities and provide investors with the tangible results of our product development and commercialization process.

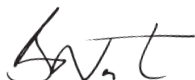
In particular, we believe the PREVU* Skin Cholesterol Test may have revolutionary potential – in both medical and commercial terms – as a product that will help identify individuals who are most likely to suffer heart attack or stroke, before such an event occurs.

As always, we remain committed to reducing the human toll of cardiovascular disease and cancer around the world. Through our predictive tests and technology, we seek not only to prevent deaths from these diseases, but to enable timely medical attention that maintains patients' quality of life.

I also express my thanks to you, our shareholders, for your enthusiasm for our mission and your continuing support of our work. Management and insiders collectively own approximately 17 per cent of PreMD's issued shares, and this significant personal stake ensures that our interests remain aligned with yours: creating and maintaining increased sustainable value.

We expect 2007 to be a very busy year. We look forward to reporting to you on our progress.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Norton", written in a cursive style.

DR. BRENT NORTON

President and Chief Executive Officer

Management's Discussion and Analysis of Financial Condition and Operating Results

The following discussion and analysis should be read in conjunction with the audited financial statements and notes thereto for the years ended December 31, 2006, 2005 and 2004, which have been prepared in accordance with Canadian generally accepted accounting principles. Some of the statements contained in this Management's Discussion and Analysis of Financial Condition and Operating Results constitute forward-looking statements. These statements relate to future events or to PreMD's future financial performance and involve known and unknown risks, uncertainties and other factors that may cause PreMD's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements.

Unless otherwise noted, all dollar amounts referenced herein are in Canadian dollars.

VISION

PreMD Inc. ("PreMD" or the "Company") is a predictive medicine company dedicated to improving health outcomes with tools for the early detection of life-threatening diseases, particularly cardiovascular disease and cancer.

CORPORATE OVERVIEW

PreMD's products are designed to identify those patients at risk for disease. With early detection, cardiovascular disease and cancer can be more effectively treated, or perhaps, prevented altogether. PreMD is developing easy-to-use, accurate and cost-effective tests designed for use at the point of care, in the doctor's office, at the pharmacy, for insurance testing and, eventually, right at home.

Our product development pipeline includes:

Coronary Artery Disease Risk Assessment:

- PREVU* Point of Care ("POC") Skin Cholesterol Test (cleared for sale in the U.S. and Canada and CE-Marked in Europe)
- PREVU* LT Skin Cholesterol Test, a lab-processed format (cleared for sale in Canada and CE-Marked in Europe)
- PREVU* PT Skin Cholesterol Test, a consumer-oriented format (in development)

Cancer Screening Tests:

- ColorectAlert™
- LungAlert™
- Breast cancer test

GROWTH STRATEGY

Our objective is to be a leader in the field of predictive medicine. To achieve this goal, we are pursuing the following strategies:

Identify and Target Significant Markets with Unmet Needs

We concentrate our efforts on medical conditions where there is a well-defined need and demand for screening tests to detect serious or life-threatening diseases, which we believe we can successfully develop and bring to market. We believe that early detection, intervention and ongoing monitoring can significantly improve patient outcomes.

Ensure a Multiple Product Pipeline

We pursue sustained development by maintaining a portfolio of products at different stages, which helps to mitigate risk while enhancing opportunities to generate value for stakeholders.

We continuously assess and study other possible applications of our technologies. In addition, we continue to seek out and evaluate new, proprietary technologies that have undergone initial proof-of-principle studies and that offer clear cost/benefit trade-offs compared to products currently available on the market. The acquisition of new technologies is a key component of our long-term growth strategy.

Management's Discussion and Analysis of Financial Condition and Operating Results

Maintain a Strong Clinical Program

We maintain an active clinical program, and are currently involved in several studies. Our objectives are to advance product development and to build a critical mass of data to support new regulatory claims and indications for use. Our clinical program, along with the publications and presentations it generates, enhances the scientific validation and credibility of PreMD's products. In turn, this validation improves strategic partnering opportunities and helps to expand the potential commercial market for our tests.

Pursue Strategic Relationships

We build collaborative relationships with leading companies, organizations and institutions to conduct clinical trials and to assist with the development of our products. Some of PreMD's previous and current relationships include McNeil Consumer Healthcare; The Cleveland Clinic Foundation; U.S. National Cancer Institute; AtheroGenics, Inc.; X-Rite, Incorporated; University of Texas M.D. Anderson Cancer Center; Montreal Heart Institute; and, National Heart, Lung and Blood Institute.

PreMD also seeks, at the appropriate time, to license its products to major diagnostic, pharmaceutical or consumer goods companies for any or all of the related marketing, sales, manufacturing and distribution. This strategy allows us to minimize the expenses and risks of large-scale commercialization. In addition, through these relationships, we gain the expertise of others, which enhances our ability to pursue multiple product opportunities.

Establish and Maintain Strong Intellectual Property Portfolio

Patents and other proprietary rights are essential to our business. We file patent applications to protect technology, inventions and improvements to technology or inventions that we consider important. Such applications may cover composition of matter, the production of active ingredients or their novel applications. PreMD has acquired, by license or assignment, rights to patents and applications filed in Canada, the U.S. and internationally. We also rely upon trade secrets, non-patented proprietary know-how and continuing technological innovation to develop and maintain our competitive position.

STRATEGIC RELATIONSHIP: MCNEIL CONSUMER HEALTHCARE

On May 10, 2002, as amended on December 20, 2002 and December 9, 2005, PreMD entered into an agreement with McNeil Consumer Healthcare ("McNeil"), a Johnson & Johnson company, to market and distribute PREVU*, PreMD's test for coronary artery disease, in Canada, and for the insurance laboratory field in the United States and Mexico. The amended agreement provided McNeil with exclusive rights, in these fields and territories, to the skin cholesterol test system and the future version for consumer use. The term of the agreement was 15 years and required McNeil to purchase PREVU* and to pay ongoing royalties to PreMD on sales, in addition to a series of financial milestone payments of up to \$3.3 million which were based on McNeil's achievement of specified annual sales levels of the licensed products.

On May 28, 2004, as amended on December 9, 2005, PreMD completed an exclusive worldwide licensing agreement with McNeil to sell PreMD's skin cholesterol tests under the brand name PREVU* Skin Cholesterol Test, expanding on the previous agreement.

On December 28, 2006, the agreements with McNeil were terminated and all sales and marketing rights reverted back to PreMD. The balance of the deferred revenue, which had been received as an up-front payment, of \$2,297,400 was recorded as license revenue. In addition, PreMD received additional license revenue of \$221,000 related to annual minimum sales levels and purchased other assets from McNeil for \$221,000, including the PREVU* trademark for \$150,000.

PreMD is currently pursuing several options to market the PREVU* skin cholesterol test, including direct sales in certain markets, marketing licenses to multinational healthcare companies and distribution agreements in specific marketing territories.

RESEARCH AGREEMENT: COLORECTALERT™

Subsequent to the year end, on January 5, 2007, the Company settled litigation relating to the ColorectalAlert™ license agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11 AG (“Med-11”), the Company agreed to pay \$175,000 to Med-11 and amended the license agreements to replace Dr. Shamsuddin with Med-11 as the licensor. This amount was expensed in 2006 as general and administration expense. The amendment also reduced the royalty payable by the Company from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Company may have been required to pay under the initial agreements.

CONVERTIBLE DEBENTURE FINANCING

On August 30, 2005, PreMD completed a private placement financing of convertible debentures, maturing on August 30, 2009, for gross proceeds of \$9,828,000 (US\$8,210,000) less issue fees and expenses of \$913,000 (resulting in net proceeds of \$8,915,000). The unsecured debentures bear interest at an annual rate of 7% (effective rate of 12.75% on the liability component) payable quarterly in cash or common shares at the Company’s option. The number of common shares issuable in satisfaction of interest payments is dependent on the trading price of the common shares at the time of the applicable interest date. The debentures are convertible into common shares at any time during the term, at the option of the holder, at \$3.47 per share (subject to adjustment). If all the debentures were converted to common shares, it would result in the issuance of an additional 2,882,195 common shares. Purchasers of the convertible debentures also received warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per common share (subject to adjustment). At any time after one year from the date of issuance of the warrants, the warrants may also be exercised by means of a cashless exercise by the holder. On August 25, 2006, \$475,441 (US\$430,000) of the debentures were converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,304 of the liability, \$140,137 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital.

Under Canadian GAAP, the convertible debentures are bifurcated into separate liability, equity and warrant components, net of pro rata issue fees and expenses, as described in note 5 to the consolidated financial statements.

Under U.S. GAAP, the conversion feature of the convertible debentures is recorded on the balance sheet as a derivative liability with subsequent changes in value recorded through earnings, as described in note 10 to the consolidated financial statements.

MARKET POTENTIAL

Overview: Market for Disease Detection

Predictive medicine is an important growth market, driven by four key factors:

The Aging Population

As the population ages, so do the incidences of both cardiovascular disease and cancer, among other diseases. According to the United States Census Bureau data published in 2000, the U.S. population aged 65 and older is projected to double by 2030. By 2030, individuals aged 65 and older will account for 20% of the U.S. population. Around the world, the aging population has contributed to dramatic growth in health care spending.

Escalating Health Care Costs

In most countries around the world, total health care spending is at an unsustainable level. In many nations, including the United States, health spending is growing at a rate that exceeds economic growth. In 2004 in the U.S., health care spending accounted for approximately 15.3% of the gross domestic product. Faced with escalating expenditures, governments, insurers and consumers are evaluating and implementing cost containment strategies. We believe that technologies that are patient-friendly, easy to use and cost effective while maintaining quality of care represent a significant market opportunity.

Management's Discussion and Analysis of Financial Condition and Operating Results

Innovative Technologies Enable Improved Risk Assessment

Technological advances have created more effective, easy-to-use devices, enabling risk assessment to be moved closer to the patient. This has resulted in the earlier and more cost-effective identification of disease and the initiation of therapy or prevention at an earlier stage. The use of screening and monitoring diagnostics for early intervention, improved treatment and ongoing monitoring has emerged as an important component of managed health care.

Trend Towards Health Self-Management

The trend towards greater use of point-of-care testing and self-diagnosis began in the early 1980s and is expected to continue. Increasingly, people are focused on personal wellness and the vital role of the individual in health maintenance. Similarly, the aging population is demanding better preventative care that is patient friendly.

Theta Reports projected strong growth in the worldwide market of total point-of-care tests performed in a professional setting (in a physician's office, at a pharmacy, etc.) from 2000 to 2005. Similarly, between 2002 and 2007 the global over-the-counter ("OTC") market for home diagnostic testing is expected to increase by 49%, at a compound annual growth rate of 8.3%.

Coronary Artery Disease ("CAD") Risk Assessment: The Role of Skin Cholesterol

Overview

According to the most recent data available from the World Health Organization, cardiovascular diseases, particularly heart attack and stroke, claim the lives of 17 million worldwide annually. Coronary artery disease, or heart disease, accounts for 7.2 million of these deaths. According to the American Heart Association, in the U.S., every 26 seconds an American will suffer a coronary event, and about every minute someone will die from one.

Cholesterol is a soft, waxy substance that is produced by the body, and is obtained from eating certain foods, such as meat, eggs, and other animal products. Cholesterol is transported in the blood by plasma lipoproteins. The deposit of cholesterol onto damaged blood vessel walls results in the development of a lesion that eventually reduces both the flexibility of the afflicted blood vessel as well as intravascular space. This atherosclerotic plaque results in increased risk not only for coronary artery disease but also for angina pectoris and sudden cardiac death, stroke, and peripheral vascular disease.

Traditional Risk Factors

High blood cholesterol is considered to be a major risk factor for coronary artery disease. In the U.S., the National Cholesterol Education Program, a nationwide effort to reduce the prevalence of high blood cholesterol launched by the U.S. National Institutes of Health in 1985, has spurred significant growth in the market for cholesterol and other risk assessment tests. Clinical laboratories in the U.S. are estimated to perform approximately 250 million cholesterol tests per year and another 290 million clinical laboratory tests are performed in the rest of the world.

However, blood cholesterol tests may be highly variable in results over a series of days, relatively expensive to perform and require a fasting blood sample from the patient. Additionally, several studies suggest that about half of all heart attack patients actually have blood cholesterol levels within what is considered a normal, healthy range.

While blood cholesterol remains an important risk factor for heart disease, it is widely accepted that several risk factors for CAD must be considered together to provide an accurate picture of absolute risk of disease.

Absolute cardiovascular disease risk is determined by a combination of all cardiovascular risk factors present, and accurate assessment of risk level is the key to effective treatment and risk management. Other traditional risk factors include increasing age, heredity, tobacco smoking, high blood pressure, physical inactivity, diet, obesity and diabetes mellitus. A number of other emerging factors that have demonstrated a link to heart disease include C-reactive protein ("CRP"), homocysteine, carotid intima-media thickness ("CIMT"), electron-beam tomography for coronary calcium, ankle/brachial blood pressure index ("ABI"), and soluble intercellular adhesion molecule ("ICAM-1"), among others. Many of these factors are costly to measure or assess, and they are resource intensive and inappropriate for a primary care setting, as they require invasive procedures.

Skin Cholesterol: A New Risk Factor for Coronary Artery Disease

We have developed PREVU* POC and PREVU* LT Skin Cholesterol tests, patient-friendly and cost-effective tools that assess patients at high risk of coronary artery disease.

PREVU* non-invasively measures the amount of cholesterol in the skin tissues. As a new risk factor for heart disease, skin cholesterol provides valuable additional information to traditional CAD risk assessment. Skin contains over 11% of the body's cholesterol and ages in parallel with vascular connective tissue. As blood vessel walls accumulate cholesterol, the skin tissues also accumulate cholesterol. Clinical studies suggest that skin cholesterol tests can discriminate among healthy individuals, those at risk of developing atherosclerosis and those with overt disease. Emerging evidence supports the use of non-invasive tests, such as skin cholesterol, to detect subclinical, or hidden, disease. Identifying patients with high subclinical cardiovascular disease is the key to preventing a first cardiac event and reducing the overall burden of heart disease.

Competitive Landscape

We are not aware of any other test currently marketed or in development that non-invasively measures skin cholesterol. We are aware that research has been undertaken using other testing approaches that employ body fluids, such as saliva and tears. The stage of development of such approaches is unknown. We have 60 issued patents and patents pending internationally related to the skin cholesterol technology and 11 patents and patents pending related to our color-reading technology, which is used across PreMD's product lines.

Cancer: Screening Tests for Early-Stage Disease

Overview

The American Cancer Society defines cancer as a group of diseases characterized by uncontrolled growth and spread of abnormal cells. If the spread is not controlled, it can result in death. Cancer is the second leading cause of death in the U.S., exceeded only by heart disease.

Cancer is caused by both external factors, such as tobacco, chemicals and diet, and internal factors, such as inherited mutations and mutations that occur from metabolism. Although anyone can be diagnosed with cancer, the risk of developing cancer increases as an individual ages, with most cases affecting adults beginning in middle age. About 76% of cancers are diagnosed in persons aged 55 and older.

Preventing cancer and improving health outcomes depend in part on lifestyle changes and more effective treatment options. Preventing cancer is also contingent on early detection and better screening tests to identify disease at the very earliest stage possible. Many of the clinical tests currently in use are not sufficiently sensitive or specific to detect all cancers at a curable stage or to evaluate risk accurately enough to guide effective interventions. Currently, just 39% of colorectal cancers are found at an early, localized stage. Only 16% of lung cancers are detected at a localized stage. Most breast cancers have been present for six to 10 years by the time they are detected by mammography.

PreMD's Novel Cancer Tests: Detecting Early-Stage Disease

The use of early detection and risk assessment biomarkers will enable the detection of cancer at its earliest stages and identify those people at risk for cancer before they develop the disease. Accordingly, intervention efforts can be focused on prevention rather than treatment.

PreMD's tests offer significant advantages to currently available alternatives for their sensitivity, ease of use, convenience, patient compliance and cost.

Management's Discussion and Analysis of Financial Condition and Operating Results

Our patented cancer technology detects a carbohydrate marker, or sugar, associated with cancerous and pre-cancerous conditions. This sugar is detected by a chemical reaction performed on a specimen, or in a liquid phase reaction, placed on a test membrane by a physician following a routine exam and does not require a blood sample, dietary restrictions or any patient preparation. To date, we have developed three painless and low-cost tests based on this technology for early-stage colorectal cancer, using a sample of rectal mucus; for lung cancer, using a sample of sputum coughed up from the lungs; and to detect breast cancer, using nipple aspirate fluid.

Our tests have performed well in clinical studies to date:

- ColorectAlert™ is the only low-cost test that we are aware of reporting greater than 50% sensitivity for early-stage disease;
- LungAlert™ has been shown to identify more than half of all early-stage lung cancers; and
- In initial studies, the breast cancer test has been shown to identify early-stage disease.

There is an urgent need for affordable, easy-to-use initial screening tests for early-stage colorectal, lung and breast cancers. Such tests could be used to identify those high-risk patients who would benefit from sophisticated, more expensive diagnostic tests such as colonoscopy, computed tomography ("CT") and mammography.

Competitive Landscape

We are aware of other diagnostic tests under development for the detection of colorectal, lung and breast cancers and are currently monitoring their progress. For colorectal cancer, some of the firms involved in the development or marketing of products include Enterix Inc., EXACT Sciences Corporation and E-Z-EM Inc.

To our knowledge, no tumor markers for lung cancer have been approved by the U.S. Food and Drug Administration ("FDA"), although several are believed to be in development. Several tests for lung cancer exist, but due to their limited ability to detect cancer and their high cost, we believe that they are not suitable for cancer screening. Other companies developing diagnostic tests for lung cancer are Biomoda Inc., Xillix Technologies Corp. and Perceptronix Medical Inc.

In the breast cancer field, other companies are developing relatively expensive proteomic-based and genomic-based screening tests for cancer using nipple aspirate fluid, including Power3 Medical, Cytoc Corporation and NeoMatrix LLC.

We have 22 patents and patents pending internationally related to our cancer technologies, and nine patents and patents pending related to our color-reading technology, which is used across PreMD's product lines.

GOALS AND ACHIEVEMENTS

	2006 goals	2006 outcomes	2007 goals
PREVU* Skin Cholesterol Test	<ul style="list-style-type: none"> Complete insurance study and marketing launch for PREVU* LT 	<ul style="list-style-type: none"> Insurance study completed and submitted to U.S. FDA 	<ul style="list-style-type: none"> Obtain FDA clearance
	<ul style="list-style-type: none"> Complete PASA⁽¹⁾ study 	<ul style="list-style-type: none"> Testing completed; data being analyzed 	<ul style="list-style-type: none"> Submit data for publication
	<ul style="list-style-type: none"> Achieve expanded regulatory claims for PREVU* POC in U.S. 	<ul style="list-style-type: none"> PASA trial complete; data being analyzed 	<ul style="list-style-type: none"> Submit FDA application based on PASA data
	<ul style="list-style-type: none"> Achieve regulatory clearance for PREVU* LT in U.S., Canada and E.U. 	<ul style="list-style-type: none"> Cleared in Canada and E.U.; submitted to U.S. FDA 	<ul style="list-style-type: none"> Launch PREVU*LT in the life insurance market
	<ul style="list-style-type: none"> Complete development and internal validation of home test 	<ul style="list-style-type: none"> Delayed due to change in priorities 	<ul style="list-style-type: none"> Complete development and initiate clinical testing
	<ul style="list-style-type: none"> Publish and present data in scientific publications and forums 	<ul style="list-style-type: none"> Completed 	<ul style="list-style-type: none"> Submit PREPARE and PASA data for publication
	<ul style="list-style-type: none"> Pursue legal action against law firm responsible for managing PreMD's patent portfolio at the time when the maintenance fees for the two patents in question should have been paid 	<ul style="list-style-type: none"> Claim filed – awaiting outcome 	<ul style="list-style-type: none"> Resolve claim against law firm
ColorectAlert™	<ul style="list-style-type: none"> Advance EDRN⁽²⁾ study Develop an additional clinical trial Initiate partnering discussions 	<ul style="list-style-type: none"> Delayed startup, but progressing well Subject to outcome of EDRN interim data Discussions delayed pending interim data 	<ul style="list-style-type: none"> Analyze interim data Expand clinical trials If data positive, discuss partnering opportunities
LungAlert™	<ul style="list-style-type: none"> Expand role in I-ELCAP⁽³⁾ at Princess Margaret Hospital in Toronto Add an additional I-ELCAP site Initiate partnering discussions Submit data for publication and/or presentation 	<ul style="list-style-type: none"> Scope expanded to 2,500 patients Subject to outcome of I-ELCAP data analysis Discussions delayed pending interim data Manuscript delayed pending interim data 	<ul style="list-style-type: none"> Complete I-ELCAP study Complete analysis of data If data positive, discuss partnering opportunities
Breast Cancer Test	<ul style="list-style-type: none"> Complete pivotal study Initiate partnering discussions Submit data for publication and/or presentation 	<ul style="list-style-type: none"> Enrolment slower than expected Discussions delayed pending interim data Manuscript delayed pending interim data 	<ul style="list-style-type: none"> Complete pivotal study and analyze data If data positive, discuss partnering opportunities

⁽¹⁾ Predictor of Advanced Subclinical Atherosclerosis

⁽²⁾ Early Detection Research Network

⁽³⁾ International Early Lung Cancer Action Program

CLINICAL PROGRAM

PreMD maintains an active clinical program. Please refer to our Annual Information Form for the fiscal year ended December 31, 2006, available at www.sedar.com, for a summary of the development and clinical evaluations of our skin cholesterol and cancer technologies to date.

CRITICAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

PreMD prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), consistently applied within the framework of the significant accounting policies summarized below. The significant differences between Canadian GAAP and United States generally accepted accounting principles ("U.S. GAAP") are described in note 10 to the consolidated financial statements as at and for the year ended December 31, 2006. Our critical accounting policies include foreign currency translation, use of estimates, cash and cash equivalents, short-term investments, financial instruments, inventory, deferred financing fees, indemnifications, revenue recognition, recording of research and development expenses, useful lives of capital assets and of intangible assets, recovery of tax credits, the valuation of stock-based compensation, income taxes and loss per share.

New Pronouncements

The Canadian Institute of Chartered Accountants ("CICA") released five new standards related to financial instruments and hedging. The Company is currently evaluating the impact on its consolidated financial statements of adopting these sections on January 1, 2007. These standards are effective for years beginning on or after October 1, 2006 and include the following sections:

[a] Section 3855 of the CICA Handbook, "Financial Instruments – Recognition and Measurement" describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This section requires that:

- All financial assets be measured at fair value, with some exceptions, such as loans and receivables 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 carrying value; and
- All derivative financial instruments be measured at fair value, even when they are part of a hedging relationship;

[b] Section 3865 of the CICA Handbook, "Hedges", describes when and how hedge accounting can be used. Hedging is an activity used by a company 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;
- Changes resulting from a risk exposure relating to a hedged item and hedging item.

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period;

[c] Section 1530 of the CICA Handbook, "Comprehensive Income", describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a company's net assets that results from transactions, events and circumstances from sources other than the company's shareholders. It includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments. Adopting this section will require the Company to start reporting the following items in the consolidated financial statements: comprehensive income and its components; and, accumulated other comprehensive income and its components;

[d] Section 3250 of the CICA Handbook, "Surplus", was changed and reissued as Section 3251, "Equity". The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of Section 1530, "Comprehensive Income";

[e] Section 3861 of the CICA Handbook, "Financial Instruments – Disclosure and Presentation", establishes standards for presentation of financial instruments as non-financial derivatives and identifies disclosure requirements. Adopting this section would impact the classification of a financial instrument, or its component parts, as a liability or as an equity instrument in accordance with the substance of the contractual arrangement on initial recognition.

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, PreMD International Inc., Berne, incorporated under the laws of Switzerland, and 6211178 Canada Inc., incorporated under the laws of Canada. All significant intercompany transactions and balances have been eliminated upon consolidation.

Foreign Currency Translation

The Company's functional currency is the Canadian dollar. Foreign operations are considered integrated and are translated into Canadian dollars using the temporal method. Monetary items are translated using the exchange rate in effect at the year end and non-monetary items are translated at historical exchange rates. Revenue and expenses are translated at the average rate for the year, except for amortization of capital assets, which is translated at the same exchange rates as the assets to which they relate. Exchange gains or losses are included in the determination of net loss for the year.

Use of Estimates

The preparation of consolidated financial statements in conformity with Canadian GAAP 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 revenue and expenses during the reporting periods. Actual results could differ materially from those estimates. Significant estimates made by management include stock option valuation assumptions, achievement of milestones for stock options, valuation of acquired technologies, useful lives of long-lived assets, and accruals for clinical trials in process based on percentage completion.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and highly liquid investments that are readily convertible into cash with maturities of less than 90 days when purchased. There were no cash equivalents at December 31, 2006, but at December 31, 2005 they were comprised of funds with an average interest rate of 2.9%.

Short-Term Investments

Short-term investments are carried at the lower of cost and market. Market value approximates cost. Short-term investments at December 31, 2006 were comprised of money market funds and fixed income securities with interest rates of approximately 4.5% (2005 – 3.6%). Short-term investments are comprised of highly liquid investments with maturity periods greater than 90 days but less than one year when purchased.

Financial Instruments

The carrying values of cash and cash equivalents, short-term investments, accounts receivable, other receivables, accounts payable and accrued liabilities are considered to approximate their respective fair values due to their short-term nature.

The fair values of the equity and warrant components of the convertible debentures are determined using the Black-Scholes option pricing model and are reported as "equity component of convertible debentures" and "warrants", respectively, net of allocated financing costs. The carrying value of the convertible debentures is recorded as a liability and is being accreted to its maturity value through charges to income for the imputed interest, as described in note 5 to the consolidated financial statements.

Management's Discussion and Analysis of Financial Condition and Operating Results

Inventory

Inventory of raw materials is valued at the lower of cost and replacement cost. Inventories of finished goods are valued at the lower of cost and net realizable value, determined on a first-in, first-out basis.

Deferred Financing Fees

Financing costs relating to the issue of convertible debentures are pro-rated between the liability and the equity and warrant components of the debentures. The expenses related to the liability component are deferred and are amortized on a straight-line basis over the term of the debentures. Should the debentures be converted prior to maturity, the unamortized balance of financing costs will be transferred to capital stock. The "equity component of convertible debentures" and "warrants" are recorded net of the respective allocated financing costs.

Capital Assets

Capital assets are recorded at acquisition cost less accumulated amortization.

Purchases of molds required for the manufacture of product are capitalized and amortized over the useful life of the asset on the basis of units produced. The amortization expense for molds is recorded as a cost of product sales.

We provide for amortization on the declining balance basis, unless otherwise indicated, at rates which are expected to charge operations with the cost of the assets over their estimated useful lives as follows:

Manufacturing equipment	useful life on basis of units produced
Computer equipment	30%
Furniture and equipment	20%
Research instrumentation	30%
Laboratory equipment	20%
Leasehold improvements	straight-line over the term of the lease

Intangible Assets

Patents, patent rights and trademarks acquired by the Company are recorded at acquisition cost and are amortized on a declining balance basis at 20% per year. Management evaluates the carrying value of intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized when the carrying amount of an intangible asset exceeds the sum of the undiscounted cash flows expected to result from its use.

Indemnifications

Many of the Company's agreements, specifically those related to financing, clinical trials, research and development and supply arrangements, include indemnification provisions where the Company agrees to indemnify and hold harmless the counterparty against possible claims by third parties. Potential payments under these provisions relate to personal injury resulting from clinical trials and from breach of fundamental representation and warranty terms in the agreements with respect to matters such as corporate status, title of assets, consents to transfer, employment matters, litigation and other potential material liabilities. None of the indemnification provisions absorb the credit risk of the counterparties' assets or liabilities. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is not reasonably quantifiable as certain indemnifications are not subject to a monetary limitation. The Company also maintains product liability insurance to cover claims related to its clinical trials and sales of products. At December 31, 2006, management believes there is only a remote possibility that the indemnification provisions would require any material cash payment.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

Revenue Recognition

PreMD earned 100% of its revenue from one customer under the terms of two contracts, as described in note 8(a) to the consolidated financial statements. These contracts outlined the terms for all products and services provided to the customer, and were considered multiple revenue arrangements. Under the terms of Emerging Issues Committee No. 142, "Revenue Arrangements with Multiple Deliverables", products and services under these contracts are separated into units of accounting for revenue recognition purposes.

License Revenue: Non-refundable, up-front payments received from licensees are deferred and recognized in income on a straight-line basis over the respective terms of the agreements. Milestone payments received from licensees are recorded as income in the period when the respective measurable milestones are achieved and collectability is assured. Royalty revenues are based on sales by licensees and are recorded as income in the period earned and reported by the licensees.

Sales of Products: Revenue from sales of products to licensees is recognized when the title passes to the licensee and when the products are shipped.

Interest income is recognized as earned.

Research and Development and Related Investment Tax Credits

Research and development expenditures include related salaries, subcontractor fees, product development expenses including patent costs, clinical trials costs and an allocation of administrative expenses and corporate costs specifically attributable to research and development. Research and development excludes any costs associated with the acquisition of capital assets and acquired technology. Research and development expenditures are charged to expenses as incurred unless management believes a development cost meets the generally accepted criteria for deferral. All development costs incurred to date have been expensed. Reimbursements for specific expenditures received through collaborative funding have been applied against research and development expenses.

Investment tax credits earned as a result of incurring qualified scientific research and experimental development expenses are recorded when the amounts are readily determinable. The amounts are recorded as follows:

- For capital assets – as a reduction of the cost of the related asset; and
- For operating expenses – as a recovery within the consolidated statements of loss and deficit.

Stock-Based Compensation

The Company has two stock-based compensation plans for employees, directors and consultants. Certain of the stock options granted vest over a fixed term and others vest based on performance upon the achievement of certain measurable milestones.

Canadian GAAP requires that options issued to employees be accounted for using the fair value method of accounting. Non-cash compensation expense for fixed term options is recorded over the term of the vesting period whereas compensation expense for performance options is recorded when it is determined that achievement of the milestone is likely. Unvested performance options are accounted for using the variable method of accounting. Prior to 2003, no compensation expense was recognized for stock options granted to employees. For stock options awarded to employees prior to January 1, 2003 but subsequent to January 1, 2002, pro forma disclosure of net loss and net loss per share is provided as if these awards were accounted for using the fair value method. Consideration paid on the exercise of stock options and warrants is credited to capital stock.

Shares issued to employees under the share purchase plan are accounted for as direct awards of stock and are recognized as an expense in the consolidated statements of loss and deficit.

Management's Discussion and Analysis of Financial Condition and Operating Results

Income Taxes

PreMD applies the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are provided if it is more likely than not that some or all of the future tax assets will not be realized.

Loss per Share

Loss per share has been calculated on the basis of net loss for the year divided by the weighted average number of common shares outstanding during the year. Diluted loss per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method. The inclusion of the Company's stock options, the conversion feature of the convertible debentures and warrants in the computation of diluted loss per share would have an anti-dilutive effect on loss per share. Therefore, stock options and warrants have been excluded from the calculation of diluted loss per share. Consequently, there is no difference between basic loss per share and diluted loss per share.

ECONOMIC DEPENDENCE AND CONCENTRATION OF CREDIT RISK

Revenues earned by the Company in fiscal years 2004 to 2006 were from one customer. These revenues were pursuant to a license agreement that was terminated on December 28, 2006. All amounts due to the Company from this customer had been collected prior to the year end. As at December 31, 2005, substantially all the accounts receivable were due from this customer.

DISCLOSURE CONTROLS AND PROCEDURES

Our corporate disclosure policy outlines our approach to the determination and dissemination of material information and the circumstances under which confidentiality of information will be maintained. The policy extends to the conduct of directors, officers, spokespersons and other employees and agents of the Company and all methods that the Company uses to communicate to the public.

Certification

The Chief Executive Officer and Chief Financial Officer of the Company must certify that they are responsible for establishing and maintaining disclosure controls and procedures and have designed such disclosure controls and procedures (or caused such disclosure controls and procedures to be designed under their supervision) to provide reasonable assurance that material information with respect to PreMD, including its consolidated subsidiaries, is made known to them by others within PreMD and that they have evaluated the effectiveness of PreMD's disclosure controls and procedures as of the end of the period covered by these annual filings. Disclosure controls and procedures ensure that information required to be disclosed by PreMD in the reports that it files or submits under provincial securities legislation is recorded, processed, summarized and reported, within the time periods required. PreMD has adopted or formalized such controls and procedures as it believes are necessary and consistent with its business and internal management and supervisory practices.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of PreMD's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 and in Rules 13(a)–15(e) and 15(d)–15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) and have concluded that, as of December 31, 2006, our disclosure controls and procedures are effective and provide reasonable assurance that material information relating to the Company is reported to them in a timely manner and that such information is disclosed within the time periods specified under the applicable legislation.

As part of the Form 52-109 certification, the Chief Executive Officer and Chief Financial Officer must also certify that they are responsible for establishing and maintaining internal control over financial reporting for PreMD and have designed such internal control over financial reporting (or caused such internal control over financial reporting to be designed under their supervision). Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of PreMD's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"), and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the Company's financial statements.

The Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2006, the Company has designed such internal control over financial reporting (as defined in Multilateral Instrument 52-109) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

OPERATING RESULTS

Annual Financial Information

The following selected financial information has been derived from the audited consolidated financial statements of PreMD as at and for the years ended December 31, 2006, 2005 and 2004.

	Year ended December 31, 2006	Year ended December 31, 2005	Year ended December 31, 2004
Operating results			
Product sales	\$ 6,513	\$ 425,730	\$ 183,258
License revenue	3,328,827	1,153,308	302,080
Total expenses	9,712,856	6,512,146	6,192,649
Investment tax credits	200,000	198,923	205,000
Interest income	265,369	173,130	123,626
Net loss	\$ 5,948,971	\$ 4,989,705	\$ 5,568,899
Net loss per share: basic and diluted	\$ 0.27	\$ 0.23	\$ 0.26
Financial position	December 31, 2006	December 31, 2005	December 31, 2004
Total assets	\$ 5,279,500	\$ 11,293,190	\$ 6,996,079
Long-term debt	6,350,680	5,893,340	Nil
Shareholders' equity (deficiency)			
Total shareholders' equity (deficiency)	\$ (2,967,542)	\$ 1,844,297	\$ 2,496,842
Cash dividends declared per share	Nil	Nil	Nil

As at the date of this Management's Discussion and Analysis of Financial Condition and Operating Results, the total issued and outstanding common shares of the Company is 24,863,655.

Management's Discussion and Analysis of Financial Condition and Operating Results

YEAR ENDED DECEMBER 31, 2006 COMPARED WITH 2005

Net Loss

The consolidated loss for the year ended December 31, 2006 was \$5,948,000 or \$(0.27) per share compared with a loss of \$4,990,000 or \$(0.23) per share for the year ended December 31, 2005, an increase of \$958,000. Sales and license revenue increased by \$1,756,000 but was offset by an increase in interest and imputed interest on convertible debentures of \$1,013,000, an increase in research and development expenses of \$1,654,000 and a litigation settlement of \$175,000.

Revenue

Product sales of PREVU* Skin Cholesterol tests to our licensee amounted to \$7,000 in 2006 compared with \$426,000 in 2005. Throughout 2006, numerous pilot programs were conducted by the Company's licensee, particularly in the retail pharmacy setting, utilizing inventory that had been purchased from the Company in 2005.

License revenue was \$3,329,000 in 2006 compared to \$1,153,000 in 2005, an increase of \$2,176,000. Milestone revenues earned and received from our licensee were recorded as license revenue and amounted to \$500,000 in 2006 compared with \$638,000 in 2005. In addition, minimum sales levels in the agreements provided additional license revenue of \$220,000 and \$194,000 in 2006 and 2005, respectively. The up-front cash payments from both the worldwide agreement and the original Canadian agreement of \$3,000,000 and \$100,000, respectively, had previously been deferred and were being recognized into income on a straight-line basis over the relative terms of the agreements (10 and 15 years, respectively). Upon termination of the agreements on December 28, 2006, the balance of the deferred revenues, representing the unamortized portion of the upfront payments received from the licensee, was recognized as license revenue. Thus, the amount of the upfront payments recognized in 2006 amounted to \$2,609,000 compared with the amortized amount of \$307,000 in 2005.

Cost of Product Sales and Gross Profit

Cost of product sales exceeded sales for 2006 by \$30,000, compared to \$3,000 in 2005. The loss resulted from inventory obsolescence and development costs for label and software changes to inventory.

Research and Development

Research and development expenses for the year increased by \$1,654,000 to \$4,774,000 from \$3,120,000 in 2005.

The variance for the year reflects:

- An increase of \$1,673,000 in spending on clinical trials for skin cholesterol and cancer to \$2,571,000 from \$898,000 in 2005. This increase is related to acceleration and completion of several large trials for skin cholesterol to lead to additional regulatory submissions and advancement of the lung cancer trial (the "I-ELCAP" study). PreMD currently has five clinical trials ongoing, compared with 15 in 2005;
- An increase of \$77,000 in product liability insurance due to the significant increase in patients tested;
- A decrease of \$173,000 in subcontract research as the development of a second-generation color reader for the skin cholesterol test was completed;
- A decrease in compensation of \$41,000, reflecting lower incentive payments for the year for performance milestones and a personnel vacancy; and
- Minor changes in other development costs during the period.

In August 2004, PreMD learned that two of its U.S. patents had been listed as abandoned by the United States Patent and Trademark Office (“U.S. PTO”) for failure to pay maintenance fees. The failure to pay these maintenance fees occurred when the files were transferred between U.S. and Canadian patent agents. PreMD filed a petition with the U.S. PTO for reinstatement of the patents. After several appeals, the U.S. PTO denied PreMD’s request for reinstatement. The U.S. PTO found that the patents lapsed as a result of the law firm’s failure to use its established docketing procedures regarding payment of the maintenance fees. PreMD has authorized legal action against the law firm that was responsible for managing its patent portfolio at the time when the maintenance fees for the two patents in question should have been paid. The claim for damages was outstanding at December 31, 2006.

General and Administration Expenses

General and administration expenses amounted to \$3,025,000 compared with \$2,691,000 in 2005, an increase of \$334,000.

The increase for the year reflects:

- An increase of \$435,000 in professional expenses which included approximately \$330,000 in legal fees relating to litigation regarding the ColorectAlert™ License Agreement. The litigation was settled in January 2007;
- A payment of \$175,000 upon completion of an amendment to the ColorectAlert™ License Agreement on January 5, 2007 (see note 8[b][i] to the consolidated financial statements);
- An increase in market research expenses of \$46,000 and in travel of \$58,000 relating to business development opportunities;
- A reduction of \$44,000 in expenses (from \$44,000 to nil) relating to a prior year’s unsolicited offer to acquire the shares of another company;
- A reduction in compensation of \$105,000 reflecting lower incentive payments for 2006 for performance milestones and a personnel vacancy;
- A reduction in investor relations expenses and annual report costs of \$99,000 and \$40,000, respectively; and
- A reduction of \$38,000 in stock-based compensation for options for administrative personnel and consultants resulting in a non-cash expense of \$384,000 compared with \$422,000 in 2005.

Interest on Convertible Debentures

Interest on convertible debentures (issued on August 30, 2005) amounted to \$678,000 in 2006 compared to \$228,000 in 2005. The debentures bear interest at an annual rate of 7%, payable quarterly in either cash or stock. In 2006, \$281,000 of the interest expense was paid in stock, rather than cash, compared with nil in 2005. Imputed interest of \$820,000 (compared with \$256,000 in 2005) represents the expense related to the accretion of the liability component at an effective interest rate of 12.75%.

Amortization

Amortization expenses for equipment and acquired technology for 2006 amounted to \$180,000 compared with \$210,000 in 2005. Leasehold improvements in the research facilities and purchases of equipment to support administration, clinical trials and manufacturing amounted to \$25,000 in 2006 and \$130,000 in 2005. In addition, the PREVU* trademark was purchased from the former licensee of the skin cholesterol technology for \$150,000. Amortization of deferred financing fees amounted to \$139,000 for 2006 compared to \$43,000 in 2005. The financing fees are amortized over the four-year life of the convertible debentures.

Management's Discussion and Analysis of Financial Condition and Operating Results

Investment Tax Credits

Recoveries of provincial scientific investment tax credits ("ITCs") amounted to \$200,000 for 2006 compared with \$199,000 in 2005.

Interest Income

Interest income amounted to \$265,000 for 2006, compared with \$173,000 for 2005. The increase resulted from the investment of the proceeds on the convertible debentures in August 2005.

U.S. GAAP

For purposes of U.S. GAAP, the consolidated loss for 2006 was \$5,887,000 compared with \$4,904,000 (as restated) in 2005.

Other

Accounts receivable as at December 31, 2006 amounted to \$11,000 compared to \$882,000 as at December 31, 2005. The 2005 amount includes license revenues billed to the licensee, whereas there were no amounts outstanding from the licensee as at December 31, 2006.

The increase in prepaid expenses and other receivables of \$254,000 includes a deposit of \$370,000 made to a contract manufacturer against future production of a new color reader for the skin cholesterol test.

The financing fees related to the convertible debentures are pro-rated between the debt and the fair value of the equity and warrant features. The debt portion is deferred and amortized over the term of the debenture. Additional costs of \$51,000 related to the 2005 issue of convertible debentures were incurred in 2006. Upon conversion of a portion of the convertible debentures in 2006, the unamortized portion transferred to capital stock amounted to \$22,000. The unamortized balance at December 31, 2006 amounted to \$348,000 compared with \$478,000 for the prior year.

Accounts payable at December 31, 2006 amounted to \$964,000, compared with \$291,000 at December 31, 2005. The 2006 amount includes \$316,000 for clinical trial expenses and \$344,000 for legal fees. The increase of \$277,000 in accrued liabilities for 2006 includes \$175,000 related to the settlement of litigation on a cancer license agreement which was concluded on January 5, 2007.

In August 2005, PreMD issued \$9,828,000 (US\$8,210,000) of unsecured convertible debentures. During 2006, \$475,000 (US\$430,000) was converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,000 of the liability, \$140,000 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital. Additional financing expenses of \$51,000 were incurred in 2006, of which \$14,000 was allocated to the equity component of the convertible debentures and \$7,000 was allocated to warrants based on their relative fair values.

YEAR ENDED DECEMBER 31, 2005 COMPARED WITH 2004

Net Loss

The consolidated loss for the year ended December 31, 2005 was \$4,990,000 or \$(0.23) per share compared with a loss of \$5,569,000 or \$(0.26) per share for the year ended December 31, 2004, a decrease of \$579,000. The improvement resulted from an increase in sales and license revenue of \$1,094,000 which was partially offset by an increase in interest and imputed interest of \$484,000 on the convertible debentures issued on August 30, 2005.

Revenue

Product sales of PREVU* Skin Cholesterol tests to our licensee, McNeil Consumer Healthcare, amounted to \$426,000 in 2005 compared with \$183,000 in 2004.

In 2004, we completed a worldwide licensing agreement with McNeil to sell our cardiovascular products under the brand name PREVU* Skin Cholesterol Test. The up-front cash payments from both the worldwide agreement and the original Canadian agreement of \$3,000,000 and \$100,000, respectively, were deferred and recognized into income on a straight-line basis over the relative terms of the agreements (10 and 15 years, respectively). Thus, the amounts being recognized into income for 2005 and 2004 were \$307,000 and \$182,000, respectively. Furthermore, minimum sales levels in the agreement provided additional license revenue of \$194,000 and \$120,000 in 2005 and 2004, respectively. Revenues received upon achievement of milestones amounted to a further \$638,000 in license revenue for 2005 compared with nil in 2004. Total license revenue amounted to \$1,153,000 for 2005 compared with \$302,000 in 2004.

Cost of Product Sales and Gross Profit

Cost of product sales exceeded sales for 2005 by \$3,000, compared to \$7,000 in 2004. The loss resulted from development costs for label and software changes to inventory.

Research and Development

Research and development expenditures for the year increased by \$507,000 to \$3,120,000 from \$2,613,000 in 2004.

The variance for 2005 reflects:

- A \$410,000 increase in spending on clinical trials for skin cholesterol and cancer to \$898,000 from \$488,000 in 2004. This increase was related to additional trials for skin cholesterol to lead to additional regulatory approvals, a new trial for breast cancer and continuation of the lung cancer trial (the "I-ELCAP" study);
- Increased legal fees on intellectual property, which amounted to \$331,000 compared with \$292,000 in fiscal 2004. These costs included \$189,000 in 2005 (\$96,000 in 2004) relating to the petition for reinstatement of two U.S. patents for skin cholesterol that had been deemed abandoned;
- An increase of \$135,000 in subcontract research to \$451,000 in support of the development of a second-generation color reader for the skin cholesterol test. This was partially offset by a decrease in product development expenditures for supplies of \$55,000;
- An increase in stock-based compensation expense of \$23,000 resulting in non-cash expenses for research personnel of \$147,000 in 2005 compared with \$124,000 for 2004, reflecting the amortization of the 2003 and 2004 grants as well as the 2005 grants;
- A decrease in compensation of \$53,000 reflecting lower incentive payments for the year for performance milestones; and
- Minor changes in other development costs during the period.

General and Administration Expenses

General and administration expenses amounted to \$2,691,000 compared with \$3,347,000 in 2004, a decrease of \$656,000.

The decrease for 2005 reflects:

- A reduction of \$434,000 in professional expenses resulting from the non-recurring expenditure of \$478,000 in 2004 for the unsolicited offer to acquire the shares of IBEX Technologies Inc. ("IBEX").
- A reduction of \$54,000 in stock-based compensation for options for administrative personnel and consultants which resulted in a non-cash expense of \$422,000 compared with \$476,000 in 2004. The 2004 amount included \$95,000 as the fair value of the cashless exercise of options by an officer of PreMD.
- A reduction in investor relations expenses by \$61,000 following the completion of some consulting contracts during 2005.
- A reduction in compensation of \$38,000, reflecting lower incentive payments in 2005 for performance milestones.
- A reduction of \$45,000 in travel expenses as a result of fewer international business development meetings.

Management's Discussion and Analysis of Financial Condition and Operating Results

Interest on Convertible Debentures

Interest on convertible debentures (issued on August 30, 2005) amounted to \$228,000 in 2005 compared to nil in 2004. The debentures bear interest at an annual rate of 7%, payable quarterly in either cash or stock. Imputed interest of \$256,000 (compared to nil in 2004) represents the expense related to the accretion of the liability component at an effective interest rate of 12.75%.

Amortization

Amortization expenses for equipment and acquired technology for 2005 amounted to \$210,000 compared with \$224,000 in 2004. The amortization of production molds amounted to \$3,000 in 2005 (2004 – \$7,000) and was recorded as a cost of inventory. Purchases of equipment to support administration, clinical trials and manufacturing amounted to \$130,000 in 2005 and \$165,000 in 2004. Amortization of deferred financing fees amounted to \$43,000 for 2005 compared to nil in 2004. The financing fees are amortized over the four-year life of the convertible debentures.

Investment Tax Credits

Recoveries of provincial scientific investment tax credits ("ITCs") amounted to \$199,000 for 2005 compared with \$205,000 in 2004.

Interest Income

Interest income amounted to \$173,000 for 2005, compared with \$124,000 for 2004. The increase resulted from the investment of the proceeds on the convertible debentures in August 2005.

U.S. GAAP

For purposes of U.S. GAAP, the consolidated loss for 2005 was \$4,904,000 (as restated) compared with \$5,478,000 in 2004.

Other

The increase in accounts receivable as at December 31, 2005 reflects the milestone revenues receivable from our licensee, referred to above under "Revenue".

The financing fees related to the convertible debenture are pro-rated between the debt and the fair value of the equity and warrant features. The debt portion is deferred and amortized over the term of the debenture. The unamortized portion amounted to \$478,000 at December 31, 2005.

There was a significant decrease of \$730,000 in accounts payable in 2005 compared with 2004. The 2004 amount included an amount for the purchase of inventory of approximately \$340,000 and most of the expenses related to the IBEX offer.

In August 2005, PreMD issued \$9,828,000 (US\$8,210,000) unsecured convertible debentures. As explained in note 5 to the consolidated financial statements, \$5,893,000 was recorded as a liability, \$1,178,000 as warrants and \$2,393,000 as an equity instrument.

CONTRACTUAL OBLIGATIONS

As at December 31, 2006, PreMD had certain contractual obligations and commitments related to ongoing clinical trials and research agreements as follows:

	Total	Less than 1 year	1–2 years	1–2 years
Clinical trials	\$ 305,000	\$ 305,000	\$ Nil	\$ Nil
Consulting agreement	87,000	87,000	Nil	Nil
Operating leases	293,000	139,000	135,000	19,000
Total	\$ 685,000	\$ 531,000	\$ 135,000	\$ 19,000

Certain other obligations, totaling up to \$225,000, are only payable upon the achievement of specific events.

The balance outstanding of \$9,067,000 (US\$7,780,000) for the convertible debentures that were issued on August 30, 2005 is payable in U.S. dollars and is due in August 2009.

LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2006, PreMD had cash, cash equivalents and short-term investments totaling \$3,276,000 (\$8,679,000 as at December 31, 2005). We invest our funds in short-term financial instruments and marketable securities. Cash used in operating activities during the year amounted to \$5,079,000 compared with \$5,308,000 in 2005.

On August 30, 2005, the Company issued \$9,828,000 (US\$8,210,000) unsecured convertible debentures, maturing on August 30, 2009, for net proceeds of \$8,966,000 after deducting issue fees and expenses of \$862,000. Additional expenses of \$51,000 were incurred in 2006. The issue costs attributable to the liability component were deferred and will be amortized over the life of the debt. The issue costs attributable to the equity component of the convertible debentures and the warrants were deducted from the respective balances.

Effective December 28, 2006, the agreements with McNeil Consumer Healthcare to market and distribute the PREVU* skin cholesterol tests were terminated. The Company is pursuing several opportunities to continue the commercialization of these tests, including direct sales in certain markets, licensing the marketing rights to other multinational healthcare companies and negotiating distribution agreements in specific territories.

On March 28, 2007, the Company issued, by way of private placement, 2,917,268 common shares and 1,458,634 common share purchase warrants for gross proceeds of approximately \$3.9 million. Each common share purchase warrant expires in March 2010 and entitles the holder to acquire one common share at a price of \$1.66 per share.

To date, we have financed our activities through product sales, license revenues, the issuance of shares and convertible debentures and the recovery of provincial ITCs. Management believes that, based on historical cash expenditures and the current expectation of future revenues from product sales, royalties and license revenues, our existing cash resources, together with the proceeds of the private placement subsequent to the year end (see note 12 to the consolidated financial statements) and the ITC receivable of \$200,000, will be sufficient to meet our current operating and capital requirements through at least 2008.

However, our future capital requirements will depend on many factors, including our ability to negotiate new licensing and/or sales distribution agreements to market our PREVU* Skin Cholesterol tests, continued progress in our product development and clinical programs, time and expense associated with regulatory filings, prosecution and enforcement of our patent claims, and costs associated with obtaining regulatory approvals. In the immediate term, until we obtain additional regulatory approvals for PREVU* and conclude new relationships for sales and marketing of PREVU*, revenue growth is expected to be slow.

RESEARCH AND DEVELOPMENT

In 2006, we spent \$4,774,000 on PreMD-sponsored research and development activities, compared with \$3,120,000 and \$2,613,000 in 2005 and 2004, respectively. Below is a summary of our products and the related stages of development for each product in clinical development. The summary contains forward-looking statements regarding timing of completion of product development phases. The actual timing of completion of those phases could differ materially from the estimates produced in the table.

Coronary Artery Disease ("CAD") Risk Assessment Technology

Product	Description	Phase of development	2006 expenses	Next phase for 2007
PREVU* POC Skin Cholesterol Test	Point-of-care skin cholesterol test that provides information about an individual's risk of coronary artery disease	Regulatory clearance in Canada, U.S. and Europe		Analysis of clinical trials for additional regulatory claims; prepare for new regulatory submission; commercial sales
PREVU* LT Skin Cholesterol Test	Lab-processed skin test	Completed insurance clinical trial; submitted to FDA		FDA clearance; commercial launch in select markets
PREVU* PT Skin Cholesterol Test	Semi-quantitative consumer-oriented test	Prototype development		Complete development and initiate pilot clinical trial
Total expenditures on skin cholesterol:			\$ 3,103,000	

Cancer

Product	Description	Phase of development	2006 expenses	Next phase for 2007
ColorectAlert™ and Colopath™	Mucus test for detection of colorectal cancer	2,500 patients tested in clinical trials	\$ 275,000	Analyze interim data; if positive, discuss partnering opportunities and add additional clinical trials for regulatory clearance
LungAlert™	Sputum test for detection of lung cancer	2,500 patients tested in clinical trials	\$ 659,000	Analyze interim data; if positive, discuss partnering opportunities; publish/present scientific papers; expand clinical trials for regulatory clearance
Breast cancer test	Nipple aspirate test for detection of breast cancer	Pilot clinical trial in progress	\$ 79,000	Complete pivotal clinical study and, if data positive, initiate clinical trial

RISKS AND UNCERTAINTIES

The forward-looking statements contained in this report are based on management's current expectations and are subject to a number of factors and uncertainties that could cause actual results or outcomes to differ materially from those described in such forward-looking statements. Investors should carefully consider the risks and uncertainties described below. This list of risks and uncertainties below is not exhaustive. Furthermore, additional risks and uncertainties not presently known to PreMD or that PreMD believes to be immaterial may also adversely affect PreMD's business.

Prospects for companies in the biotechnology industry generally may be regarded as uncertain given the nature of the industry and the significant degree of risk involved in research, development and marketing. Accordingly, investments in biotechnology companies should be regarded as speculative.

Interest Rate and Foreign Exchange Risk

PreMD is exposed to market risk related to changes in interest and foreign currency exchange rates, each of which could adversely affect the value of our current assets and liabilities. Our cash is invested in short-term, high-grade securities with varying maturities. Since PreMD's intention is to hold these securities to maturity, adverse changes in interest rates would not have a material effect on PreMD's results of operations. PreMD also makes commitments with foreign suppliers for clinical trials and other services. Adverse changes in foreign exchange rates could increase the costs of these services.

Changes in foreign exchange could also affect our ability to repay the convertible debentures since they are repayable in U.S. dollars on maturity in August 2009.

Volatility of Trading Market for PreMD's Common Shares

The volatility of PreMD's share price may affect the trading market for PreMD's common shares. There can be no assurance that an active trading market for the common shares will be sustained. Our share price could fluctuate significantly in the future for a number of reasons, including, among others, future announcements concerning PreMD, quarterly variations in operating results, the introduction of competitive products, reports of results of clinical trials, regulatory developments, and intellectual property developments.

In addition, stock markets, in general, and the market for shares of biotechnology and life science companies, in particular, have experienced extreme price and volume fluctuations in recent years that may be unrelated to the operating performance or prospects of the affected companies. These broad market fluctuations may affect the market price of PreMD's common shares.

Other Risks

Additionally, as a company in the early stages of commercialization, there are several risks related to operations, technology access and acceptance, and product performance that have the potential to materially adversely affect PreMD's long-term prospects. While management is optimistic about PreMD's future, the following risks and uncertainties, without limitation, should be considered in evaluating the Company:

- PreMD has no experience in marketing products. If we cannot successfully market and cause acceptance of our products, we will be unable to execute PreMD's business plan.
- If PreMD is unable to generate significant revenue and become profitable in the near future, our business will fail. We anticipate partnering the sales and marketing rights for the PREVU* Skin Cholesterol tests in 2007 for certain markets and may service other markets directly.
- If we cannot obtain additional financing required to support business growth, we will be unable to fund PreMD's continuing operations in the future.
- We will need to generate cash to pay the principal on the convertible debentures when they mature in 2009. Any conversion of the debentures, exercise of the warrants, or issuance of common shares to pay interest, when permitted, would dilute the interests of our current shareholders.

Management's Discussion and Analysis of Financial Condition and Operating Results

- PreMD's success depends in part on obtaining and maintaining meaningful patent protection on our products and technologies. The protection offered by our patents and patent applications may be challenged, invalidated or circumvented by our competitors, and there is no guarantee that we will be able to obtain or maintain patent protection for our products or product candidates. In addition, our petition to reinstate two of our U.S. patents was denied by the U.S. PTO and, accordingly, we could face additional competition from companies seeking to exploit the intellectual property that was previously covered by these patents.
- We rely on third parties to manufacture some of our products, and any delay, volume constraints or mistakes on the part of such manufacturers could result in cancelled orders and a loss of revenue for PreMD.
- PreMD faces potential risks of product liability, which could divert funding from ongoing operations and harm operating results.
- If we are unable to acquire future technology necessary for our products, PreMD may be unable to commercialize new products.
- The loss of any key employee could impair our ability to execute PreMD's business plan.
- Intense competition in the diagnostics industry could harm PreMD's ability to license and develop products.
- Any inability by PreMD to develop products and comply with government regulations may hinder or prevent the development and sale of PreMD's products.
- Rising health care costs could impair PreMD's ability to commercialize its products.
- We do not anticipate paying dividends on our common shares, which may affect investors who require a certain amount of liquidity on their investment.

A detailed discussion of risks and uncertainties is contained in our Annual Information Form for the fiscal year ended December 31, 2006, which is filed with the Ontario Securities Commission ("OSC") and is available at www.sedar.com, and in PreMD's reports and documents filed from time to time with the U.S. Securities and Exchange Commission ("SEC"), available at www.sec.gov. Except as required by law, PreMD is not under any obligation, and expressly disclaims any obligation, to update forward-looking statements. You should carefully consider the factors set forth in these other reports or documents that PreMD files with the OSC and the SEC.

QUARTERLY FINANCIAL INFORMATION

The following is a summary of unaudited quarterly financial information for each of the last eight quarters.

	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Product sales	\$ Nil	\$ 1,381	\$ 5,015	\$ 117	\$ 40,768	\$ 39,902	\$ 332,701	\$ 12,359
License revenue	2,555,157	576,995	79,624	77,051	918,804	79,698	78,081	76,725
Investment tax credits	25,000	45,000	70,000	60,000	31,000	70,000	47,923	50,000
Interest income	52,391	56,049	70,394	86,535	85,781	36,076	22,383	28,890
Net loss	\$ 339,602	\$ 1,120,175	\$ 2,115,432	\$ 2,373,762	\$ 788,825	\$ 1,443,941	\$ 1,455,027	\$ 1,301,912
Net loss per share⁽¹⁾: basic and diluted	\$ 0.01	\$ 0.05	\$ 0.10	\$ 0.11	\$ 0.04	\$ 0.07	\$ 0.07	\$ 0.06

⁽¹⁾ Net loss per share has been calculated on the basis of net loss for the period divided by the weighted average number of common shares outstanding during the period. The weighted average number of common shares outstanding for the year ended December 31, 2006 was 21,663,698.

Q4 2006 COMPARED WITH Q4 2005

The net loss for the three months ended December 31, 2006 was \$340,000 (\$0.01 per share) compared with \$789,000 (\$0.04 per share) for the three months ended December 31, 2005, a reduction of \$449,000.

Three significant factors in Q4 2006 contributed to this improvement. First, license revenue increased by \$1,637,000. Upon termination of the license agreements on December 28, 2006, the balance of the unamortized up-front license fees was recognized as license revenue. Second, this revenue was partially offset by an increase of \$429,000 in professional fees, primarily related to the litigation on a cancer license agreement. The litigation was subsequently settled on January 5, 2007 and included payments on settlement of \$175,000. Third, changes in foreign exchange rates caused a non-cash loss of \$308,000, primarily related to the valuation of the convertible debentures which are repayable in U.S. funds.

SUBSEQUENT EVENT

On March 28, 2007, the Company issued, by way of private placement, 2,917,268 common shares and 1,458,634 common share purchase warrants for gross proceeds of approximately \$3.9 million. Each common share purchase warrant expires in March 2010 and entitles the holder to acquire one common share at a price of \$1.66 per share.

Toronto, Canada
March 30, 2007

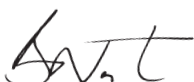
Management's Responsibility for Financial Reporting

The management of the Company is responsible for the preparation of the accompanying consolidated financial statements. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and, where appropriate, include estimates based on careful judgment. Management has determined these amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Financial information contained elsewhere in this annual report is consistent with the consolidated financial statements.

PreMD maintains a system of internal accounting and administrative controls that are designed to provide reasonable assurance, at a reasonable cost, that the financial information is accurate and reliable and that the assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility through an Audit Committee, which includes three non-management directors, and meets periodically with management and the external auditors, Ernst & Young LLP. The auditors have unrestricted access to the Audit Committee. The Audit Committee reviews PreMD's quarterly and annual consolidated financial statements and recommends their approval by the Board. The Committee also recommends the appointment of the external auditors who are appointed at PreMD's Annual Meeting.

The consolidated financial statements have been audited by Ernst & Young, on behalf of the shareholders, in accordance with Canadian generally accepted auditing standards.



Brent Norton

President and Chief Executive Officer
Toronto, Canada
March 28, 2007



Ron Hosking

Vice President, Finance, and Chief Financial Officer

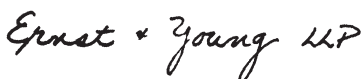
Report of Independent Auditors

To the Shareholders of **PreMD Inc.**

We have audited the consolidated balance sheets of **PreMD Inc.** as at December 31, 2006 and 2005 and the consolidated statements of loss and deficit and cash flows for each of the years in the three-year period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PreMD Inc. as at December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006 in conformity with Canadian generally accepted accounting principles, which differ in certain respects from accounting principles generally accepted in the United States of America (see note 10 (as restated) to the consolidated financial statements).



Chartered Accountants

Toronto, Canada
March 28, 2007

PreMD Inc.

Incorporated under the laws of Canada

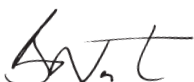
Consolidated Balance Sheets

[In Canadian dollars]

As at December 31	2006 \$	2005 \$
ASSETS		
Current		
Cash and cash equivalents	112,577	773,199
Short-term investments	3,163,482	7,905,883
Accounts receivable [note 3]	11,221	881,891
Inventory	179,219	36,306
Prepaid expenses and other receivables	570,773	317,264
Investment tax credits receivable	200,000	200,000
Total current assets	4,237,272	10,114,543
Deferred financing fees, net of accumulated amortization of \$174,863 [2005 – \$43,059] [note 5]	347,589	477,725
Capital assets, net [note 4[a]]	312,410	410,636
Intangible assets, net of accumulated amortization of \$915,027 [2005 – \$856,970] [note 4[b] and 8[a]]	382,229	290,286
	5,279,500	11,293,190
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current		
Accounts payable	963,990	291,125
Accrued liabilities	932,372	655,113
Current portion of deferred revenue [note 8[a]]	–	311,915
Total current liabilities	1,896,362	1,258,153
Convertible debentures [note 6]	6,350,680	5,893,340
Deferred revenue [note 8[a]]	–	2,297,400
Total liabilities	8,247,042	9,448,893
Commitments [note 8]		
Shareholders' equity (deficiency)		
Capital stock [note 6]	25,263,480	24,449,826
Contributed surplus [note 6]	2,521,915	1,840,979
Equity component of convertible debentures [note 5]	2,239,385	2,393,145
Warrants [notes 5, 6[c] and 8[b][ii]]	1,170,020	1,373,718
Deficit	(34,162,342)	(28,213,371)
Total shareholders' equity (deficiency)	(2,967,542)	1,844,297
	5,279,500	11,293,190

See accompanying notes

On behalf of the Board:



Brent Norton, MD, MBA
Director



Stephen A. Wilgar
Director

Consolidated Statements of Loss and Deficit

[In Canadian dollars]

Years ended December 31	2006 \$	2005 \$	2004 \$
REVENUE			
Product sales <i>[note 3]</i>	6,513	425,730	183,258
License revenue <i>[note 3]</i>	3,328,827	1,153,308	302,080
	3,335,340	1,579,038	485,338
Cost of product sales, including amortization of nil [2005 – \$3,456; 2004 – \$6,600]	36,824	428,650	190,214
Gross profit	3,298,516	1,150,388	295,124
EXPENSES			
Research and development	4,773,762	3,120,276	2,612,770
General and administration	3,024,811	2,690,790	3,346,720
Interest on convertible debentures <i>[notes 5 and 6]</i>	677,723	228,481	–
Imputed interest on convertible debentures <i>[note 5]</i>	819,609	255,529	–
Amortization <i>[notes 4[a], [b] and 5]</i>	319,205	252,804	224,428
Loss (gain) on foreign exchange	97,746	(35,734)	8,731
	9,712,856	6,512,146	6,192,649
RECOVERIES AND OTHER INCOME			
Investment tax credits	200,000	198,923	205,000
Interest	265,369	173,130	123,626
	465,369	372,053	328,626
Net loss for the year	(5,948,971)	(4,989,705)	(5,568,899)
Deficit, beginning of year	(28,213,371)	(23,223,666)	(17,654,767)
Deficit, end of year	(34,162,342)	(28,213,371)	(23,223,666)
Basic and diluted loss per share	\$ (0.27)	\$ (0.23)	\$ (0.26)
Weighted average number of common shares outstanding	21,663,698	21,487,008	21,276,497

See accompanying notes

Consolidated Statements of Cash Flows

[In Canadian dollars]

Years ended December 31	2006 \$	2005 \$	2004 \$
OPERATING ACTIVITIES			
Net loss for the year	(5,948,971)	(4,989,705)	(5,568,899)
Add (deduct) items not involving cash			
Amortization	319,205	256,260	231,028
Stock-based compensation costs included in			
Research and development expense	156,920	147,085	123,925
General and administration expense	383,767	421,812	476,164
Loss (gain) on sale of capital asset	(1,743)	–	6,098
Imputed interest on convertible debenture	819,609	255,529	–
Interest on convertible debenture paid in common shares	281,462	–	–
Loss (gain) on foreign exchange	97,748	(35,734)	8,731
Net change in non-cash working capital			
balances related to operations <i>[note 9]</i>	1,422,730	(1,061,397)	535,284
Increase (decrease) in deferred revenue	(2,609,315)	(301,885)	2,818,100
Cash used in operating activities	(5,078,588)	(5,308,035)	(1,369,569)
INVESTING ACTIVITIES			
Short-term investments	4,589,356	(3,065,568)	1,678,190
Purchase of trademark	(150,000)	–	–
Purchase of capital assets	(24,965)	(130,310)	(164,789)
Sale of capital assets	3,000	–	628
Cash provided by (used in) investing activities	4,417,391	(3,195,878)	1,514,029
FINANCING ACTIVITIES			
Issuance of convertible debentures <i>[note 5]</i>	–	9,827,616	–
Financing fees <i>[note 5]</i>	(51,399)	(861,328)	–
Issuance of capital stock, net of issue costs	–	198,400	33,373
Cash provided by (used in) financing activities	(51,399)	9,164,688	33,373
Effect of exchange rate changes on cash and cash equivalents	51,974	(127,034)	–
Net increase (decrease) in cash and cash equivalents during the year	(660,622)	533,741	177,833
Cash and cash equivalents, beginning of year	773,199	239,458	61,625
Cash and cash equivalents, end of year	112,577	773,199	239,458
Represented by			
Cash	112,577	773,199	173,302
Cash equivalents	–	–	66,156
	112,577	773,199	239,458
Supplemental cash flow information			
Cash paid during the year for interest	396,261	228,481	–

See accompanying notes

Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

1. NATURE OF THE COMPANY

PreMD Inc. [the “Company”] operates in a single business segment and is a predictive medicine company dedicated to improving health outcomes with non-invasive or minimally-invasive tools for the early detection of life-threatening diseases, particularly cardiovascular disease and cancer. The Company develops easy-to-use, accurate and cost-effective tests designed for use in a point-of-care setting, in a laboratory, in the life insurance industry, and, eventually, at home, and licenses the global marketing rights to third parties.

The Company currently owns patents for a test used to measure skin cholesterol and has in-licensed the technologies for tests to detect the presence of a cancer-specific marker for use in colorectal, lung and breast cancer. In addition, the Company has patents and patents pending for color measurement in biological reactions and has a right of first refusal on certain genomics-related technologies in the predictive medicine field.

2. SIGNIFICANT ACCOUNTING POLICIES

New pronouncements

The Canadian Institute of Chartered Accountants [“CICA”] released five new standards related to financial instruments and hedging. The Company is currently evaluating the impact on its consolidated financial statements of adopting these standards on January 1, 2007. These standards are effective for years beginning on or after October 1, 2006 and include the following sections:

[a] Section 3855 of the CICA Handbook, “Financial Instruments – Recognition and Measurement”, describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This section requires that:

- All financial assets be measured at fair value, with some exceptions, such as loans and receivables 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 carrying value; and
- All derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

[b] Section 3865 of the CICA Handbook, “Hedges”, describes when and how hedge accounting can be used. Hedging is an activity used by a company 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; and
- Changes resulting from risk exposure relating to a hedged item and a hedging item.

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period.

[c] Section 1530 of the CICA Handbook, “Comprehensive Income”, describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a company’s net assets that results from transactions, events and circumstances from sources other than the company’s shareholders. It includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments. Adopting this section will require the Company to start reporting the following items in the consolidated financial statements: comprehensive income and its components, and accumulated other comprehensive income and its components.

[d] Section 3250 of the CICA Handbook, “Surplus”, was changed and reissued as Section 3251, “Equity”. The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of Section 1530, “Comprehensive Income”.

[e] Section 3861 of the CICA Handbook, “Financial Instruments – Disclosure and Presentation”, establishes standards for presentation of financial instruments as non-financial derivatives and identifies disclosure requirements. Adopting this section would impact the classification of a financial instrument, or its component parts, as a liability or as an equity instrument in accordance with the substance of the contractual arrangement on initial recognition.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles [“Canadian GAAP”] consistently applied within the framework of the significant accounting policies summarized below. The significant differences between Canadian GAAP and United States generally accepted accounting principles [“U.S. GAAP”] are described and reconciled in note 10.

Basis of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, PreMD International Inc., Berne, incorporated under the laws of Switzerland, and 6211178 Canada Inc., incorporated under the laws of Canada. All significant intercompany transactions and balances have been eliminated upon consolidation.

Foreign currency translation

The Company’s functional currency is the Canadian dollar. Foreign operations are considered integrated and are translated into Canadian dollars using the temporal method. Monetary items are translated using the exchange rate in effect at the year end and non-monetary items are translated at historical exchange rates. Revenue and expenses are translated at the average rate for the year, except for amortization of capital assets which is translated at the same exchange rates as the assets to which they relate. Exchange gains or losses are included in the determination of net loss for the year.

Use of estimates

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ materially from those estimates.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and highly liquid investments that are readily convertible into cash with maturities of less than 90 days when purchased. There were no cash equivalents as at December 31, 2006 and 2005, but as at December 31, 2004, cash equivalents were comprised of funds with an average interest rate of 2.9%.

Short-term investments

Short-term investments are carried at the lower of cost and market value. Market value approximates cost. Short-term investments as at December 31, 2006 were comprised of money market funds and fixed income securities with interest rates of approximately 4.5% [2005 – 3.6%]. Short-term investments are comprised of highly liquid investments with maturity periods greater than 90 days but less than one year when purchased.

Financial instruments

The carrying values of cash and cash equivalents, short-term investments, accounts receivable, other receivables, accounts payable and accrued liabilities are considered to approximate their respective fair values due to their short-term nature.

The fair values of the equity and warrant components of the convertible debentures are recorded as “equity component of convertible debentures” and “warrants”, respectively, net of the allocated financing costs. The carrying value of the convertible debentures is recorded as a liability and is being accreted to its maturity value through charges to income for the imputed interest [note 5].

Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

Inventory

Inventory of raw materials is valued at the lower of cost and replacement cost. Inventories of finished goods are valued at the lower of cost and net realizable value, determined on a first-in, first-out basis.

Deferred financing fees

Financing costs relating to the issue of convertible debentures are pro-rated between the liability and the equity and warrant components of the debentures [note 5]. The expenses related to the liability component are deferred and are amortized on a straight-line basis over the term of the debentures. Should the debentures be converted prior to maturity, the unamortized balance of financing costs will be transferred to capital stock. The “equity component of convertible debentures” and the “warrants” are recorded net of the respective allocated financing costs.

Capital assets

Capital assets are recorded at acquisition cost less accumulated amortization.

Purchases of molds required for the manufacture of products are capitalized and amortized over the useful life of the assets on the basis of units produced. The amortization expense for molds is recorded as a cost of product sales.

The Company provides for amortization on the declining balance basis, unless otherwise indicated, at rates which are expected to charge operations with the cost of the assets over their estimated useful lives as follows:

Manufacturing equipment	useful life on basis of units produced
Computer equipment	30%
Furniture and equipment	20%
Research instrumentation	30%
Laboratory equipment	20%
Leasehold improvements	straight-line over the term of the lease

Intangible assets

Patents, patent rights and trademarks acquired by the Company are recorded at acquisition cost and are amortized on a declining balance basis at 20% per year. The Company evaluates the carrying value of intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized when the carrying amount of an intangible asset exceeds the sum of the undiscounted cash flows expected to result from its use.

Indemnifications

Many of the Company's agreements, specifically those related to financing, clinical trials, research and development and supply arrangements, include indemnification provisions where the Company agrees to indemnify and hold harmless the counterparty against possible claims by third parties. Potential payments under these provisions relate to personal injury resulting from clinical trials and from breach of fundamental representation and warranty terms in the agreements with respect to matters such as corporate status, title of assets, consents to transfer, employment matters, litigation and other potential material liabilities. None of the indemnification provisions absorb the credit risk of the counterparties' assets or liabilities. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is not reasonably quantifiable as certain indemnifications are not subject to a monetary limitation. The Company also maintains product liability insurance to cover claims related to its clinical trials and sales of products. At December 31, 2006, management believes there is only a remote possibility that the indemnification provisions would require any material cash payment.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

Revenue recognition

The Company earned 100% of its revenue from one customer under the terms of two contracts [note 8[a]]. These contracts outlined the terms for all products and services provided to the customer, and were considered multiple revenue arrangements. Under the terms of Emerging Issues Committee No. 142 – “Revenue Arrangements with Multiple Deliverables”, products and services under these contracts are separated into units of accounting for revenue recognition purposes.

Non-refundable, up-front payments received from licensees are deferred and recognized in income on a straight-line basis over the respective terms of the agreements. Milestone payments received from licensees are recorded as income in the period when the respective measurable milestones are achieved and collectability is assured. Royalty revenues are based on sales by licensees and are recorded as income in the period earned and reported by the licensees.

Revenue from sales of products to licensees is recognized when the title passes to the licensee and when the products are shipped.

Interest income is recognized as earned.

Research and development and related investment tax credits

Research and development expenditures include related salaries, subcontractor fees, product development expenses including patent costs, clinical trials costs and an allocation of administrative expenses and corporate costs specifically attributable to research and development. Research and development excludes any costs associated with the acquisition of capital assets and acquired technology. Research and development expenditures are charged to expenses as incurred unless management believes a development cost meets the generally accepted criteria for deferral. All development costs incurred to date have been expensed. Reimbursements for specific expenditures received through collaborative funding have been applied against research and development expenses.

Investment tax credits earned as a result of incurring qualified scientific research and experimental development expenses are recorded when the amounts are readily determinable. The amounts are recorded as follows:

- For capital assets – as a reduction of the cost of the related asset; and
- For operating expenses – as a recovery within the consolidated statements of loss and deficit.

Stock-based compensation

The Company has two stock-based compensation plans for employees, directors and consultants, which are described in note 6[d]. Certain of the stock options granted vest over a fixed term and others vest based on performance upon the achievement of certain milestones.

Canadian GAAP requires that options issued be accounted for using the fair value method of accounting. Non-cash compensation expense for fixed-term options is recorded over the term of the vesting period, whereas compensation expense for performance options is recorded when it is determined that achievement of the milestone is likely. Prior to 2003, no compensation expense was recognized for stock options granted to employees. For stock options awarded to employees prior to January 1, 2003 but subsequent to January 1, 2002, pro forma disclosure of net loss and loss per share is provided as if these awards were accounted for using the fair value method. Consideration paid on the exercise of stock options and warrants is credited to capital stock.

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Shares issued to employees under the share purchase plan are accounted for as direct awards of stock and are recognized as a non-cash compensation expense in the consolidated statements of loss and deficit [note 6[e]].

Income taxes

The Company applies the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are provided if it is more likely than not that some or all of the future tax assets will not be realized.

Loss per share

Loss per share has been calculated on the basis of net loss for the year divided by the weighted average number of common shares outstanding during the year. Diluted loss per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method. The inclusion of the Company's stock options, the conversion feature of the convertible debentures and the warrants in the computation of diluted loss per share would have an anti-dilutive effect on loss per share. Therefore, stock options and warrants have been excluded from the calculation of diluted loss per share. Consequently, there is no difference between basic loss per share and diluted loss per share.

3. ECONOMIC DEPENDENCE AND CONCENTRATION OF CREDIT RISK

Revenues earned by the Company in fiscal years 2004 to 2006 were from one customer. These revenues were pursuant to a license agreement that was terminated on December 28, 2006 [note 8[a]]. All amounts due to the Company from this customer had been collected prior to the year end. As at December 31, 2005, substantially all the accounts receivable were due from this customer.

4. CAPITAL AND INTANGIBLE ASSETS

[a] Capital assets consist of the following:

			2006
	Cost	Accumulated	Net book
	\$	amortization	value
		\$	\$
Manufacturing equipment	20,585	10,056	10,529
Computer equipment	299,947	218,529	81,418
Furniture and equipment	65,609	48,373	17,236
Research instrumentation	666,460	515,576	150,884
Laboratory equipment	61,437	24,023	37,414
Leasehold improvements	39,983	25,054	14,929
	1,154,021	841,611	312,410

			2005
	Cost \$	Accumulated amortization \$	Net book value \$
Manufacturing equipment	20,585	10,056	10,529
Computer equipment	293,388	185,361	108,027
Furniture and equipment	65,609	44,064	21,545
Research instrumentation	669,183	452,701	216,482
Laboratory equipment	60,496	14,787	45,709
Leasehold improvements	23,159	14,815	8,344
	1,132,420	721,784	410,636

Amortization expense on capital assets amounted to \$121,934 in 2006 [2005 – \$140,629; 2004 – \$140,313].

[b] Intangible assets consist of the following:

			2006
	Cost \$	Accumulated amortization \$	Net book value \$
Patents and patent rights	1,147,256	915,027	232,229
Trademarks	150,000	–	150,000
	1,297,256	915,027	382,229

			2005
	Cost \$	Accumulated amortization \$	Net book value \$
Patents and patent rights	1,147,256	856,970	290,286
	1,147,256	856,970	290,286

Amortization expense on intangible assets amounted to \$58,057 in 2006 [2005 – \$72,572; 2004 – \$90,715].

5. CONVERTIBLE DEBENTURES

On August 30, 2005, the Company completed a financing, by way of a private placement of convertible debentures maturing on August 30, 2009, for gross proceeds of \$9,827,616 [US\$8,210,000] less issue fees and expenses of \$913,000 (resulting in net proceeds of \$8,915,000). The unsecured debentures bear interest at an annual rate of 7% [effective rate of 12.75% on the liability component], payable quarterly in cash or common shares at the Company's option. The number of common shares issuable in satisfaction of interest payments is dependent on the trading price of the shares at the time of the applicable interest payment date. The debentures are convertible into common shares at any time during the term, at the option of the holder, at \$3.47 per share (subject to adjustment). If all the debentures were converted into common shares, it would result in the issuance of an additional 2,882,195 common shares. Purchasers of the convertible debentures also received warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per share (subject to adjustment). At any time after one year from the date of issuance of the warrants, the warrants may also be exercised by means of a cashless exercise by the holder. On August 25, 2006, \$475,441 [US\$430,000] of the debentures were converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,304 of the liability, \$140,137 of the equity component of the convertible debentures and \$22,000 of the deferred financing fees to share capital.

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Of the total amount of the financing, \$5,917,209 was recorded as a liability using the residual method. The fair value of the equity component of the convertible debentures at the date of grant is estimated at \$2,393,145 [net of expenses of \$228,292], using the Black-Scholes option pricing model. The fair value of the warrants is estimated at \$1,176,718 [net of expenses of \$112,252], determined using the Black-Scholes option pricing model. Additional financing expenses of \$51,399 were incurred in 2006, of which \$13,623 was allocated to the equity component of the convertible debenture and \$6,698 was allocated to warrants based on their relative fair values. The assumptions used to calculate the fair value of the equity component and the warrants are as follows:

	Equity component	Warrants
Expected volatility	42.7%	41.7%
Risk-free interest rate	3.35%	3.35%
Expected option life	4 years	5 years
Dividend yield	nil	nil

The table below presents a summary of the offering:

	Proceeds \$	Deferred financing fees \$	Net \$
Issuance of convertible debenture	9,827,616	861,328	8,966,288
Equity component of convertible debentures	(2,621,437)	(228,292)	(2,393,145)
Warrants	(1,288,970)	(112,252)	(1,176,718)
Liability component of convertible debenture	5,917,209	520,784	5,396,425

The liability component is being accreted over time by a charge to the consolidated statements of loss and deficit for imputed interest at an effective rate of 12.75% and, at maturity, will be equal to the face value of the debentures. All cash repayments, default payments or redemptions of the principal under the debentures shall be made in U.S. dollars.

The table below presents a reconciliation of the valuation of the liability component from date of issue to December 31, 2006:

	\$
Issuance of convertible debentures, August 30, 2005	5,917,209
Changes in foreign exchange rates	(279,398)
Imputed interest	255,529
Balance, December 31, 2005	5,893,340
Conversion to common shares	(357,304)
Changes in foreign exchange rates	(4,965)
Imputed interest	819,609
Balance, December 31, 2006	6,350,680

The amortization of the deferred financing fees amounted to \$139,214 for 2006 [2005 – 43,059; 2004 – nil].

6. CAPITAL STOCK AND CONTRIBUTED SURPLUS

[a] Authorized

The authorized capital stock of the Company consists of an unlimited number of common shares, without nominal or par value, and an unlimited number of preferred shares, issuable in series.

[b] Issued and outstanding shares

	Number \$	Stated value \$	Contributed surplus \$	Total \$
Common shares				
Balance, December 31, 2003	21,260,902	24,056,853	723,993	24,780,846
Expiry of warrants [notes 6[c] and 8[b][iii]]	–	–	115,200	115,200
Stock-based compensation expense [note 6[d]]	–	–	488,994	488,994
Issued under share purchase plan [note 6[e]]	1,830	7,595	–	7,595
Issued on exercise of options [note 6[d]]	8,150	23,368	–	23,368
Issued on cashless exercise of options	27,713	94,500	–	94,500
Repayment of share purchase loans	15,000	10,005	–	10,005
Balance, December 31, 2004	21,313,595	24,192,321	1,328,187	25,520,508
Expiry of warrants [note 6[c]]	–	–	3,000	3,000
Stock-based compensation expense [note 6[d]]	–	–	509,792	509,792
Issued under share purchase plan [note 6[e]]	23,167	59,105	–	59,105
Issued on exercise of options [note 6[d]]	31,000	78,400	–	78,400
Repayment of share purchase loans	180,000	120,000	–	120,000
Balance, December 31, 2005	21,547,762	24,449,826	1,840,979	26,290,805
Expiry of warrants [note 8[b][i]]	–	–	197,000	197,000
Stock-based compensation expense [note 6[d]]	–	–	483,936	483,936
Issued under share purchase plan [note 6[e]]	25,910	56,751	–	56,751
Issued as payment for interest [note 5]	133,674	281,462	–	281,462
Issued on conversion of debenture [note 5]	150,877	475,441	–	475,441
Balance, December 31, 2006	21,858,223	25,263,480	2,521,915	27,785,395

On September 13, 2004, an executive of the Company exercised, on a cashless basis, 75,000 options to acquire common shares of the Company at \$2.15 per share. The Company issued 27,713 common shares to the executive with an aggregate value equal to the difference between the exercise price of the options and the fair market value of the Company's common shares [\$94,500] on September 13, 2004. The Toronto Stock Exchange and the Board of Directors of the Company approved this cashless exercise.

[c] Warrants

Pursuant to the issue of convertible debentures on August 30, 2005, the Company granted warrants to purchase 1,288,970 common shares at any time before August 30, 2010 at an exercise price of \$3.57 per share [note 5].

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Pursuant to a research collaboration agreement dated October 31, 2000, the Company granted warrants to purchase up to 50,000 common shares at an exercise price of \$4.50 per share; these warrants were issued in annual increments of 10,000 warrants exercisable immediately and expiring in one year. As of October 31, 2005, all warrants expired unexercised.

The status of warrants as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

	2006		2005		2004	
	Number of warrants #	Weighted average exercise price \$	Number of warrants #	Weighted average exercise price \$	Number of warrants #	Weighted average exercise price \$
Outstanding, beginning of year	1,388,970	3.60	110,000	4.05	185,000	4.23
Granted	–	–	1,288,970	3.57	10,000	4.50
Expired or forfeited	(100,000)	4.00	(10,000)	4.50	(85,000)	4.50
Outstanding, end of year	1,288,970	3.57	1,388,970	3.60	110,000	4.05

[d] Options

Under the 1998 Stock Option Plan, the Company grants options to its employees, directors and consultants. The Company may issue options for up to 3,500,000 common shares. As at December 31, 2006, 3,189,517 options had been issued, of which 2,920,304 remain outstanding under this plan, and the remaining 310,483 are eligible to be issued. The exercise price of each option granted may not be less than the market price of the Company's stock on the date of the grant and no option may have a term exceeding 10 years.

Certain of the options vest over a fixed term and others vest based on performance upon the achievement of certain milestones. A summary of the status of the two types of options is presented below:

Fixed stock options

Fixed stock options vest on an annual basis over a period of up to five years. The status of fixed stock options as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

	2006		2005		2004	
	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$
Outstanding, beginning of year	2,297,785	3.41	1,954,285	3.54	1,757,035	3.45
Granted	896,500	1.48	549,500	3.02	406,000	3.79
Exercised	–	–	(31,000)	2.53	(33,613)	2.24
Expired or forfeited	(454,981)	3.08	(175,000)	3.79	(175,137)	3.50
Outstanding, end of year	2,739,304	2.83	2,297,785	3.41	1,954,285	3.54
Options exercisable end of year	1,461,783	3.47	1,458,114	3.49	1,258,957	3.52

The following table presents information about fixed stock options outstanding at December 31, 2006:

Range of exercise prices \$	Number outstanding #	Weighted average remaining life [in years]	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
1.25 – 1.40	735,500	4.14	1.31	–	–
2.20 – 2.95	1,056,304	2.20	2.88	633,783	2.86
3.20 – 3.97	218,000	2.77	3.58	168,200	3.48
4.00 – 4.09	709,500	1.24	4.01	643,800	4.01
6.05	20,000	0.43	6.05	16,000	6.05
	2,739,304	2.51	2.83	1,461,783	3.47

The assumptions used to calculate the fair value of stock-based compensation expense using the Black-Scholes option pricing model are approximately as follows:

	2006	2005	2004
Expected volatility	43.9%	42.2%	50.1%
Risk-free interest rate	3.97%	3.66%	3.79%
Expected life	5 years	5 years	5 years

Dividend yield assumption used for all years presented was nil.

The Black-Scholes option pricing model, used by the Company to calculate option values, as well as other accepted option valuation models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values. Accordingly, management believes that these models do not necessarily provide a reliable single measure of the fair value of the Company's stock option awards.

Performance stock options

Performance stock options vest immediately upon the achievement of certain milestones as determined by the Board of Directors at the time of issuance. The performance stock option milestones include criteria measured by product-related goals and corporate goals. Product-related goals include product development, completion of clinical trials, regulatory submissions, regulatory approvals, signing of marketing partners and commercial launch of the Company's products. The corporate goals include successful investor and public relations activities related to media publications and investor analyst coverage, as well as financial goals including completion of financings and government grants.

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The status of performance stock options as at December 31, 2006, 2005 and 2004 and changes during the years ended on those dates is presented below:

	December 31, 2006		December 31, 2005		December 31, 2004	
	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$
Outstanding, beginning of year	176,000	3.46	176,000	3.46	214,750	3.54
Granted	120,000	2.35	–	–	–	–
Exercised	–	–	–	–	(2,250)	3.45
Expired or forfeited	(115,000)	3.17	–	–	(36,500)	3.93
Outstanding, end of year	181,000	2.91	176,000	3.46	176,000	3.46
Options exercisable end of year	34,700	4.00	85,825	3.29	85,825	3.29

The following table presents information about performance stock options outstanding at December 31, 2006:

Range of exercise prices \$	Number outstanding #	Weighted average remaining life [in years]	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
2.35	120,000	4.83	2.35	–	–
4.00	61,000	0.13	4.00	34,700	4.00
	181,000	3.24	2.91	34,700	4.00

Pro forma impact of stock-based compensation

The table below presents pro forma net loss and basic and diluted loss per common share as if stock options granted to employees between January 1, 2002 and December 31, 2002 had been determined based on the fair value method.

	2006 \$	2005 \$	2004 \$
Net loss as reported	(5,948,971)	(4,989,705)	(5,568,899)
Estimated stock-based compensation expenses	(50,610)	(116,286)	(223,830)
Pro forma net loss	(5,999,581)	(5,105,991)	(5,792,729)
Pro forma basic and diluted loss per common share	\$ (0.28)	\$ (0.24)	\$ (0.27)

The assumptions used to calculate the fair value of stock-based compensation expense using the Black-Scholes option pricing model are approximately as follows: expected volatility of 54.3%; risk-free interest rate of 4.06%; dividend yield of nil; and expected life of the options of five years.

[e] Share purchase plan

The Company implemented a share purchase plan effective March 22, 1999, as amended on May 25, 2005. Pursuant to the terms of the plan, the Company will match the value of the common shares purchased by its employees or directors by issuing from treasury an equal number of common shares, up to a maximum value of the lesser of 50% of the maximum allowable

annual contribution for registered retirement savings plans [being \$9,000 as at December 31, 2006 or 9% of the employee's annual salary]. The maximum number of common shares which may be issued by the Company pursuant to the share purchase plan is 350,000. Under the plan, the Company issued 25,910 common shares to employees and directors during the year ended December 31, 2006 and 23,167 and 1,830 common shares during the years ended December 31, 2005 and 2004, respectively.

7. INCOME TAXES

[a] Significant components of the Company's future tax assets are as follows:

	2006 \$	2005 \$
Future tax assets		
Federal tax loss carryforwards	3,045,000	2,450,000
Ontario tax loss carryforwards	2,170,000	1,612,000
Investment tax credits	2,061,000	1,700,000
Financing and share issue costs	194,000	263,000
SR&ED expenditures	3,684,000	3,380,000
Capital assets	95,000	99,000
Deferred revenue	-	684,000
Future tax assets before valuation allowance	11,249,000	10,188,000
Valuation allowance	11,249,000	10,188,000
Net future tax assets	-	-

No net future tax assets have been recognized in the consolidated financial statements as the realization of the net future tax assets does not meet the more likely than not recognition criteria.

[b] The Company has accumulated tax losses for federal and provincial purposes in Canada. The Company also has unclaimed federal scientific research investment tax credits. The losses and investment tax credits can be used to offset future years' Canadian taxable income, the benefit of which has not been recorded in the accounts.

The approximate tax losses and investment tax credits expire as follows:

	Federal \$	Ontario \$	Investment tax credits \$
2007	1,062,000	1,340,000	-
2008	1,562,000	1,562,000	-
2009	2,887,000	2,887,000	18,000
2010	2,018,000	2,018,000	247,000
2011	-	-	337,000
2012	-	-	297,000
2013	-	-	397,000
2014	494,000	494,000	423,000
2015	2,178,000	2,178,000	464,000
2016	5,024,000	5,024,000	458,000
	15,225,000	15,503,000	2,641,000

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[c] The Company has available scientific research and experimental development [“SR&ED”] expenditures for income tax purposes which may be carried forward indefinitely to reduce future years’ taxable income. The total of such expenditures accumulated to December 31, 2006 was approximately \$11,162,000. The potential income tax benefits associated with these expenditures have not been recorded in the accounts.

[d] The Company is entitled to receive provincial investment tax credits relating to SR&ED expenditures incurred, the benefits of which have been accrued in the accounts.

[e] The following is a reconciliation of the provision for (recovery of) income taxes between those that are expected, based on substantially enacted rates, to those currently reported:

	2006		2005		2004	
	\$	%	\$	%	\$	%
Loss before income taxes	(5,948,971)		(4,989,705)		(5,568,899)	
Expected recovery of						
income taxes	(2,148,768)	(36.1)	(1,802,281)	(36.1)	(2,011,486)	(36.1)
Permanent differences	526,482	8.8	299,044	6.0	268,428	4.8
Change in valuation allowance	1,622,286	27.3	1,503,237	30.1	1,743,058	31.3
	-	-	-	-	-	-

8. COMMITMENTS

[a] Commercialization agreements

Pursuant to an agreement dated May 10, 2002, as amended on December 20, 2002 and December 9, 2005, the Company licensed to McNeil Consumer Healthcare [“McNeil”] the right to market and distribute the Company’s test for coronary artery disease in Canada and for the insurance laboratory field in the United States and Mexico. The term of the agreement was 15 years and required McNeil to purchase the Company’s skin cholesterol test and to pay ongoing royalties to the Company based on McNeil’s sales, in addition to a series of financial milestone payments of up to \$3,300,000, which were to be based on McNeil’s achievement of specified annual sales levels of the licensed products.

On May 28, 2004, as amended on December 9, 2005, the Company signed an additional marketing agreement with McNeil and completed an exclusive worldwide licensing agreement to sell the Company’s skin cholesterol tests under the brand name PREVU* Skin Sterol Test. The agreement had a minimum term of 10 years. Under the financial terms of the agreement, the Company received a non-refundable \$3,000,000 up-front payment.

On December 28, 2006, the agreements with McNeil were terminated and the balance of the deferred revenue, which had been received as an up-front payment, of \$2,297,400 was recorded as license revenue. In addition, the Company received additional license revenue of \$221,000 related to annual minimum sales levels and purchased other assets from McNeil for \$221,000, including the PREVU* trademark for \$150,000.

[b] Research and collaboration agreements

The Company has entered into agreements with various clinical sites to conduct clinical trials on its technologies. The Company is committed, upon the progressive completion of the trials, to make further payments of approximately \$305,000.

The Company has acquired or is developing in collaboration with others a number of technologies that will require the Company to make payments upon the successful achievement of certain technological milestones. Additionally, in connection with the development of the technologies, the Company has entered into research agreements whereby a minimum fee will be paid for research and development to be carried out by other parties. The Company is committed, upon the successful achievement of future operating performance milestones, to make further payments of approximately \$225,000 to these parties.

[i] Pursuant to agreements [the “ColorectAlert™ License Agreements”] dated March 27, 1998, May 1, 1998, and October 23, 2001 between the Company and Dr. A.K.M. Shamsuddin [the “ColorectAlert™ Inventor”], the Company acquired a license, including the three existing United States and Japanese patents, for a technology that detects a carbohydrate marker associated with cancerous and pre-cancerous conditions [“ColorectAlert™”]. Pursuant to the terms of the agreements, the Company is required to make payments upon achieving certain research and development milestones as well as royalty payments based on revenues from sales of this technology. As at December 31, 2006, the Company had made milestone payments under the ColorectAlert™ License Agreements of approximately \$328,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$120,000. In addition, the Company granted warrants to purchase up to 100,000 common shares at exercise prices ranging from \$3.50 to \$4.50 per share to the ColorectAlert™ Inventor. These warrants expired unexercised on October 19, 2006, and the fair value of \$197,000 was reclassified from warrants to contributed surplus [note 6[b]].

Subsequent to the year end, on January 5, 2007, the Company settled litigation relating to the ColorectAlert™ License Agreements. Under the terms of the settlement with Dr. Shamsuddin and Med-11 AG, the Company agreed to pay \$175,000 to Med-11 AG [“Med-11”] and amended the agreements to replace Dr. Shamsuddin with Med-11 as the licensor. This amount was expensed in 2006 as general and administration expense. The amendment also reduced the royalty payable by the Company from 10% to 7.5% on its revenues from products utilizing the patents and eliminated all future milestone payments that the Company may have been required to pay under the initial agreements.

[ii] The Company entered into an agreement [the “Procyon License Agreement”] with Ambrilia Biopharma, Inc. (formerly, Procyon Biopharma Inc.) [“Procyon”] dated March 19, 2001, as amended, whereby the Company has the right to complete the development, clinical trials and regulatory submission for the technology and is entitled to develop, manufacture, market and distribute the ColoPath™ technology exclusively on a global basis. Pursuant to the terms of the Procyon License Agreement, all new patents will be owned by the Company. Procyon is entitled to payments based on the completion of certain research and development milestones as well as a royalty payment based on sales of all mucus-based colorectal cancer tests. As at December 31, 2006, the Company had made milestone payments under the Procyon License Agreement of \$125,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$225,000. The Procyon License Agreement does not have a fixed termination date and it may be terminated upon written agreement of the parties, if the Company has not at that time engaged in any clinical work or product development in connection with the research and development of ColorectAlert™ or ColoPath™ or met minimum levels of sales of these products. In addition, the Company granted Procyon warrants to purchase up to 75,000 common shares at an exercise price of \$4.50 per share in connection with this agreement. These warrants expired unexercised on March 19, 2004, and the fair value of \$108,000 was reclassified from warrants to contributed surplus [note 6[b]].

[c] Key man life insurance

A subsidiary of the Company, 6211178 Canada Inc. [the “Subsidiary”], owns life insurance policies for the CEO in the amount of \$8,000,000, with the Subsidiary as the named beneficiary. In the event of the CEO’s death, the Subsidiary shall use 75% of the insurance proceeds to purchase the CEO’s common shares in the Company from his estate. Pursuant to the terms of the insurance agreement, on January 1 of each year, the Subsidiary shall ensure that the amount of the insurance policy is not less than 100% of the fair market value of the CEO’s common shares at that date. The Company owns an additional life insurance policy for the CEO in the amount of \$3,000,000.

Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

[d] Operating leases and other commitments

The Company has contractual commitments and future minimum annual lease payments under operating leases for its office premises and laboratory facilities as follows:

	\$
2007	226,000
2008	135,000
2009	19,000
2010 and thereafter	—
	<u>380,000</u>

9. CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	2006 \$	2005 \$	2004 \$
Accounts receivable	870,670	(659,543)	(211,648)
Inventory	(142,913)	231,194	(267,500)
Prepaid expenses and other receivables	(253,509)	(180,249)	186,774
Investment tax credits receivable	—	189,000	(209,000)
Accounts payable and accrued liabilities	948,482	(641,799)	1,036,658)
	1,422,730	(1,061,397)	535,284

Excluded from the consolidated statements of cash flows for the years ended December 31, 2006 was the issuance of common shares paid as consideration for interest on the convertible debentures of \$281,462 and a foreign exchange adjustment of \$1,642. There was no impact on the years ended December 31, 2005 and 2004.

The Company did not pay any amounts for income taxes from 2004 to 2006.

10. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Company prepares its consolidated financial statements in accordance with Canadian GAAP, which, as applied in these consolidated financial statements, conforms in all material respects to U.S. GAAP, except as follows:

	2006 \$	2005 \$	2004 \$
Net loss for the year [Canadian GAAP]	(5,948,971)	(4,989,705) [note b]	(5,568,899)
Adjustments			
Amortization of acquired technology [a]	58,057	72,572	90,715
Mark-to-market adjustment on derivative [b]	54,088	28,807	–
Amortization of deferred financing fees [c]	(50,043)	(15,798)	–
Net loss and comprehensive loss for the year			
[U.S. GAAP] [e]	(5,886,869)	(4,904,124)	(5,478,184)
Basic and diluted loss per share			
[U.S. GAAP]	\$ (0.27)	\$ (0.23)	\$ (0.26)
Weighted average number of common shares outstanding			
Basic and diluted	21,663,698	21,487,008	21,276,497

Basic loss per common share is determined using the weighted average number of common shares outstanding during the years. As a result of the net losses for the years ended December 31, 2006, 2005 and 2004, the potential dilutive effect of the exercise of stock options and warrants was anti-dilutive, and therefore, it was not included in the calculation of diluted loss per share.

Consolidated balance sheet items, which would differ under U.S. GAAP, are as follows:

	2006 \$	2005 \$	2004 \$
ASSETS			
Intangible assets, net [a]	150,000	–	–
Deferred financing fees [c]	475,851	686,653	–
	5,167,639	11,211,832	6,633,221
LIABILITIES AND SHAREHOLDERS' EQUITY			
Derivative liability [b]	2,402,244	2,592,630	–
	10,649,286	12,041,523	4,499,237
Shareholders' equity			
Capital stock	29,981,717	29,182,269	28,924,764
Additional paid-in capital [d]	5,167,851	4,735,952	3,049,442
Deficit [a] [b] [c]	(40,631,215)	(34,747,912)	(29,840,222)
	(5,481,647)	(829,691)	2,133,984
	5,167,639	11,211,832	6,633,221

Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

[a] Intangible assets

Under U.S. GAAP, the Company's patents and patent rights, which are primarily comprised of patents and know-how which require regulatory approval to be commercialized and which have no proven alternative future uses, are considered in-process research and development and are immediately expensed upon acquisition in accordance with Statement of Financial Accounting Standards ["SFAS"] No. 2, "Accounting for Research and Development Costs". The Company's patents and patent rights do not have an alternative future use given their specialized nature and limited alternative use. Under Canadian GAAP, the patents and patent rights are considered to be a development asset that is capitalized and amortized over its expected useful life.

[b] Convertible debentures

During 2006, the Company determined that the conversion feature of the convertible debentures met the definition of a derivative under FAS 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and should be recorded on the balance sheet as a derivative liability with subsequent changes in value recorded through earnings. Previously, the fair value assigned to the conversion feature of the convertible debenture was recorded as a liability and accreted to its maturity value through charges to income for the imputed interest at an effective rate of 3.52%. As a result, the previously reported difference relating to the imputed interest on the liability component of \$154,900 no longer exists. The elimination of the imputed interest is partially offset by the mark-to-market gain of the derivative liability of \$28,807, as well as a reduction in the amortization of the deferred financing fees (see [c] below). The net impact of these three adjustments increases the net loss for 2005 under U.S. GAAP by \$122,527 from amounts previously reported and also increases basic and diluted loss per share of \$0.22 previously reported to \$0.24. The restated pro forma basic and diluted loss per share increases from \$0.23 previously reported to \$0.24 [see note f].

The impact of these adjustments on the balance sheet under U.S. GAAP is as follows:

- The fair value of the conversion feature of \$2,621,437, as at August 30, 2005, being the same value as the equity component under Canadian GAAP, was reclassified from convertible debentures to derivative liability;
- The derivative liability was revalued to \$2,592,630 as at December 31, 2005 which represents a mark-to-market gain of \$28,807.

In accordance with Accounting Principles Board ["APB"] Opinion No. 14, a value is assigned to the warrants when they are detachable from the convertible debentures. As a result, there is no difference in the value assigned to warrants under Canadian and U.S. GAAP.

On August 25, 2006, \$461,235 [US\$430,000] of the debentures were converted into 150,877 common shares of the Company, which resulted in a reclassification of \$357,304 of the liability component of the convertible debentures, \$136,298 of the derivative liability and \$32,367 of the deferred financing fees to share capital. These amounts differ slightly from the amounts reported under Canadian GAAP described in note 5.

[c] Deferred financing fees

Under U.S. GAAP, financing fees relating to the issue of convertible debentures are pro-rated between the liability (exclusive of the fair value assigned to the conversion feature) and the warrant components of the debentures. Under Canadian GAAP, the financing fees are allocated between the liability and the equity and the warrant components. The expenses related to the liability component are deferred and amortized over the term of the debentures whereas the expenses related to the equity and warrant components are netted against their respective fair values. The resulting difference is that the financing fees allocated to the liability component under U.S. GAAP are higher than under Canadian GAAP, and therefore, additional amortization expense is recorded.

As a result of the 2005 restatement discussed in [b] above, the Company determined that the deferred financing fees allocated to the liability and warrant components as at August 30, 2005 were restated to \$706,289 and \$155,039, respectively

(previously reported as \$748,493 and \$112,834, respectively). The unamortized portion of deferred financing fees as at December 31, 2005 has been restated to \$647,423, a decrease of \$39,230 from the previously reported amount of \$686,653. Amortization of deferred financing fees under U.S. GAAP for fiscal 2005 has decreased \$3,566 to \$15,798 from the previously reported amount of \$19,364. Furthermore, additional paid-in capital has decreased by \$42,787 to \$4,693,165 to reflect the additional deferred financing fees netted against the warrants when compared to Canadian GAAP.

[d] Stock options

Prior to 2003, the Company did not recognize compensation expense relating to stock options under Canadian or U.S. GAAP. Effective January 1, 2003, the Company adopted the provisions of SFAS No. 123 ["SFAS 123"], which aligned with the provisions of CICA Handbook Section 3870. Prior to January 1, 2003, the Company recognized compensation expense for the fixed and performance stock options granted to employees in accordance with APB Opinion No. 25 ["APB 25"]. APB 25 required the Company to recognize compensation expense relating to the intrinsic value of the options when the market price of the underlying stock is greater than the exercise price of the stock options on the grant date. Compensation expense recorded prior to January 1, 2003 was recorded as additional paid-in capital and was reclassified to capital stock upon exercising of the actual options. Under Canadian GAAP, there was no recognition of compensation expense related to employee options prior to January 1, 2003.

[e] Comprehensive income

SFAS No. 130, "Reporting Comprehensive Income", establishes standards for the reporting and display of comprehensive income and its components in general purpose financial statements. Comprehensive income is defined as the change in net assets of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, and includes all changes in equity during a period. For the years presented, the Company did not have any material transactions that would otherwise have had an impact on comprehensive income. As such, net loss for the year under U.S. GAAP is equal to comprehensive income.

[f] SFAS 123 pro forma disclosures

SFAS 123 requires pro forma disclosures of net loss and loss per share as if the fair value method, as opposed to the intrinsic value-based method, of accounting for employee stock options had been applied for performance stock options granted prior to January 1, 2003.

The following tables present the Company's net loss and loss per share on a pro forma basis using the fair value method as determined by the Black-Scholes option pricing model:

	2006 \$	2005 \$	2004 \$
			[note b]
Net loss for the year			
U.S. GAAP – as reported	(5,886,869)	(4,904,124)	(5,478,184)
Pro forma stock-based compensation expense [d]	(45,888)	(225,923)	(376,879)
Net loss under U.S. GAAP – pro forma	(5,932,757)	(5,130,047)	(5,855,063)
Basic and diluted loss per share [U.S. GAAP]			
As reported	\$ (0.27)	\$ (0.24)	\$ (0.26)
Pro forma	\$ (0.27)	\$ (0.24)	\$ (0.28)
Weighted average number of common shares outstanding			
Basic and diluted	21,663,698	21,487,008	21,276,497

Notes to Consolidated Financial Statements

December 31, 2006 [In Canadian dollars, unless otherwise noted]

The assumptions used to calculate the fair value of stock-based compensation expense for performance stock options granted in the respective years prior to 2003 using the Black-Scholes option pricing model are as follows:

	High	Low
Expected volatility	62.3%	55.5%
Risk-free interest rate	6.19%	4.56%
Expected option life	5 years	5 years
Dividend yield	Nil	Nil

[g] Additional consolidated balance sheet information

Accounts payable and accrued liabilities consisted primarily of amounts owing to trade creditors of \$1,208,702 [2005 – \$573,818; 2004 – \$1,352,014] and accruals related to clinical trials of \$512,660 [2005 – \$372,420; 2004 – \$236,023] and a litigation settlement of \$175,000 [nil in 2005 and 2004].

In accordance with Canadian GAAP, the Company's cash and cash equivalents and short-term investments are carried at the lower of cost or market based on quoted market prices. Under U.S. GAAP, these investments would have been classified as held-to-maturity and would have been recorded at amortized cost. There is no significant difference between cost under Canadian GAAP and amortized cost under U.S. GAAP.

[h] Recent accounting developments

The Company has adopted SFAS No. 123(R), "Share-Based Payment" on a modified prospective basis. SFAS No. 123(R) is a revision of SFAS 123 and supersedes APB 25 and requires all share-based payments to employees to be recognized in the financial statements based on their fair values. The Company has reviewed its policies and determined that there is no material impact on the consolidated financial statements as a result of the Company adopting this pronouncement.

In July 2006, the Financial Accounting Standards Board ["FASB"] issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109". FIN 48 is effective for years beginning after December 15, 2006. The Company is currently reviewing this standard, but has not yet determined its impact on the consolidated financial statements.

11. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements for the years ended December 31, 2005 and 2004 have been reclassified from statements previously presented to conform to the presentation of the 2006 consolidated financial statements.

12. SUBSEQUENT EVENT

On March 28, 2007, the Company issued, by way of private placement, approximately 2,917,268 common shares and 1,458,634 common share purchase warrants at \$1.33 per unit for gross proceeds of approximately \$3.9 million. Each common share purchase warrant expires in March 2010 and entitles the holder to acquire one common share at a price of \$1.66 per share.

Corporate Governance

MESSAGE FROM THE CHAIRMAN

Dear Fellow Shareholders,

As the Message to Shareholders from Dr. Brent Norton, President and Chief Executive Officer, makes clear, 2006 was a year that presented more than a typical year's share of business challenges, but also a year in which PreMD made enormous progress in our core mission: developing products that can reduce the human toll of life-threatening cardiovascular disease and cancer through predictive medicine.

Although, as a result of these business challenges, PreMD did not achieve the financial progress we anticipated at the beginning of the year, we fully expect that in 2007 the Company and its shareholders will begin to see the rewards of the increased pace of commercialization of our products and technologies.

It may therefore be appropriate to emphasize that the Company's fundamental strengths are undiminished, and that our business potential has never been greater. First in this regard, let me point to the proprietary technologies and products the Company has been developing. These technologies and products are being developed in collaboration with the leading institutions and individual researchers in their associated disease fields. These assets are not merely proprietary, they are unique. Second, with reference to the commercial potential of our products and technologies, let me simply point you to the statistics on the incidence of disease, which continue to reflect the terrible human cost.

Against this backdrop, I can assure you that we are driven and passionate about being successful in our mission. Further, by maintaining significant personal investments in PreMD, our management, directors and other insiders ensure that we share common objectives and strategies, and that our interests are aligned with those of our shareholders. Through our majority-independent Board of Directors, PreMD's corporate governance processes fully reflect the highest contemporary standards mandated by securities regulators in both Canada and the United States. Over the course of 2006, PreMD's directors recorded a 93% average attendance at six Board meetings.

On behalf of the Board of Directors, I extend my thanks for your continuing trust and support. In closing, let me reiterate my confidence, which is shared throughout the Board, management and staff of PreMD, that this Company has a great future as a leader in the emerging field of predictive medicine, and that we remain focused on delivering on that potential.

Sincerely,



Stephen A. Wilgar

Chairman of the Board

Corporate Governance

BOARD OF DIRECTORS

Stephen A. Wilgar, BA, MBA^{1,3}
Chairman

- Past President, Warner-Lambert Canada, Asia, Australia and Latin America
- Presently serves on the Board of Directors of AIM PowerGen Corporation (Chairman), Team EMS and Electrohome Ltd.

Anthony F. Griffiths, BA, MBA^{1,2,3}
Consultant and Corporate Director

- Presently serves on the Board of Directors of Russel Metals Inc. (Chairman), Alliance Atlantis Communications Inc., Vitran Corporation Inc., Hub International Limited, Fairfax Financial Holdings Limited, Novadaq Technologies Inc., Jaguar Mining Inc., Cunningham Lindsey Group Inc., Northbridge Financial Corporation and Odyssey Re Holdings Corp.

Ron Henriksen, MBA^{2,3}
Chief Investment Officer, Twilight Ventures, LLC

- Presently serves on the Board of Directors of QLT, Inc., Cytori Therapeutics and Semafore Pharmaceuticals Inc.

Brent Norton, MD, MBA
President and Chief Executive Officer, PreMD

David Rosenkrantz, P.ENG.^{1,2,4}
President, Patuca Securities Limited

- Presently serves on the Board of Directors of Stellar Pharmaceuticals Inc., Carfinco Income Fund, and Medisystem Technologies Inc. (Lead Director)

1 – Audit Committee

2 – Compensation and Corporate Governance Committee

3 – Nominating Committee

4 – Chairman of the Audit Committee

From left to right: Stephen Wilgar, Anthony Griffiths, Ron Henriksen, Brent Norton and David Rosenkrantz



Management Listing and Scientific Advisory Board

SCIENTIFIC ADVISORY BOARD (SAB)

John Bienenstock, FRCP, FRCPC, FRSC
Chairman

Professor (and former Dean)
Departments of Medicine and Pathology
Faculty of Health Sciences
McMaster University
Hamilton, Ontario

Herbert A. Fritsche, Jr., PhD
Professor, Biochemist and Chief of Clinical Chemistry
Department of Pathology and Laboratory Medicine
University of Texas
M.D. Anderson Cancer Center
Houston, Texas

Norman Marcon, MD, FRCPC
Gastroenterologist and Past-Chief
Division of Gastroenterology
St. Michael's Hospital

Associate Professor of Medicine
University of Toronto
Toronto, Ontario

Dennis L. Sprecher, MD
Director, Dyslipidemia Discovery Medicine
GlaxoSmithKline

Adjunct Professor
University of Pennsylvania
Department of Cardiology, University of Pennsylvania
Medical Center Presbyterian
Philadelphia, Pennsylvania

Cardiologist, Adjunct Staff (formerly head of Preventative Cardiology)
The Cleveland Clinic Foundation
Cleveland, Ohio

MANAGEMENT

Brent Norton, MD, MBA
President and Chief Executive Officer

Michael Evelegh, PhD
Executive Vice President, Clinical and Regulatory Affairs

Ron Hosking, CA
Vice President, Finance, and Chief Financial Officer

Tim Currie, BA
Vice President, Corporate Development

Laila Gurney, B.Sc., M.Sc., RAC
Director, Clinical, Quality and Regulatory Affairs

Peter Horsewood, B.Sc., PhD
Director, Scientific Affairs

Corporate Information

CORPORATE HEADQUARTERS

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Toronto, Ontario M2P 2A9
www.premdinc.com
info@premdinc.com

STOCK LISTING

Toronto Stock Exchange: PMD
American Stock Exchange: PME

TRANSFER AGENT AND REGISTRAR

Equity Transfer Services Inc.
200 University Avenue, Suite 400
Toronto, Ontario
www.equitytransfer.com
T: 416.361.0930

AUDITORS

Ernst & Young LLP, Chartered Accountants
Ernst & Young Tower
Toronto-Dominion Centre
Toronto, Ontario

LEGAL COUNSEL

Aird & Berlis LLP
181 Bay Street, Suite 1800
BCE Place
Toronto, Ontario

Mintz, Levin, Cohn, Ferris, Glovsky and Popeo PC
One Financial Center
Boston, Massachusetts

INVESTOR RELATIONS (IR)

Current stock prices, financial reports, recent press releases and annual reports are accessible on PreMD's corporate website. The IR department may be contacted at info@premdinc.com or 416.222.3449.

ANNUAL MEETING AND WEBCAST

Shareholders are invited to attend the Company's annual meeting on Thursday, May 24, 2007 at 4 p.m. (ET) at the Toronto Stock Exchange, TSX Broadcast Centre, The Exchange Tower, 130 King Street West, Toronto, Ontario M5X 1J2. A live audio webcast will be available at www.premdinc.com.

TRADEMARKS

- PREVU*
- Cholesterol 1,2,3™
- ColorectAlert™
- LungAlert™
- ColoPath™



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FM 73853