

AVAC 2003 ANNUAL REPORT

AVAC's \$19.3 million investment in agrivalue™ projects has been leveraged into more than \$100 million of industry support.

03.1 CHAIR'S MESSAGE

I'm pleased to present this annual report – which details a year of progress and accomplishments – on behalf of AVAC Ltd.

When AVAC was formed five years ago, we coined a new word: agrivalue™. We wanted to describe an emerging industry with a vast pool of untapped potential. The province of Alberta's vision of achieving \$20 billion in value-added agriculture sales annually illustrates that potential.

We're proud to be one of the organizations propelling agrivalue toward that goal. Reaching that goal won't be without its challenges. The cattle crisis, spiraling energy costs and growing competition mean we have to think differently if we're going to be successful. We have to be better, smarter and more innovative.

We also have to work together more, an approach AVAC has always advocated and taken. Our past successes are as much about working with industry partners and investors as they are about good leadership and management.

Throughout 2002/03, we continued to build trust and partnerships. Entrepreneurship is often associated with independence, but we see entrepreneurs succeed more when they collaborate with others who share their vision and passion.

Collaboration is also one of the reasons we've seen Alberta investments in agrivalue grow to more than \$100 million to date. Our own partnerships have strengthened and flourished: our relationship with our two major funders – Alberta Agriculture, Food and Rural Development and Agriculture and Agri-Food Canada – continues to grow. In particular, the establishment of the AVAC/AAFRD Liaison Team illustrates the innovative partnership approach needed for the Province to achieve its goal. Working together, we've demonstrated the merit of long-term commitment and investment in agrivalue to one another and to new investors and collaborators. I'd like to thank them for their support and vision.

I'd also like to thank the growing number of "ambassadors" promoting and supporting the achievements and potential of our business and our clients. As a result, confidence and faith in agrivalue is growing. People are looking at crops and livestock – the traditional commodities of agriculture – in new ways, intent on finding new value-added products and processes. What's interesting is that so much attention is being given to non-traditional, non-food areas such as nutraceuticals, construction and energy.

A growing number of people are seeing the potential of agrivalue.

In closing, I'd like to say that it's been an honour for me to work with the people of AVAC. Special thanks go to retiring Board members Patrick Durnin and Alanna Koch for serving with AVAC. I would also like to express my appreciation for the contributions of our new Board members Bob Splane, Neal Oberg and Ted Bosse. The dedication, flexibility, expertise and vision which our entire Board, our members and our management team bring to AVAC are reflected in AVAC's success in 2002/03.

Aaron Falkenberg
Chair, AVAC

Our mission:
to help accelerate
the growth of
agrivalue in Alberta.

03.2 PRESIDENT AND CEO'S MESSAGE

What if we could use methane to heat greenhouses? What if we found plant extracts to treat the common cold? What if we discovered a way to make plastic from canola?

Such questions reflect a major shift in the way we view agriculture. The search for the answers is what agrivalue is all about. Each year, AVAC Ltd. and our clients, partners and investors come a step closer to answering these questions. For AVAC, the search comes in part from our mission – to help accelerate the growth of agrivalue in Alberta – but is largely driven by consumer demand in all industry sectors.

AVAC, our clients and a widening network of agrivalue organizations have made remarkable progress in understanding and providing what consumers and markets want. By the end of AVAC's 2002/03 fiscal year, our total investment in research and development projects reached \$19.3 million and had attracted more than \$80 million of additional capital plus dozens of new partnerships and alliances. We also saw seven clients take their products to the market stage and a record number of others turn to us for coaching and mentoring assistance to make their products and companies viable.

The more people look to us for capital and expertise, the more we realize our own potential. AVAC gains momentum with each passing year. Our fiscal year 2002/03 was no different; operating highlights include:

- Reaching all-time highs for aggregate funds approved and aggregate funds disbursed
- Mentoring and coaching 96 clients
- Approving 57 new deals and nearly \$10 million of investment support
- Contributing to Alberta's Agriculture Research and Innovation Strategic Framework
- Establishing, training and developing the AVAC/Alberta Agriculture, Food and Rural Development Liaison Team
- Supporting 23 knowledge events that reached more than 4,100 participants.

Our management team, which evolved during the past year, recognizes and understands the operational and industry challenges ahead. Hence, we'll continue to extend unprecedented knowledge, support and effort to our clients and industry partners.

I would like to thank the many people associated with AVAC – from our Board, members and staff to our clients, partners and funders. Your contributions go well beyond the ordinary and are helping us find the many answers we're all looking for.

Keith Jones
President & CEO, AVAC

MANAGEMENT DISCUSSION AND ANALYSIS

03.3

\$100 MILLION AND GROWING: AGRIVALUE IN ALBERTA

AN UNPRECEDENTED LEVEL OF DEAL FLOW, COACHING ACTIVITY AND PARTNERSHIPS MADE 2002/03 AVAC'S MOST PRODUCTIVE YEAR EVER. WE ACHIEVED BOTH OUR GOALS AND THE AGGRESSIVE GROWTH TARGETS FOR OUR MEASURES. MOST REMARKABLY, AVAC'S ACTIVITIES HAVE HELPED GENERATE MORE THAN \$100 MILLION OF INVESTMENT IN INNOVATIVE AGRIVALUE PROJECTS IN ALBERTA DURING THE PAST FIVE YEARS.

ATTRACTING AGRIVALUE INVESTMENT

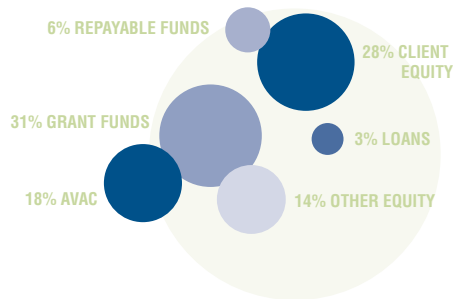


FIGURE 03.3.1

\$104.8 MILLION HAS BEEN COMMITTED TO GOOD AGRIVALUE PROJECTS SINCE AVAC BEGAN...FACILITATED BY \$19.3 MILLION FROM AVAC.

AVAC PROJECT APPROVALS BY FOCUS AREA

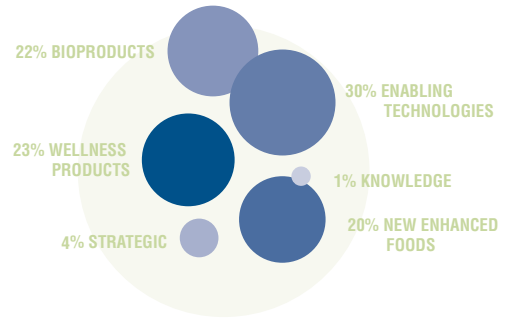


FIGURE 03.3.2

AGRIVALUE IS MORE THAN FOOD: OF \$15.5 MILLION APPROVED BY AVAC OVER THE PAST TWO YEARS, FOOD PROJECTS ARE ONLY 20% OF TOTAL INVESTMENT.

GOALS

- Increase agrivalue project quality and quantity
- Enhance likelihood of project success
- Attract financial capital to agrivalue
- Establish and grow agrivalue network
- Connect entrepreneurs with knowledge for success
- Improve access to research capacity for agrivalue
- Build Alberta's technology commercialization capability

HIGHLIGHTS FOR THE YEAR INCLUDE:

- Leveraging our investment in Alberta agrivalue for a total of \$104.8 million
- Reaching all-time highs for aggregate funds approved (\$24.5 million) and aggregate funds disbursed (\$10.8 million)
- Approving 57 new deals and more than \$9.5 million of approvals
- Fostering a record number of joint science/industry projects: 56
- Contributing to Alberta's Agriculture Research and Innovation Strategic Framework
- Playing a key role in delivering joint funding of \$16.5 million over the past two years through the Ag Funders Consortium (in conjunction with the Alberta Agricultural Research Institute)
- Establishing, training and developing the AVAC/Alberta

Agriculture, Food and Rural Development Liaison Team

- Supporting 23 knowledge events that reached more than 4,100 participants
- Increasing coaching and referrals by 38% and 48% respectively
- Creating BioProducts Alberta, an alliance of the agriculture, forestry and energy industries committed to pursuing bioproduct opportunities in Alberta.

AVAC's management team is pleased to report on our progress for 2002/03, our fifth full year of operations.

	HISTORIC (MAR 2002)	YEAR END (MAR 2003)	TARGET (MAR 2003)	STRETCH (MAR 2005)
PROPOSALS RECEIVED	103	173	164	205
AGGREGATE \$ APPROVED (MILLIONS)	15.0	24.5	21.5	30.4
PROJECTS APPROVED	35	57	57	85
AGGREGATE \$ DISBURSED (MILLIONS)	6.0	10.8	12.7	22.1
LEVERAGE RATIO	6.0	5.4	6.3	7
MONTHLY COACHING SCORE	160	221	198	250
PARTNER REFERRALS TO AVAC	247	366	300	300
JOINT IND/SCIENCE PROJECTS	30	56	50	100

YEAR OVER YEAR DEAL FLOW GROWTH

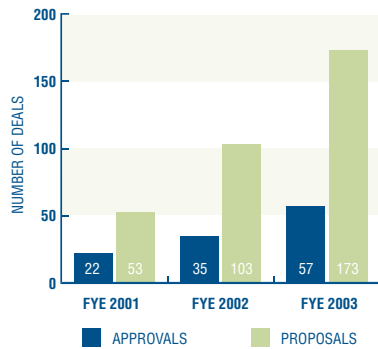


FIGURE 03.3.3

Expressions of interest continued to grow and we received 788 in 2002/03. By approving 57 new projects and more than \$9.5 million in funding, we exceeded our target for aggregate investment approvals by more than \$3 million. We were also very successful in contracting new approvals on a timely basis.

Our clients' ability to attract capital for their agrivalue projects reached a significant milestone: \$104.8 million in investment, including AVAC's contracted obligations of \$19.3 million.

We continued to coach and mentor many of our current clients, particularly those completing their current projects and looking for support to reach the next level of business development. Commercialization funding is difficult to access in today's risk capital market, challenging a number of our clients' management and financing abilities. Several clients reported accrued royalties to AVAC, however, many are start-up firms in a delicate cash flow position. AVAC is working with each of them to establish startup-friendly royalty payment programs. By year-end, seven AVAC clients reported agrivalue sales; we expect this number to grow next year. We also anticipate some royalty receipts in the next financial year, but expect the impact to our revenue will be modest.

Year-over-year deal flow growth has been very impressive, as shown in the figure 03.3.3.

2003 AVAC DEAL FLOW

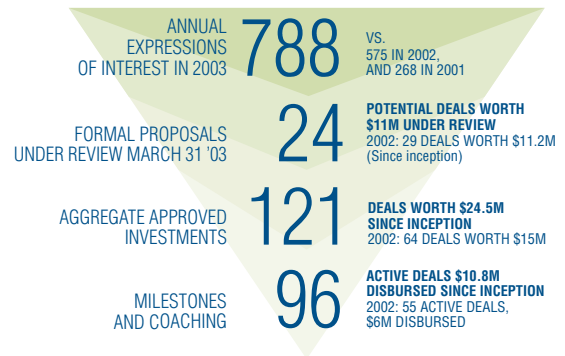


FIGURE 03.3.4

In 2002/03, we saw a subtle shift in our management team. We moved from a heavy emphasis on generating new investments and new projects to providing substantial coaching and mentoring to our current clients. At year-end, AVAC was actively managing 96 clients/projects.

Operating from our Calgary headquarters, AVAC nonetheless serves clients located throughout the entire province, as illustrated in figure 03.3.5.

A recap of AVAC's direct investments to clients to the end of March 2003 is provided on pages 8 and 9. Client success stories relating to a number of these clients, projects and partnerships are profiled in "AV03: Alberta Agrivalue 2003", an AVAC publication.

Our knowledge program bridges the gap between innovator and success and is an increasingly important component of our work. We saw remarkable growth in this area in 2002/03. We played a role in 23 knowledge events, which exposed 4,100 participants to the opportunities in Alberta agrivalue. These events took last year's Agrivalue Seminars to a higher level; for example, the Alberta BioProducts Showcase in January, made possible by a partnership between AVAC and BioAlberta, attracted favourable comments and follow-up deal inquiries.

INVESTMENT BY GEOGRAPHIC AREAS SINCE INCEPTION

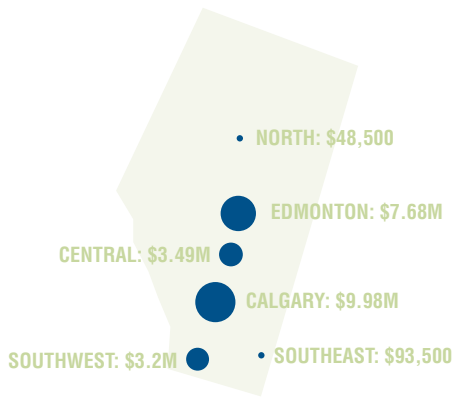


FIGURE 03.3.5

Our communications initiatives continue to yield good results: our print advertising campaign attracted more than 2,200 visitors to our Web site; many gave positive feedback about the site's content. We're implementing a strategy to make the Web site even more valuable to our clients and network.

In 2002/03, we launched a series of dinners and presentations, which helped tap into the knowledge of AVAC's members. These dinners also provided the opportunity for our members to meet with some of our clients and learn more about some specific entrepreneurial and research opportunities.

AVAC continues to improve its abilities to administer and report its investment activities. In the second quarter of 2003/04, we'll implement our new Client Relationship Management System. The system represents a total capital investment of \$195,000 over 18 months. We expect it to increase our deal flow capacity and streamline processes in our unique early-stage investment model. The system will also more fully connect the AVAC network to client needs.

As a result of our increased strategic focus on agrivalue research and technology commercialization, we received many requests to provide insight to various provincial and national discussions and strategic initiatives, including:

- Agrivalue Incubation Capacity Initiative
- German BioProducts Mission

JOINT INDUSTRY/SCIENCE PROJECTS ACTIVE AT EACH MONTH END

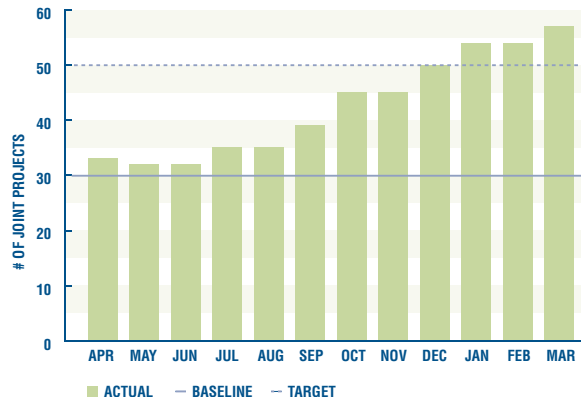


FIGURE 03.3.6

- Creation of BioProducts Alberta
- Design of the Functional Foods Core Team at the University of Alberta
- Alberta Value Added Strategy
- National BioProducts Technology Roadmap
- Development and delivery of the Alberta Agriculture Research and Innovation Strategic Framework.

AVAC has been invited to participate further in a number of these initiatives. While some are still making their conclusions, all have the potential to enhance Alberta agrivalue by promoting the commercialization of technology in Alberta, as well as facilitating industry collaboration and partnerships.

AVAC has learned that technology commercialization occurs best when industry and science collaborate on specific projects. AVAC has had strong success over the past year in continuing to facilitate joint science/industry projects, with 56 such projects in progress as of March 31, 2003 as shown in figure 03.3.6.

In summary, AVAC continues to provide tremendous contributions to our clients and strategic partners. The evolution of our business resulted in an organizational restructuring in May 2003, which better enables us to help our clients pursue commercialization success.

AVAC INVESTMENTS AND DISBURSEMENTS*

NAME	FOCUS AREA	\$ AMOUNT APPROVED	\$ AMOUNT DISBURSED
2002-03			
ALBERTA CHAMBERS OF COMMERCE	KNOWLEDGE	3,000	3,000
CEVENA BIOPRODUCTS INC.	ENABLING TECHNOLOGIES	1,000,000	600,000
MALAY KING	NEW & ENHANCED FOODS	24,000	16,080
FAHLER CO-OPERATIVE SEED CLEANING PLANT LTD.	NEW & ENHANCED FOODS	20,000	13,400
CEAPRO INC	WELLNESS PRODUCTS	19,750	13,167
KSL FOODS INC.	NEW & ENHANCED FOODS	25,000	16,750
NUTRIS (INC.)	NEW & ENHANCED FOODS	25,000	16,750
ASTECH AWARDS (2002)	STRATEGIC	22,000	22,000
BIOPRODUCTS CANADA	STRATEGIC	10,000	10,000
ALBERTA BEEF COMPANY INC.	NEW & ENHANCED FOODS	15,000	10,050
ALBERTA CHAMBERS OF COMMERCE	KNOWLEDGE	11,000	11,000
AGRI GENOMICS	INDUSTRIAL APPLICATION	25,000	16,667
ALHEIM CORPORATION	NEW & ENHANCED FOODS	130,350	114,475
CANADIAN FIBRETECH LTD.	INDUSTRIAL APPLICATION	317,500	215,325
NEW ERA NUTRITION INC.	NEW & ENHANCED FOODS	1,400,000	200,000
AB BIOPHARMA INC.	WELLNESS PRODUCTS	1,250,000	400,000
GERMAN BIOPRODUCTS MISSION	STRATEGIC	28,000	
EDA – ECONOMIC DEVELOPER OF THE YEAR AWARD	KNOWLEDGE	1,500	1,500
AUTM CANADIAN REGION	KNOWLEDGE	1,500	1,500
ALBERTA E-BUSINESS LEADERSHIP AWARDS	KNOWLEDGE	5,000	5,000
CALGARY COUNCIL FOR ADVANCED TECHNOLOGIES SPONSORSHIP	KNOWLEDGE	2,000	2,000
MEDICINE HAT CHAMBER OF COMMERCE	KNOWLEDGE	2,000	2,000
PREDA DEVELOPMENT CENTRE	STRATEGIC	25,000	16,750
ALBERTA WOMEN'S ENTERPRISE INITIATIVE	KNOWLEDGE	2,025	2,025
PALLISER ECONOMIC PARTNERSHIP	KNOWLEDGE	2,150	2,150
AGRICULTURE AND FOOD COUNCIL OF AB. – VALUE CHAIN INITIATIVE	KNOWLEDGE	19,976	19,976
GLENLOY BIOTECH LTD.	ENABLING TECHNOLOGIES	25,000	16,750
OF THE ESSENCE	NEW & ENHANCED FOODS	25,000	16,750
BUSINESS EXPO 2002	KNOWLEDGE	3,000	3,000
OLDS AG-TECH INDUSTRIES	INDUSTRIAL APPLICATION	25,000	16,750
DIVERSIFOODS INC.	NEW & ENHANCED FOODS	25,000	16,750
EDA CEDAP AGRIVALUE COURSE	KNOWLEDGE	25,000	3,750
GROWING ALBERTA	STRATEGIC	35,000	35,000
EXPLORE DIRECT	KNOWLEDGE	5,000	4,750
BIOALBERTA: BIOPRODUCTS SHOWCASE	KNOWLEDGE	10,000	10,000
TIFFEN CONFERENCE SERIES	KNOWLEDGE	10,000	
ANNELIDA ENTERPRISES	KNOWLEDGE	1,250	1,250
GENESIS PROJECTS CORP.	KNOWLEDGE	1,250	1,250
PEACE VALUE ADDED FOOD & AG ASSOCIATION	KNOWLEDGE	2,500	2,500
LAKEVIEW BAKERY	NEW & ENHANCED FOODS	25,000	16,750
BDC WEST – JOURNEY TO THE PEAKS	KNOWLEDGE	5,000	
CANADIAN STEVIA CORP	WELLNESS PRODUCTS	25,000	
WHEATLAND SELECT ORGANIC TURKEY LTD.	NEW & ENHANCED FOODS	107,800	25,500
U OF A SEMINAR SERIES, EDMONTON	KNOWLEDGE	10,000	
ALBERTA RESTAURANT AND FOOD SERVICE ASSOCIATION	KNOWLEDGE	10,000	
U OF L EDIBLE OILS DR. PRZYBYLSKI, LETHBRIDGE	NEW & ENHANCED FOODS	1,200,000	
AGRIVALUE MARKETING COMPETITION	KNOWLEDGE	15,000	
VENTURE CAPITAL ASSOCIATION OF ALBERTA	KNOWLEDGE	2,500	2,500
ASTECH AWARDS (2003)	STRATEGIC	20,000	12,000
AGRONOMIC GROWTH INDUSTRIES	INDUSTRIAL APPLICATION	315,143	
AAFC RESEARCH CENTRE – PROTEIN BIOPOLYMER PRECURSORS	ENABLING TECHNOLOGIES	347,500	
SEMBIOSYS PROTEIN A	INDUSTRIAL APPLICATION	2,500,000	750,000
U OF A SUPERCRITICAL FLUID EXTRACTION, EDMONTON	ENABLING TECHNOLOGIES	70,000	
U OF A BETA GLUCAN DEPLETED FLOUR AS ANIMAL FEED, EDMONTON	INDUSTRIAL APPLICATION	87,750	
U OF A FF FOR MANAGEMENT			
OF INFLAMMATORY BOWEL DISEASE, EDMONTON	NEW & ENHANCED FOODS	103,500	
AAFRD – ROSEMARY STUDY	WELLNESS PRODUCTS	32,500	
AFNS U OF A BETA GLUCAN IN WEANED PIGLETS, EDMONTON	INDUSTRIAL APPLICATION	38,978	

* based on the year that the investment was approved.

NAME	FOCUS AREA	\$ AMOUNT APPROVED	\$ AMOUNT DISBURSED
2001-02			
SEMBIOSYS GENETICS INC	WELLNESS PRODUCTS	2,384,000	1,950,000
GROWING ALBERTA	STRATEGIC	35,000	35,000
PRAIRIE TANNERS	INDUSTRIAL APPLICATION	227,058	212,058
INNO-CENTRE ALBERTA	STRATEGIC	500,000	200,000
ACCESS TO CAPITAL SYMPOSIUM & WORKSHOP	KNOWLEDGE	776	778
ASTECH INNOVATION IN AGRICULTURAL SCIENCE AWARD	KNOWLEDGE	22,000	22,000
CROP DEVELOPMENT OPPORTUNITIES INITIATIVE	STRATEGIC	10,000	10,000
AGRIVALUE BUSINESS AWARD OF DISTINCTION	KNOWLEDGE	10,000	10,000
ECONOMIC DEVELOPERS ASSOCIATION ALBERTA	KNOWLEDGE	1,000	1,000
FIRST AGRA	ENABLING TECHNOLOGIES	22,500	22,500
BIOTECHNOLOGY & BIOMEDICINE CONFERENCE	KNOWLEDGE	2,000	2,000
FOOD FEST 2001	KNOWLEDGE	1,000	1,000
BASHAW PULSE GROUP	NEW & ENHANCED FOODS	12,500	12,500
ALHEIM CORPORATION	NEW & ENHANCED FOODS	21,225	21,225
D & B SPECIALTY FOODS	NEW & ENHANCED FOODS	25,000	25,000
CANADIAN COUNCIL OF GROCERY DISTRIBUTORS	KNOWLEDGE	5,000	5,000
ORCHARD MIST	NEW & ENHANCED FOODS	25,000	25,000
LALANY'S INTERNATIONAL MEALS	NEW & ENHANCED FOODS	25,000	25,000
CV TECHNOLOGIES INC.II	WELLNESS PRODUCTS	25,000	25,000
UNIVERSITY OF LETHBRIDGE – AG BIOTECHNOLOGY	ENABLING TECHNOLOGIES	1,500,000	
PURE LEAN HOGS INC.	INDUSTRIAL APPLICATION	15,000	15,000
BIOALBERTA	KNOWLEDGE	15,025	15,025
CANADIAN SOCIETY OF PLANT PHYSIOLOGISTS	KNOWLEDGE	1,500	1,500
PRAIRIE NATURAL PROCESSING	NEW & ENHANCED FOODS	78,620	78,620
SCIMED LABORATORIES	ENABLING TECHNOLOGIES	296,813	150,000
AFNS BIOPOLYMERS NETWORK	INDUSTRIAL APPLICATION	500,000	125,000
AVANTERA TECHNOLOGIES INC.	KNOWLEDGE INITIATIVE	2,100	2,100
OUTLOOK PORK LTD.	INDUSTRIAL APPLICATION	24,000	16,080
ALBERTA INSTITUTE OF AGROLOGISTS 2002 CONFERENCE	KNOWLEDGE	5,000	5,000
DOTS CANADA	NEW & ENHANCED FOODS	6,000	4,020
MMICODO MANAGEMENT LTD.	NEW & ENHANCED FOODS	25,000	25,000
U OF A AFNS – TAPAN BASU	WELLNESS PRODUCTS	70,000	30,000
U OF A AFNS – WENDY WISMER	ENABLING TECHNOLOGIES	100,000	32,934
U OF A AFNS – FERAL TEMELLI	WELLNESS PRODUCTS	66,125	
AGRICULTURAL BIOTECHNOLOGY INTERNATIONAL CONFERENCE 2002	KNOWLEDGE	2,820	2,820
2000-01			
QEVA VELVET PRODUCTS CORP. / ELK EQUITIES INC.	WELLNESS PRODUCTS	40,000	40,000
AFPA - E COMMERCE	KNOWLEDGE	1,000	1,000
CLASSIC CANNING INC.	NEW & ENHANCED FOODS	88,500	72,813
MOVING THE MARKETS	KNOWLEDGE	5,000	5,000
KINNIKINNICK FOODS INC.	NEW & ENHANCED FOODS	232,079	195,000
REBUS CORPORATION	INDUSTRIAL APPLICATION	2,000,000	700,000
FUNCTIONAL FOODS ALBERTA	WELLNESS PRODUCTS	15,000	15,000
ECONOMIC DEVELOPMENT ASSOC. OF CANADA	KNOWLEDGE	15,000	15,000
G.S. TECHNOLOGY CORP.	ENABLING TECHNOLOGIES	136,150	78,000
AGRIVALUE BUSINESS AWARD OF DISTINCTION	KNOWLEDGE	10,000	10,000
PRAIRIE NATURAL PROCESSING INC.	NEW & ENHANCED FOODS	51,000	51,000
NATURAL FARMWORKS LTD.	WELLNESS PRODUCTS	200,000	200,000
1999-00			
URBAN WAFER CO.	NEW & ENHANCED FOODS	148,000	148,000
GOING ORGANIC CONFERENCE	KNOWLEDGE	40,000	40,000
GROWING ALBERTA	KNOWLEDGE	35,000	35,000
BIOTECHNOLOGY NETWORK	KNOWLEDGE	2,761	2,761
BCL LANDVIEW	ENABLING TECHNOLOGIES	25,000	25,000
UNIVERSITY OF ALBERTA – FACULTY OF BUSINESS	KNOWLEDGE	50,000	50,000
UNIVERSITY OF ALBERTA – FOOD FOR HEALTH	RESEARCH CAPACITY	1,941,917	1,389,556
ALBERTA SOFT WHEAT GROWERS	NEW & ENHANCED FOODS	3,718	3,718
OLDS COLLEGE CENTRE FOR INNOVATION	RESEARCH CAPACITY	2,500,000	542,182
AFPA FOOD SAFETY PROGRAM	KNOWLEDGE	274,500	240,812
ASTECH INNOVATION IN AGRICULTURAL SCIENCE AWARD	KNOWLEDGE	10,000	10,000
EDELWEISS SOFT CHEESE	NEW & ENHANCED FOODS	58,500	58,500
1998-99			
CV TECHNOLOGIES INC.	ENABLING TECHNOLOGIES	500,000	483,333
CANBIOCIN INC.	ENABLING TECHNOLOGIES	250,000	250,000
CEAPRO INC.	INDUSTRIAL APPLICATION	164,882	164,882
ALTA GENOME SERVICES	ENABLING TECHNOLOGIES	60,000	60,000
AVANET	KNOWLEDGE	100,000	100,000
AGGREGATE PROJECT APPROVALS/AGGREGATE DISBURSEMENTS		\$24,515,491	\$10,761,532



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BOARD MEMBERS

1. Ted Bosse
2. Bob Splane
3. Barry Mehr
4. Ed Knash
5. Tom Droog
6. Shelly Bradshaw
7. Brian Rhiness
8. Robert Church
9. Aaron Falkenberg, Chair
10. Neil Oberg
11. Bern Kotelko
12. Dan Bader (not shown)

CORPORATE GOVERNANCE

An industry-focused Board of Directors, elected from and by the Corporation's membership, guides AVAC LTD. The list of AVAC members at March 31, 2003 appears on page 13.

The Board of Directors is kept informed of the Corporation's operations through regularly scheduled meetings of the Board and its committees, and through reports, analysis and discussions with management. The Board also meets to review and establish AVAC's strategic direction. During the fiscal year 2002/03, the Board met 14 times at: five Board meetings, an annual general meeting, two strategic planning meetings, five member events and one conference call.

AVAC benefits tremendously from the strategic perspectives shared by its three ex-officio directors at meetings of the Board:

Brian Rhiness, Assistant Deputy Minister, Alberta
Agriculture, Food and Rural Development

Barry Mehr, Deputy Minister, Alberta Economic Development

Dan Bader, Deputy Minister, Alberta Innovation and Science

Over the past year, **Ken McCready**, Regional Director, Agriculture and Agri-Food Canada, also attended Board meetings as a special guest of the board.

REMUNERATION OF DIRECTORS

A retainer is paid to all regular directors for their services as directors of the Corporation. An additional retainer is paid to Board and committee chairs. Directors (other than ex-officio directors) are compensated on a per diem basis for attendance at Board or committee meetings, or while otherwise engaged in AVAC business at the request of the Corporation.

Board compensation is reviewed on an annual basis by the audit committee and approved by the membership at the annual general meeting. The Board chair's compensation and out-of-pocket expenses are reviewed and approved by the chair of the Governance and Compensation Committee, while directors' expenses are reviewed and approved by the Board Chair.

The following summarizes the compensation paid to all directors for the fiscal year ending March 31, 2003.

Director Compensation

Director Retainer (per year)	\$ 5,000 ¹
Board Chair Retainer (per year)	\$14,400 ²
Committee Chair Fee (per year)	\$ 2,000
Meeting Fee Attendance	\$ 500 per full day, \$ 250 for half day, for Board or Committee meetings or while engaged in other AVAC business
Conference Call Meeting Fee	\$ 250 ¹
Out of Pocket Expenses	Reasonable expenses reimbursed

¹ The \$5,000 annual retainer includes participation in up to eight conference call meetings and attendance at up to three functions on AVAC's behalf, on an expenses basis only. Conference call meetings in excess of eight are compensated at \$250 per meeting. Directors are compensated for travel to meetings held outside their normal place of residence at \$125 for up to four hours and \$250 for more than four hours.

² The Board Chair retainer fee includes compensation for Chair duties. The Chair receives Board meeting fees and the Director retainer. The Chair also receives a \$500 per diem or part thereof while engaged in AVAC business for any period in excess of the two days per month committed under the Board Chair retainer.

COMMITTEES OF THE BOARD

The Board's three standing committees perform certain advisory functions, make recommendations and report to the Board as a whole. Committee members are appointed annually, following the annual general meeting of members, on the recommendation of the Corporate Governance and Compensation Committee.

Corporate Governance and Compensation Committee

Committee members are: Bob Splane (Chair), Ted Bosse, Robert Church and Aaron Falkenberg. The committee met five times in the 2002/03 fiscal year.

Audit Committee

Committee members are Bern Kotelko (Chair), Tom Droog, Ed Knash and Neal Oberg. The committee met six times during 2002/03.

Investment Committee

Committee members are Ed Knash (Chair), Shelley Bradshaw, Robert Church and a director-at-large. The committee met five times in 2002/03.



03.6 STAFF

Our staff's knowledge, expertise and encouragement are invaluable in development of new agrivalue projects and companies, helping entrepreneurs, businesses and researchers understand the complexities, risk and potential of competing in consumer markets. They bring our Board's and our Members' directives to life and play a significant role in AVAC's growing success.

1		2	
	3		4
5			6

1. Amber Daniels
2. Keith Jones
3. Ross Bricker
4. Lorna Sexsmith
5. Mike Leslie
6. Dale Clark

AVAC MEMBERS

Our members play an important role in governance and in our knowledge network. They provide valuable input to AVAC and with their help Alberta can achieve \$20 billion in value-added agricultural product sales by 2010. AVAC members are known for their leadership contributions to the growth of the value-added industry – and are recruited for their industry insight, leadership, innovation and collaboration, and experience across the agrifood and non-food chain.

TED ALLEN

Agricore United
Okotoks, Alberta

JOHN ARNOLD

RBC Royal Bank
Calgary, Alberta

ANDREW BAUM

SemBiosys Genetics Inc.
Calgary, Alberta

TED BOSSE

Ogilvie and Company
Edmonton, Alberta

JERRY BOUMA

J. Bouma & Associates
Edmonton, Alberta

SHELLEY BRADSHAW

Beck Farms
Innisfail, Alberta

FRANK BURDZY

Lilydale Foods
Edmonton, Alberta

STEWART CAMPBELL

S.J. Campbell Investments Ltd.
Cochrane, Alberta

ROBERT CHURCH

Lochend Luining Ranch
Airdrie, Alberta

TOM DROOG

Alberta Sunflower Seeds Ltd
Bow Island, Alberta

PATRICK DURNIN

Camas Inc.
Kathryn, Alberta

AARON FALKENBERG

Skyline Poultry
Sherwood Park, Alberta

FRANK FALLWELL

Billingsgate Fish Co. Limited
Calgary, Alberta

DENNIS FITZPATRICK

University of Lethbridge
Lethbridge, Alberta

GRANT HANSEN

Canada Safeway Limited
Calgary, Alberta

JIM HOLE

Hole's Greenhouse & Gardens
St. Albert, Alberta

LLOYD JOHNSTON

Alberta Chicken Producers
Edmonton, Alberta

ROBERT KALEF

Centennial Food Corp.
Calgary, Alberta

KERRY KEATING

API Grain Processing
Red Deer, Alberta

PAT KLAK

Leduc/Nisku EDA
Leduc, Alberta

ED KNASH

Alberta Treasury Branch
Edmonton, Alberta

ALANNA KOCH

Agricore United
Edenwold, Saskatchewan

BERN KOTELKO

Highland Feeders Ltd.
Vegreville, Alberta

JOE MAKOWECKI

Heritage Frozen Foods Ltd.
Edmonton, Alberta

TOM MARWICK

Agriculture & Food Council
Nisku, Alberta

ELSON MCDUGALD

3MC Stock Farms
Drumheller, Alberta

MURRAY MCLAUGHLIN

Foragen Technology Ventures Inc.
Guelph, Ontario

IAN MORRISON

University of Alberta
Edmonton, Alberta

NEAL OBERG

Canadian Fibretech
Forestburg, Alberta

MIKE PERCY

University of Alberta
Edmonton, Alberta

TOM POOLE

Dallimore Management
Langley, British Columbia

GREG ROCKAFELLOW

Lux Farms Inc.
Crossfield, Alberta

DAVE SCHURMAN

AFSC
Lacombe, Alberta

RICK SEARS

Two-W Livestock Equipment
Nanton, Alberta

BOB SPLANE

Splane Farms
Boyle, Alberta

KEN STICKLAND

KenAgra Management
Edmonton, Alberta

IAN STRANG

Strang Management
Mount Manganui, New Zealand

JIM THACKER

G. Thacker Sons
Bow Island, Alberta

TOM THOMPSON

Olds College
Olds, Alberta

BLAIR WRIGHT

Transfeeder Inc.
Olds, Alberta

BRYAN YAAKOV

Wow! Factor Desserts
Sherwood Park, Alberta

The more people
look to us for capital
and expertise, the
more we realize
our own potential.

MANAGEMENT COMMENTS ON FINANCIAL PERFORMANCE

AVAC's Audited Financial Statements for the financial year ending March 31, 2003 indicate strong deal flow growth, a marked increase in disbursements directly to clients and a reduction in general and administrative expenses from the previous year. Project disbursements direct to clients for the year totaled \$4.74 million, an increase of 34% over the previous year (compared to \$3.54 million in 2001/02). General and administrative expenses for the year totaled \$1.37 million, 11% below budget and 6% less than the \$1.45 million spent in 2001/02. Overall, the Corporation's mentoring efficiency (the ratio of investment approvals to overhead expenditures) increased: for every dollar of overhead, AVAC manages \$17.88 of agrivalue investment (compared to \$10.41 in 2001/02).

The increase in accounts receivable reported on the financial statements is directly attributable to the increase in federal IDF contributions for the year, facilitated by the increase in disbursements to clients.

The increase in capital assets to \$244,000 is due primarily to the payments to date of \$146,000 for the Client Relationship Management System, which will be operational in the second quarter of the new financial year.

AVAC continues to be in a strong asset position, thanks to positive investment returns, the on-going industry development fund contributions from our partners at Agriculture and Agri-food Canada, and prudent fiscal management. AVAC ended the year with unrestricted net assets of \$25.4 million. Based on the current rate of investment activity, AVAC's initial seed capital fund is

expected to be fully committed to project investments within 18 to 24 months.

AVAC's fund portfolio has performed moderately due to depressed equity markets and bond value declines, yielding an annualized return of 2.14% over the year. This compares reasonably with the following representative capital market total return indices over the same 12-month period, as reported by TD Asset Management Inc.:

Scotia Capital 91 Day T-Bills	2.71%
Scotia Capital Bond Universe	9.15%
S&P / TSE Composite Index	-17.60%

AVAC's approved budget for the 2003/04 financial year anticipates total general and administrative expenses of \$1.68 million, compared to aggregate approvals totaling \$34.1 million, representing a target mentoring efficiency of \$20.30 to \$1. The Corporation anticipates maintaining its core staff complement of eight full-time employees through the operating year, supplemented by contract and professional services as appropriate. The Corporation plans capital expenditures of \$137,300 in the coming year, primarily for computer software and hardware upgrading. AVAC's goals, measures and targets are described in AVAC's 2004 Strategic Business Plan, and progress towards these targets is published on AVAC's Web site (www.avactd.com) following quarterly review and approval by the AVAC Board.

AVAC continues
to be in a strong
asset position thanks
to prudent fiscal
management.

03.9 AUDITOR'S REPORT TO THE SHAREHOLDERS

We have audited the statement of financial position of AVAC Ltd. as at March 31, 2003 and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at March 31, 2003 and the results of its operations, its changes in net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The logo for KPMG LLP, featuring the letters 'KPMG' in a large, bold, sans-serif font, with 'LLP' in a smaller, similar font to the right.

Chartered Accountants

Calgary, Canada

May 28, 2003

STATEMENT OF FINANCIAL POSITION

At March 31, 2003, with comparative figures for 2002

	2003	2002
Assets		
CURRENT ASSETS:		
Cash	\$ 339,081	\$ 160,689
Accounts receivable (note 2)	2,581,407	1,409,870
Prepaid expenses and deposits	9,133	5,910
Investment fund (note 3)	31,254,702	34,966,265
Total current assets	34,184,323	36,542,734
CAPITAL ASSETS (NOTE 4)	243,651	122,773
	\$ 34,427,974	\$ 36,665,507
Liabilities and Net Assets		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 218,438	\$ 186,993
NET ASSETS:		
Invested in capital assets	243,651	122,773
Net assets internally restricted for future contracted obligations (note 5)	8,578,858	5,328,230
Unrestricted	25,387,027	31,027,511
Total net assets	34,209,536	36,478,514
COMMITMENT AND CONTINGENCY (NOTE 7)		
	\$ 34,427,974	\$ 36,665,507

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

On behalf of the Board:



DIRECTOR
AARON FALKENBERG



DIRECTOR
BERN KOTELKO

STATEMENT OF OPERATIONS

Year ended March 31, 2003, with comparative figures for 2002

	2003	2002
REVENUE:		
Federal contributions	\$ 3,018,199	\$ 2,229,344
Investment fund income	1,481,083	2,353,850
Membership	7,000	6,100
Loss on disposal of fixed assets	(113)	—
Write down of investments to market value	(132,982)	—
	4,373,187	4,589,294
EXPENDITURES:		
General and administrative	1,369,712	1,445,331
Projects (note 6)	5,272,453	3,873,836
	6,642,165	5,319,167
DEFICIENCY OF REVENUE OVER EXPENDITURES	\$ (2,268,978)	\$ (729,873)

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

STATEMENT OF CHANGES IN NET ASSETS

Year ended March 31, 2003, with comparative figures for 2002

	<u>CAPITAL ASSETS</u>	<u>UNRESTRICTED</u>	<u>NET ASSETS INTERNALLY RESTRICTED FOR FUTURE CONTRACTED OBLIGATIONS</u>	2003	2002
Balance, beginning of year	\$ 122,773	\$ 31,027,510	\$ 5,328,231	\$ 36,478,514	\$ 37,208,387
Deficiency of revenue over expenditures	—	—	—	(2,268,978)	(729,873)
Depreciation of capital assets	(60,990)	—	—	—	—
Distributions to project applicants	—	—	(4,735,475)	—	—
Net adjustments to unrestricted amounts	—	2,527,487	—	—	—
Net additions to capital assets	181,868	(181,868)	—	—	—
Additional projects contracted	—	(7,986,102)	7,986,102	—	—
BALANCE, END OF YEAR	\$ 243,651	\$25,387,027	\$ 8,578,858	\$34,209,536	\$36,478,514

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

STATEMENT OF CASH FLOWS

Year ended March 31, 2003, with comparative figures for 2002

	2003	2002
CASH PROVIDED BY (USED FOR):		
Operating activities:		
Deficiency of revenue over expenditures	\$ (2,268,978)	\$ (729,873)
Items not involving cash:		
Depreciation of capital assets	60,990	31,819
Investment income re-invested	(1,481,083)	(2,353,850)
Write down of investments to market value	132,982	—
Change in non-cash working capital	(1,143,315)	(357,165)
	(4,699,404)	(3,409,069)
FINANCING AND INVESTING ACTIVITIES:		
Capital assets acquired	(181,868)	(86,648)
Investment fund proceeds	5,059,664	3,608,853
	4,877,796	3,522,205
INCREASE IN CASH	178,392	113,136
CASH, BEGINNING OF YEAR	160,689	47,553
CASH, END OF YEAR	\$ 339,081	\$ 160,689

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

NOTES TO FINANCIAL STATEMENTS

Year ended March 31, 2003, with comparative figures for 2002.

AVAC Ltd. ("AVAC" or the "Company") received funding of \$34,808,758 (\$34,944,000 less administrative costs of \$135,242) from the Alberta Ministry of Agriculture, Food and Rural Development (the "Ministry") on March 18, 1997. Upon expiry of the funding agreement on March 31, 2007, AVAC may be required to repay to the Ministry all or a portion of the original funding (together with any income earned from investment thereof) that has not been expended or committed to be expended. AVAC has granted the Province of Alberta a security interest in all of its property.

In accordance with the terms of a Companion Agreement (the "Companion Agreement") which expired March 31, 2003, AVAC was to receive contributions on a matching basis from the Government of Canada up to a cumulative amount of \$10,000,000. These matching contributions were \$3,018,199 for the year ended March 31, 2003 and amounted to \$7,295,856 on a cumulative basis. Discussions are in progress involving the Government of Canada and the Province on an extension of the Companion Agreement terms.

AVAC has received favourable income tax rulings from the Canada Customs and Revenue Agency concerning the Company's status as a not-for-profit organization.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Revenue and expenditure recognition:

The Company follows the deferral method of accounting for contributions. Unrestricted contributions are recognized as revenue when received or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured.

Investment income is recognized as revenue when earned.

Project expenditures are expensed as incurred. Some expenditures may result in a future return to the Company in the form of a contingent success-based royalty; such returns are recorded as income in the period received.

(b) Investment fund:

Investment purchases are recorded at cost. At year end, the total investment fund is reported at the lower of cost and market value.

(c) Capital assets:

Purchased capital assets are recorded at cost. Repairs and maintenance are charged to expense. Improvements, which extend the estimated life of an asset, are capitalized. When a capital asset no longer contributes to the Company's ability to provide services, its carrying amount is written down to its residual value.

Capital assets are depreciated on a straight-line basis using the following annual rates:

Computer equipment	30%
Computer software	50%
Office equipment	10%
Furniture and fixtures	10%
Leasehold improvements	Over the term of the lease

2. ACCOUNTS RECEIVABLE:

Accounts receivable consists of Government of Canada contributions due of \$2,481,444 (2002 - \$1,348,618) and GST receivable of \$99,963 (2002 - \$61,252).

3. INVESTMENT FUND:

The investment fund consists of the following portfolio of investments:

	2003 COST	2003 MARKET	2002 COST	2002 MARKET
Cash and cash equivalents	\$ 4,368,464	\$ 4,350,203	\$ 7,591,709	\$ 7,558,862
MEDIUM TERM INVESTMENT FUND:				
Federal Government bonds	12,472,843	12,463,941	17,954,244	17,736,882
Provincial Government bonds	3,993,334	4,080,642	2,814,143	2,851,040
Other bonds	4,031,718	3,973,478	387,545	387,545
Canadian equities	4,238,544	5,144,572	4,130,038	5,463,755
Global equities	2,282,781	1,241,866	2,088,586	1,569,497
	27,019,220	26,904,499	27,374,556	28,008,719
TOTAL INVESTMENT FUND	\$ 31,387,684	\$ 31,254,702	\$ 34,966,265	\$ 35,567,581

The Federal Government bonds mature between December 1, 2003 and June 1, 2012 and bear interest at rates ranging from 4.5% to 7.5%. The Provincial Government bonds mature between June 2, 2004 and December 2, 2011 and bear interest at rates ranging from 4.875% to 6.10%. Investment income has been recorded net of fees paid for portfolio management, which amounted to \$86,374 (2002 - \$88,270).

4. CAPITAL ASSETS:

				2003	2002
	<u>COST</u>	<u>ACCUMULATED DEPRECIATION</u>		<u>NET BOOK VALUE</u>	<u>NET BOOK VALUE</u>
Computer equipment	\$ 107,451	\$ 80,663	\$	26,788	\$ 29,195
Computer software	223,268	54,330		168,938	43,340
Office equipment	34,904	11,411		23,493	25,805
Furniture and fixtures	41,077	17,332		23,745	24,433
Leasehold improvements	7,044	6,357		687	-
	\$ 413,744	\$ 170,093	\$	243,651	\$ 122,773

5. NET ASSETS INTERNALLY RESTRICTED FOR FUTURE CONTRACTED OBLIGATIONS:

AVAC Ltd. invests in qualifying agrivalue pre-commercial, academic and strategic projects based on a progressive series of steps including evaluation and mentoring of investment proposals; approval of project investment based on specific milestones; contracted obligations to disburse funds; and disbursement of funds based on achievement of each milestone. During the year, \$4,735,475 was distributed directly to project applicants.

AVAC has contracted to advance a total of \$19,340,390 of which \$10,761,532 has been advanced to March 31, 2003, with the remaining balance of \$8,578,858 to be advanced in future periods. This remaining advance is contingent on reaching specified milestones as contracted. The financial statements reflect an internal restriction of net assets for the \$8,578,858 for this purpose, and is consistent with the presentation made in the 2002 financial statements.

The table below discloses the aggregate level of AVAC approvals, project obligations and disbursements to date:

Aggregate Project Approvals	\$ 24,515,491
Aggregate Contracted Obligations	\$ 19,340,390
Aggregate Disbursements	\$ 10,761,532
Future Contracted Obligations	\$ 8,578,858

During the year, amounts were transferred from unrestricted net assets to net assets internally restricted for future project obligations of \$7,986,102. These transfers occurred as projects were approved during the year.

6. PROJECT EXPENDITURES:

Project expenditures consist of project disbursements direct to investee clients, and project expenses which include allocated salary and benefits, out-of-pocket expenditures for external consultants and other expenses directly related to projects. Project disbursements are made on the basis of satisfaction of milestone commitments on approved projects. In 2003, AVAC made project disbursements of \$4,735,475 (2002 - \$3,535,677) on total aggregate project approvals of \$24,515,491 (2002 - \$15,046,159). Project expenses in 2003 of \$536,978 (2002 - \$338,159) are associated with projects which have been reviewed, projects with pending approvals, and approved projects.

7. COMMITMENT AND CONTINGENCY:

(a) Commitment:

At March 31, 2003 AVAC is committed to an office lease with minimum monthly lease payments of approximately \$3,800 to February 28, 2004 and approximately \$4,000 from March 1, 2004 to February 28, 2007.

(b) Contingency:

A legal claim has been filed against AVAC Ltd. by a contract services provider in a dispute relating to fees owed. Management does not consider the aggregate liability, if any, of this action to be material to the overall financial statements.

