

**AVAC** Ltd.

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# Management Discussion & Analysis

From April 1, 2005 to March 31, 2006, the following achievements contributed to AVAC's goal of increasing value-added agriculture in Alberta.

## 2005/2006 Highlights

- The total investment in Alberta agrivalue and agriculture research reaches \$270 million as AVAC clients become more successful in attracting financial capital .
- The Province of Alberta shows its confidence in AVAC by providing an additional \$10 million for creating value-added ventures through to 2012.
- AVAC receives \$24 million in new funding from the province in October 2005 to establish a new ag research business; the first three new approved projects each have investment from industry.
- By March 31, 2006, AVAC has approved an aggregate total of \$33.8 million for 193 projects.
- During 2005/2006, AVAC coaches 158 clients, including those working on 26 new project proposals.
- AVAC disburses an all-time high of \$6.7 million directly to clients, surpassing its previous record in 2003 by \$2 million.
- With the hiring of four new investment managers, AVAC retools its Investment Team.
- The Province of Alberta asks AVAC to lead a new initiative – dubbed IVAC – to foster growth in an expanded range of industry ventures, potentially including information and communication technology, life sciences and industrial technology.

# Business Results

Our business results for the 2005/2006 year were encouraging. In particular, our key measure (the aggregate investment in Alberta agrivalue and agriculture research projects) reached \$270 million, compared to a target of \$247.1 million. This growth (23% over the past year and 9.3% higher than our target) is a testimony to the quality of AVAC's clients and the coaching its Investment Team provided.

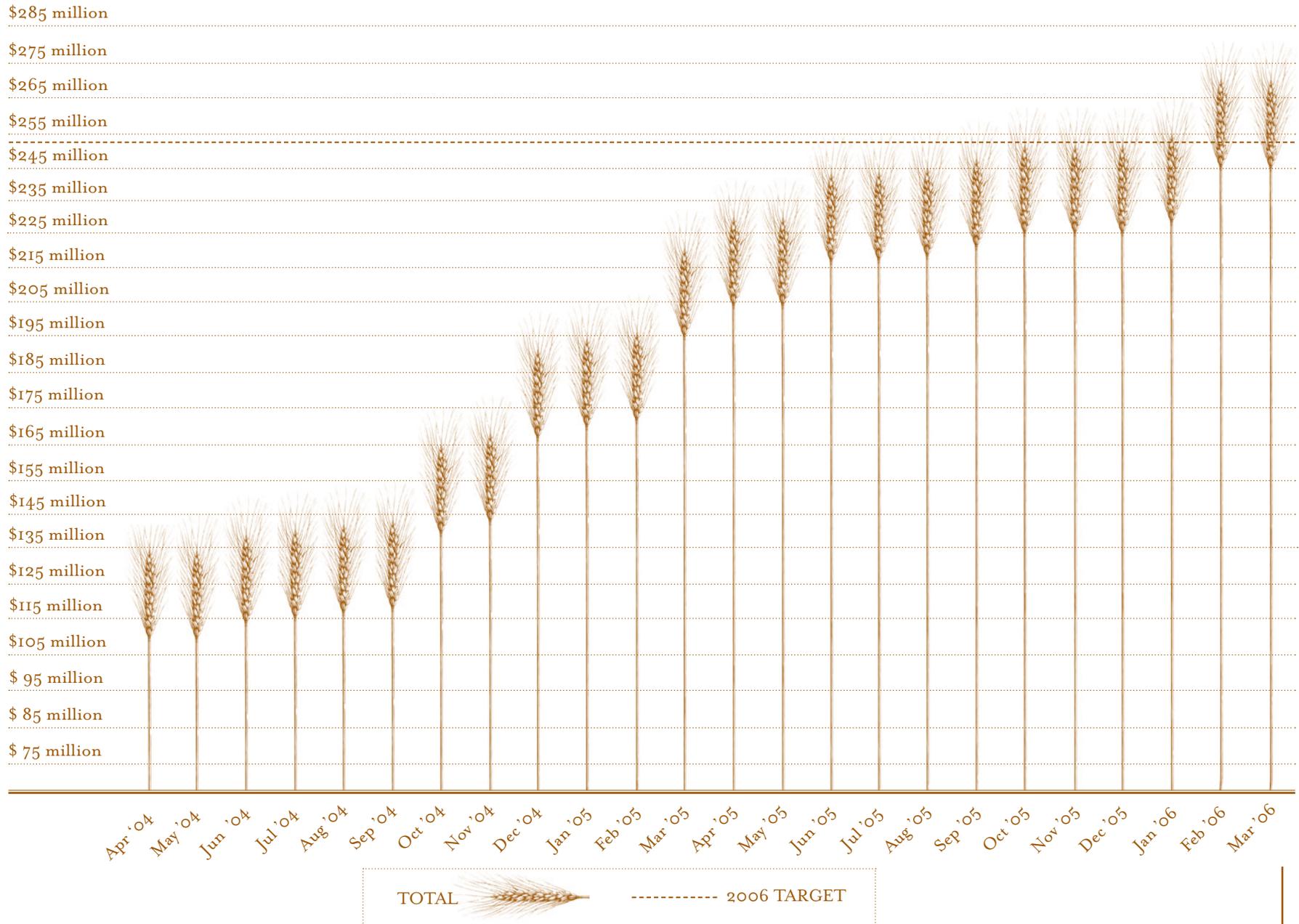
As the accompanying chart illustrates, AVAC exceeded its target in three other measures: aggregate AVAC project approvals; partners engaged in the value-added bridge; and joint science/industry projects. Of note is the 38% increase in partner organizations contributing financial or human capital to client projects.

Three measures relating to expanded deal flow (aggregate number of AVAC projects; aggregate number of precommercial approvals; and aggregate number of research programs and/or projects) saw some growth but not enough to reach our targets.

Our analysis indicates that a number of factors affected our ability to reach a number of business targets:

- A combination of staff vacancies and increased client demand for coaching restricted AVAC's ability to recruit new clients and projects
- Alberta's tight labour market and Canada's rising dollar impaired existing companies' ability to invest in new product development
- The opening of the Agrivalue Incubator in Leduc was postponed from October 2005 to the fall of 2006
- Many entrepreneurs reduced their activities due to high labour costs and pressure on the primary agriculture economy
- Re-organization by major partner groups – Alberta Agriculture, Food and Rural Development; Agriculture Financial Services Corporation; the Ag Funding Consortium; Alberta Agricultural Research Institute; and IFASA – Institute for Food and Agricultural Sciences Alberta – reduced prospective client referrals
- AVAC anticipated receiving its Ag Research Funding in April 2005 but did not receive it until October 2005.

## Aggregate Alberta Agrivalue Investment



# AVAC Evolution

Alberta's highly competitive labour market and AVAC's strategic focus contributed to a retooling of AVAC's staff in 2005/2006. The Corporation hired four new Investment managers (Mark Carlson, Jeremy Heigh, Dr. Wendy Lam and Craig Urton) and a new assistant office manager (Janet Flather). We also promoted Nicole Wozniczka to the redesigned contracts administrator role (Janet Flather provides assistance in this role's expanded reporting requirements) and hired a new Communications assistant, Sheena DeVries.

Collectively, AVAC's staff is building the Corporation's ability to assess, select and coach new agrivalue and ag research ventures. These changes have dramatically enhanced AVAC's ability to create investment-grade ventures.

We believe our new staff structure will greatly improve deal flow, client coaching, partner collaboration and financial reporting, to the benefit of our clients and stakeholders.



**Back Row:** (left to right) Lorna Sexsmith, Jeremy Heigh, Ross Bricker. **Bottom Row:** (left to right) Sheena DeVries, Keith Jones. **Missing:** Craig Urton, Dr. Wendy Lam, Mark Carlson, Janet Flather, Nicole Wozniczka and Jordan Leslie.

## *Project Review*

*A*s part of staff retooling, we extensively reviewed our client files. We subsequently updated the status of our existing project files and closed some “stalled” proposal and client files.

We would like to acknowledge the rapid progress made by our new investment managers in getting “up to speed.” They are productive and actively coaching 158 client projects.

In an additional review of more than 160 research project preproposals with the Ag Funding Consortium, Ross Bricker and Wendy Lam identified six potential investments for AVAC. One was approved prior to our year end and approval is pending for two other projects.

## *IVAC*

*A*VAC was honoured by the Province of Alberta’s request to develop and launch a new \$30-million investment fund called IVAC.

IVAC will foster growth in an expanded range of industry ventures, potentially including information and communication technology, life sciences and industrial technology.

AVAC’s Board appointed a steering committee to create a business plan for IVAC, with the intent of launching the fund in the fall of 2006.

## *Investment Fund*

*O*ur total Agrivalue Fund 1 and Ag Research Fund 3 portfolios were transferred to the management of Mawer Investment Management prior to the end of March 2006.

As of March 31, 2006, the transition was partially completed, with some remaining short-term cash positions to be invested as per the Investment Policy Statement. The funds were fully invested as per the IPS guidelines by the end of April.

At March 31, 2006, the market value of the AVAC Fund 1 portfolio was \$35.25 million, and the AVAC Ag Research Fund 3 portfolio was \$24.27 million.

## *Income Statement*

*A*VAC's income statement for the year 2005/2006 shows total revenues of \$37.0 million, \$1.57 million favourable to budget. A remarkable highlight of this year's income statement is royalty income of \$722,620.58 (an all-time AVAC record), of which \$205,622 (or 28%) is favourable to budget. Of AVAC's total revenue, \$34 million was received in the fall of 2005 from the Province of Alberta (\$10 million topped up the Agrivalue Fund 1 and \$24 million was for the Ag Research Fund 3).

AVAC's project expenses of \$7 million were significantly below the target of \$10.9 million. This was due primarily to delays in disbursing milestone investments of approximately \$2.3 million to the Agrivalue Incubator project, and \$1.39 million to various precommercial projects. The majority of these funds will, however, be disbursed in 2006/2007.

Our operating expenses were also substantially below budget, \$1.65 million actual versus \$2.32 million budgeted. This variance was largely due to staffing vacancies and subsequent delays in public relations activities, upgrading our computer system and redesigning our customer relationship management (CRM) system.

# Management Comments

AVAC's financial statements for the year ending March 31, 2006 illustrate the Company's increasing volume and quality of early-stage value-added investments, and prudent financial management.

The Company disbursed a record \$6.72 million directly to clients over the past financial year, an increase of 90% over the previous year (2005 – \$3.53 million). Aggregate project approvals and aggregate contracted obligations both attained new highs of \$33.8 million (2005 – \$32.9 million) and \$33.6 million (2005 – \$29.0 million) respectively.

AVAC's investment managers have focused successfully on elevating our clients' focus on outcomes, such that the vast majority of our investments are contracted within three months of approval. Client disbursements continue on a pace consistent with their achievement of reporting and outcome milestones. We expect client disbursements to accelerate in the coming year, based on significant project outcomes such as the completion of the Agrivalue Business Processing Incubator at Leduc.

The high volume of direct disbursements to clients has reduced the net assets internally restricted for future contracted obligations from \$12.1 million to \$10.0 million. With the addition of new moneys for the Agrivalue Fund, the Ag Research Fund and the new IVAC initiative, AVAC is in the strongest financial position in its history, with unrestricted assets of \$80.3 million.

We are gratified and honoured by the Province's confidence in our performance, illustrated by the new funding and the extension of AVAC's mandate to 2012.

AVAC continues to be in a strong asset position thanks to positive investment returns and prudent fiscal management. As AVAC's clients begin to attain commercial success, AVAC's royalty revenue is growing dramatically. We are pleased to report royalty revenues of \$722,620 for the year, a 90% increase over last year (2005 – \$380,292). We anticipate a modest reduction of royalty income in 2007, followed by a rapid and dramatic acceleration of royalty income in ensuing years.

## Management Comments, continued

AVAC conducted a five-year review of portfolio performance this year, and invited nine investment firms to bid on the management of its portfolio funds. In December 2005, Mawer Investment Management Ltd. of Calgary was selected to manage AVAC's portfolio fund. These assets were transferred to Mawer from TD Waterhouse Private Investment Counsel Inc. (AVAC's previous investment managers) in January and March of 2006. As shown in Note 3 of the financial statements, at year end 13.4% of the AgriValue Fund portfolio (on a cost basis) was held in Canadian and global equities, with the remainder invested in fixed income and cash instruments. This portfolio achieved an annualized return of approximately 8.2% over the year, generating investment income of \$2.99 million (2005 – \$1.77 million). The performance of the Agrivalue Fund portfolio compares reasonably with the following representative capital market total return indices over the same period as reported by Mawer Investment Management Ltd.:

Scotia Capital 91 Day T-Bills	2.8%
Scotia McLeod Mid-term Bonds	4.12%
S&P/TSE Composite Index	28.4%
MS EAFE	20.5%

The Ag Research Fund was invested in cash and fixed income instruments when received in October 2005, and was transferred to Mawer's management just prior to year end. This fund has yielded investment income of \$308,607 since its creation in October 2005, representing an annualized return of approximately 2.6%. Mawer has invested this fund on the basis of AVAC's revised Investment Policy Statement, and AVAC anticipates returns of 4% to 6% on the portfolio, based on this policy direction.

Once again, AVAC's total general and administrative overhead expenses of \$1.66 million (2005 – \$1.58 million) were more than offset by its investment income, and operating expenses were significantly below budget for the year. The Company anticipates increasing its core staff through the 2007 fiscal year to implement the revised strategic direction established in May 2006.

# AVAC Measures of Success

## Key Result Areas

- Agrivalue commercialization bridge established
- Increased precommercial projects
- Clients moved toward commercial success
- Increased financial and human capital attracted to agrivalue
- Improved technology commercialization from research in agrivalue

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Measures	Baseline (March 2005)	Actual (March 31,2006)	Target (March 2006)	Stretch (March 2008)
\$ = millions				
Aggregate Alberta Agrivalue and Ag Research Investment	\$219.2	\$270	\$247.1	\$375
Aggregate AVAC Project Approvals	\$32.9	\$33.8	\$39.2	\$70.8
Aggregate Precommercial Approvals	37	41	52	75
Aggregate Research Projects/Programs	17	19	22	40
Active Projects Being Coached	140	158	160	200
Clients at/entering Revenue Stage	18	19	27	40
Partners Engaged in Value-added Bridge	91	126	120	135
Joint Science and Industry Projects	72	73	70	90

# Auditor's Report to The Members

We have audited the statement of financial position of AVAC Ltd. as at March 31, 2006 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, 2006 and the results of its operations and its cash flows for the year then

ended in accordance with Canadian generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The current year's supplementary information included in Schedule I is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



KPMG LLP  
Chartered Accountants  
Calgary, Canada

June 14, 2006

# Statement of Financial Position

March 31, 2006, with comparative figures for 2005	2006	2005
<b>Assets</b>		
Current assets:		
Cash	580,839	216,793
Accounts receivable (note 2)	30,025,104	873,231
Prepaid expenses and deposits	22,517	5,910
Total current assets	30,628,460	1,095,934
Agrivalue Fund Investments (note 3)	36,083,256	30,101,128
Ag Research Fund Investments (note 4)	23,834,946	—
Capital assets (note 5)	70,457	69,494
	90,617,119	31,266,556
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable and accrued liabilities	195,526	172,442
Net assets:		
Invested in capital assets	70,457	69,494
Net assets internally restricted for future contracted obligations (notes 3 and 4)	10,008,219	12,141,581
Unrestricted	80,342,917	18,883,039
Total net assets	90,421,593	31,094,114
Commitment (note 9)		
	90,617,119	31,266,556

See accompanying notes to financial statements.

On Behalf of the Board,

  
Aaron Falkenburg, Director

  
Ed Knash, Director

# Statement of Operations

Year ended March 31, 2006, with comparative figures for 2005	2006	2005
General revenue:		
Membership	4,800	5,700
Interest income	2,734	—
Gain on disposal of capital assets	—	2,412
Royalty income	361,310	190,146
	368,844	198,258
Agrivalue Fund revenue:		
Royalty income	361,310	190,146
Investment income	2,990,328	1,774,569
Funding agreement proceeds	10,000,000	—
Federal contributions	—	810,244
Other revenue (note 7)	—	81,735
	13,561,638	2,856,694
Ag Research Fund revenue:		
Investment income	308,607	—
Funding agreement proceeds	24,000,000	—
	24,308,607	—
IVAC Fund revenue:		
Funding agreement proceeds	30,000,000	—
<b>Total revenue</b>	<b>68,029,089</b>	<b>3,054,952</b>
General and Administrative Expenditures (schedule 1):		
Agrivalue fund	1,242,076	1,576,065
Ag Research fund	414,025	—
	1,656,101	1,576,065
Agrivalue Fund Project Expenditures (note 6)	6,984,078	3,802,047
Ag Research Fund Project Expenditures (note 6)	61,431	—
<b>Total expenditures</b>	<b>8,701,610</b>	<b>5,378,112</b>
<b>Excess (deficiency) of revenue over expenditures</b>	<b>59,327,479</b>	<b>(2,323,160)</b>

See accompanying notes to the financial statements.

# Statement of Change in Net Assets

Year ended March 31, 2006, with comparative figures for 2005	Capital assets	Net assets internally restricted for future contracted obligations	Unrestricted	2006	2005
Balance, beginning of year	69,494	12,141,581	18,883,039	31,094,114	33,417,274
Excess (deficiency) of revenue over expenditures	—	—	59,327,479	59,327,479	(2,323,160)
Depreciation of capital assets	(33,058)	—	33,058	—	—
Distributions to Agrivalue projects	—	(6,677,303)	6,677,303	—	—
Distributions to Ag Research projects	—	(47,469)	47,469	—	—
Additions to capital assets	34,021	—	(34,021)	—	—
Additional Agrivalue projects contracted	—	4,457,271	(4,457,271)	—	—
Additional Ag Research projects contracted	—	134,139	(134,139)	—	—
Balance, end of year	70,457	10,008,219	80,342,917	90,421,593	31,094,114

See accompanying notes to financial statements.

# Statement of Cash Flows

Year ended March 31, 2006, with comparative figures for 2005	2006	2005
Cash provided by (used for):		
Operating activities:		
Excess (deficiency) of revenue over expenditures	59,327,479	(2,323,160)
Items not involving cash:		
Depreciation of capital assets	33,058	145,606
Investment income re-invested	(4,302,399)	(1,910,741)
Change in non-cash working capital	(29,155,071)	1,085,281
	25,903,067	(3,003,014)
Financing and investing activities:		
Capital assets acquired	(34,021)	(16,837)
Investment fund proceeds	(25,505,000)	3,210,000
	(25,539,021)	3,193,163
Increase in cash	364,046	190,149
Cash, beginning of year	216,793	26,644
Cash, end of year	580,839	216,793

See accompanying notes to financial statements.

# Notes to Financial Statements

Year ended March 31, 2006, with comparative figures for 2005

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 and a further \$10 million on October 4, 2005. Upon expiry of the Agrivalue funding agreement on March 31, 2012, 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 expensed 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 and was extended by way of agreement to March 31, 2006, AVAC was to receive contributions on a matching basis from the Government of Canada up to a cumulative amount of \$9,944,000. These matching contributions have been paid in full. AVAC allocates 50% of royalties received from projects funded under the Companion Agreement as general revenue.

AVAC received additional funding of \$24 million from the Alberta Ministry of Agriculture, Food and Rural Development on September 29, 2005. Upon expiry of the Ag Research funding agreement on March 31, 2012, 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 expensed or committed to be expended.

AVAC was granted additional funds in the amount of \$30 million from the Government of Alberta, under the “IVAC Initiative – Grant Agreement” dated March 23, 2006. The funds will be used to facilitate and advance other industry sectors which may include information and communication technology, life sciences and other industrial technology ventures, all consistent with and in furtherance of the “Securing Tomorrow’s Prosperity” strategy of the Government of Alberta.

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

## Notes to Financial Statements, continued

Year ended March 31, 2006, with comparative figures for 2005

### I. Significant accounting policies:

The financial statements of AVAC have been prepared by management in accordance with Canadian generally accepted accounting principles for not-for-profit organizations. A precise determination of many assets and liabilities is dependent upon future events and consequently the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Those estimates also affect the disclosure of contingencies at the date of financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

#### (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. 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) Investments:

Investments are reported at cost. If the market value of investments becomes lower than cost and this decline in value is considered to be other than temporary, the investments are written down to market value.

#### (c) Capital assets:

Purchased capital assets are recorded at cost. Repairs and maintenance are charged to expenses. 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:**

On April 5, 2006, AVAC received additional funds in the amount of \$30 million from the Government of Alberta, under the “IVAC Initiative – Grant Agreement” dated March 23, 2006. The funds will be used to facilitate and promote a range of industry sectors like information and communication technology, life sciences and other industrial

technology ventures, all consistent with and in furtherance of the “Securing Tomorrow’s Prosperity” strategy of the Government of Alberta.

Also included in the accounts receivable is GST receivable of \$25,104 (2005 – \$59,439).

**3. Agrivalue Fund investments:**

Agrivalue Fund investments consist of the following portfolio:

	2006 Cost	2006 Market	2005 Cost	2005 Market
Cash and cash equivalents	10,966,687	11,015,736	4,528,446	4,521,287
Medium-term investment fund:				
Federal government bonds	8,040,239	7,890,963	7,846,917	7,843,883
Provincial government bonds	12,237,131	12,165,834	9,683,948	9,843,100
Other bonds and accrued interest	–	–	2,046,745	2,076,538
Canadian equities	1,839,199	3,450,463	4,060,011	6,403,781
Global equities	3,000,000	3,000,000	1,935,061	1,604,043
	25,116,569	26,507,260	25,572,682	27,771,345
	36,083,256	37,522,996	30,101,128	32,292,632

## Notes to Financial Statements, continued

Year ended March 31, 2006, with comparative figures for 2005

The Federal Government bonds mature between December 15, 2008 and September 15, 2009 and bear interest at rates ranging from 4.15% to 4.22%. The Provincial Government bonds mature between June 9, 2008 and March 8, 2015 and bear interest ranging from 4.10% to 4.54%. Investment income has been recorded net of fees paid for portfolio management, which amount to \$88,776 (2005 – \$83,868).

Agrivalue Fund assets internally restricted for future contracted obligations:

AVAC Ltd. funds qualifying Agrivalue Precommercial, research and strategic projects on a progressive series of steps including evaluating 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, \$6,677,303 was distributed directly to project applicants from the Agrivalue fund.

AVAC has contracted to advance a total of \$33,493,842 of which \$23,572,291 has been advanced to March 31, 2006 with the remaining balance of \$9,921,549 to be advanced in future periods. This remaining advance is contingent

on specified milestones being reached as contracted. The financial statements reflect an internal restriction of net assets for the \$9,921,549 for this purpose.

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

Aggregate project approvals	\$33,504,617
Aggregate contracted obligations	\$33,493,842
Aggregate disbursements	\$23,572,291
Future contracted obligations	\$9,921,549

During the year, amounts were transferred from unrestricted net assets to net assets internally restricted for future contracted obligations of \$4,457,271. These transfers occurred as projects were approved during the year. \$19,925,500 of the aggregate project approvals of \$33,504,617 is committed to projects which result in a future return to the Company in the form of a contingent success-based royalty; the remainder represents approved investment in research, strategic or knowledge projects.

**4. Ag Research Fund investments:**

Ag Research Fund investments consist of the following portfolio:	2006 Cost	2006 Market
Cash and cash equivalents	8,420,926	8,442,321
Medium-term investment fund:		
Federal government bonds	6,554,278	6,554,287
Provincial government bonds	2,838,120	2,837,823
Other bonds and accrued interest	4,021,622	4,019,886
Global equities	2,000,000	2,000,000
	15,414,020	15,411,996
	23,834,946	23,854,317

The Federal Government bonds mature between December 1, 2007 and June 1, 2010 and bear interest at rates ranging from 4.00% to 4.17%. The Provincial Government bonds mature between December 1, 2008 and October 1, 2013 and bear interest rates ranging from 4.17% to 4.56%. Investment income has been recorded net of fees paid for portfolio management which amounted to \$1,860.

Ag Research Fund assets internally restricted for future contract obligations:

AVAC Ltd. funds qualifying research and development projects and programs in three theme areas. Project and program investments are based on a progressive series of steps

including evaluating 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, \$47,469 was distributed directly to project applicants from the Ag Research fund.

AVAC had contracted to advance a total of \$134,139 of which \$47,469 has been advanced to March 31, 2006, with the remaining balance of \$86,670 to be advanced in future periods. This remaining advance is contingent on specified milestones being reached as contacted. The financial statements reflect an internal restriction of net assets for the \$86,670 for this purpose.

## Notes to Financial Statements, continued

Year ended March 31, 2006, with comparative figures for 2005

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

Aggregate project approvals	\$321,639
Aggregate contractual obligations	\$134,139
Aggregate disbursements	\$47,469
Future contracted obligations	\$86,670

During the year, amounts were transferred from unrestricted net assets to net assets internally restricted for future contracted obligations of \$134,139. These transfers occurred as projects were approved during the year.

5. Capital assets:			2006	2005
	Cost	Accumulated depreciation	Net book value	Net book value
Computer equipment	161,109	136,007	25,102	26,604
Computer software	315,859	306,502	9,357	6,122
Office equipment	44,530	22,803	21,727	19,752
Furniture and fixtures	41,288	27,292	13,996	16,604
Leasehold improvements	8,757	8,482	275	412
	571,543	501,086	70,457	69,494

Cost and accumulated depreciation is \$537,522. and \$468,028 respectively for March 31, 2005

## 6. Fund Project expenditures:

Fund expenditures consist of project disbursements directly to investee clients, project expenses which include allocated salary and benefits, out of pocket expenditures for external consultants, other expenses directly related to projects and an allocation of general and administrative expenses. Project disbursements are made on the basis of satisfaction of milestone commitments on approved projects.

### (a) Agrivalue Fund expenditures:

In 2006, AVAC made project disbursements of \$6,677,303 (2005 – \$3,525,781) on total aggregate project approvals of \$33,504,617 (2005 – \$32,904,207). Project expenses in 2006 of \$306,775 (2005 – \$276,266) are associated with projects which have been reviewed, projects with pending approvals, and approved projects.

AVAC's general and administrative expenditures are allocated among the Funds. In 2006 \$1,242,076 (75%) was allocated to the Agrivalue Fund.

### (b) Ag Research Fund expenditures:

In 2006, AVAC made project disbursements of \$47,469 on total aggregate project approvals of \$321,639.

Project expenses in 2006 of \$13,962 are associated with projects which have been reviewed, projects with pending approvals, and approved projects.

### Ag Research Fund Project Disbursements and expenses: 2006

#### Theme 1 – Food Ingredients and Fermentation Products:

Disbursements	–
Project expenses	\$ 3,454

#### Theme 2 – Biowaste Value-Added – ENMA:

Disbursements	\$ 17,454
Project expenses	\$ 9,238

#### Theme 3 – Biowaste Value-Added – SRM:

Disbursements	\$ 30,015
Project expenses	\$ 1,269

AVAC's general and administrative expenditures are allocated among the Funds. In 2006 – \$414,025 (25%) was allocated to the Ag Research Fund, which began operating activities in September 2005.

## Notes to Financial Statements, continued

Year ended March 31, 2006, with comparative figures for 2005

### 7. Other revenue:

In 2005, AVAC received \$81,735 as compensation for investment in a project. After an initial disbursement of \$200,000 in 2002, the project changed focus and was unable to meet any future milestones. The project found new investors who compensated AVAC \$81,735 to release any interest remaining in the project.

### 8. Financial instruments:

Financial instruments of AVAC include cash, accounts receivable, investments, and accounts payable and accrued liabilities. The fair values of financial instruments excluding investments approximate their carrying value due to the short-term nature of these instruments. The fair value of investments is disclosed in notes 3 and 4. AVAC's accounts receivable are due from the federal government and therefore do not carry increased credit risk.

### 9. Commitment:

At March 31, 2006 AVAC is committed to an office lease with minimum monthly lease payments of approximately \$4,000 from April 1, 2006 to February 28, 2007.

### 10. Comparatives:

Certain figures of the previous year have been reclassified to conform with the presentation adopted in these financial statements.

# General and Administrative Expenses

Schedule I

Year ended March 31, 2006, with comparative figures for 2005

	2006	2005	Remuneration and Benefits	2006
<b>General and administrative expenditures:</b>			<b>Remuneration paid for/provided to each Director:</b>	
Staff salaries, benefits & development	805,108	689,462	Aaron Falkenberg, Chairman of the Board	64,012
Directors' honoraria and fees	201,557	117,252	Mary Ritchie	15,125
Public relations and communications	148,096	165,579	Ted Bossé	18,000
Office expenses	134,231	130,355	Robert Church	8,625
Consulting/professional	111,271	72,752	Tom Droog	14,000
Director and meeting expenses	63,323	70,071	L.E. (Ed) Knash	12,020
Travel expenses	62,649	40,399	Bern Kotelko	18,125
Computer systems maintenance	56,119	67,101	Neal Oberg	19,075
Depreciation expense	33,058	145,607	Sandy Slator	12,625
GST expense	24,814	71,037	Bob Splane	19,950
Insurance	12,511	4,189		
Other charges	3,364	2,261	Management personnel reporting directly to Board*	282,578
	<u>1,656,101</u>	<u>1,576,065</u>	All other permanent personnel employed or under contract*	<u>732,399</u>

\* Amounts paid or provided to management and all other personnel include salaries, bonuses and AVAC's share of employee benefits and contributions or payments made on behalf of employees, including those allocated as direct expenses to client projects.

# *Incubating Food Business*

Since AVAC's formation in 1997, the Corporation has recognized Alberta's shortage of scale-up capacity for agrivalue ventures.

Working jointly with Alberta Agriculture, Food and Rural Development, AVAC is developing the Agrivalue Processing Business Incubator in Leduc. AVAC has committed its single largest investment to date in the Incubator (\$5 million) to give new Alberta food companies the facilities and resources they need to scale up their new products for markets across the province, Canada, and beyond. AVAC has yet to disburse funds for this project due to construction delays.

Starting in the fall of 2006, the Incubator will lease its eight bays (which range in size from 1,500 to 5,000 square feet) to companies producing everything from processed meats to jams and jellies and from baked goods to packaged meals.

Companies will operate their bays as virtual production plants, complete with their own staff. The \$22-million facility already has six companies signed on to do product scale-up. They will be able to expand from 50 pounds to 1,000 pounds of product a week, with the goal of working towards full commercial-scale manufacturing, eventually in their own manufacturing facilities.

The Incubator will be a federally registered establishment under the Federal Meat Inspection Act and the Canada Agricultural Products Act and emerging food safety standards, enabling product manufactured in the facility to be sold in markets across North America and internationally. It will also, on a fee for service basis, provide support, expertise and/or space for:

- Process troubleshooting, line setup, product and process development, sensory evaluation, packaging issues and equipment repair and maintenance
- Developing and maintaining HACCP programs
- Administrative support services (secretarial, faxing and photocopying)
- Logistics to ensure the efficiency and integrity of the flow and storage of raw materials and finished goods as well as compliance with regulatory requirements and incubator policy.

Connected to the provincial government's Food Processing Development Centre, the Incubator will give Albertans a return on the money invested in the research and development of new and enhanced food products. Statistics show that 80% of the companies that grow in business incubators succeed.

To support its clients at the Incubator, AVAC is opening a second office in Leduc.

# Board Governance

The members of AVAC's Board of Directors are independent industry representatives elected from and by the Corporation's membership.

Collectively, their role is to guide and monitor the company. Individually, Board members maintain their independence while working with AVAC management, a primary principle for successful corporate governance. By providing a disciplined approach to business concerns, AVAC's corporate governance practices ensure the corporation fulfills its mandate within prudent risk management parameters. The Board receives and approves a Statement of Compliance each quarter from the President and CEO.

A Board Manual is used to orient new Board members, and is referred to by existing members. Each Board member acknowledges the Board's code of conduct in writing and reviews the code annually. Plus, Board members complete a Board Performance Evaluation Questionnaire annually.

All Board Committees are proactive in keeping abreast of new business practices and their required responsibilities. Their due diligence processes have improved controls and enhanced the Board's monitoring of corporate results.

The Board of Directors is kept informed of AVAC'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 2005/2006, the Board met eight times (at four Board meetings, an annual general meeting, a special Members' meeting and a strategic planning meeting) and participated in five Members' events.

# 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 per diem for attendance at Board or committee meetings or while otherwise engaged in AVAC business at the request of the Corporation.

Board compensation is reviewed annually 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, Compensation and Nomination Committee; directors' expenses are reviewed and approved by the Board Chair.

The following summarizes the compensation schedule for directors as of March 31, 2006.

Director Compensation		
Director Retainer	\$	7,500 year
Board Chair Retainer	\$	27,500 year
Committee Chair Fee	\$	2,000 year
Director Meeting Fee Attendance	\$	750 full day
	\$	375 half day
Chair Meeting Fee Attendance	\$	1,000 full day
	\$	500 half day
Conference Call Fee	\$	250 meeting

## Out-of-pocket Expenses

- Directors are compensated for travel to meetings held outside their normal place of residence at \$200 for up to four hours and at \$375 for more than four hours.
- 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 \$1,000 per diem or part thereof while engaged in AVAC business.

# 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, Compensation and Nomination Committee.

## Corporate Governance, Compensation and Nomination Committee

Committee members are Bern Kotelko (chair), Ted Bossé, Bob Splane and Aaron Falkenberg. The committee met four times in 2005/2006.

## Audit Committee

Committee members are Ed Knash (chair), Tom Droog, Neal Oberg and Mary Ritchie. The committee met five times during 2005/2006.

## Investment Committee

Committee members are Bob Splane (chair), Bob Church, Sandy Slator, Neal Oberg and Aaron Falkenberg. The committee met eight times during 2005/2006.



**Back Row:** (left to right) Aaron Falkenberg, Dr. Robert (Bob) Church, Bob Splane, Tom Droog, Sandy Slator.

**Bottom Row:** (left to right) Brian Rhiness (ex officio), L.E. (Ed) Knash, Bern Kotelko

**Missing:** Mary Ritchie, Ted Bosse, Neal Oberg, Rory Campbell (ex officio), Dr. Bob Fessenden (ex officio)

# Projects List

CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA	CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA
Alheim Corporation – Precommercial	\$130,350	\$130,350	New & Enhanced Food Products	University of Alberta – Saskatoon Fruit Flavour & Quality	\$100,000	\$32,934	Enabling Technologies
Agriculture and Food Council – Value Chain Conference	\$5,000	\$5,000	Enabling Technologies	University of Alberta – Seminar Series	\$10,000	\$ 0	Enabling Technologies
Alberta Life Technology Information Forum	\$4,000	\$4,000	Enabling Technologies	University of Alberta – Supercritical Fluid Extraction	\$66,125	\$66,125	Enabling Technologies
ASTech Awards	\$17,000	\$17,000	Enabling Technologies	Alberta Institute of Agrologists	\$8,000	\$5,000	Industrial Application
BCFN US Conference	\$5,850	\$2,417	Enabling Technologies	CytoStore Inc.	\$25,000	\$25,000	Industrial Application
Chinook Entrepreneur Challenge	\$24,000	\$8,000	Enabling Technologies	AFNS – Biopolymers from Oilseeds Research Network	\$500,000	\$125,000	Industrial Applications
CytoStore Inc. – Precommercial	\$323,750	\$100,000	Enabling Technologies	CETAC West 2005	\$10,000	\$ 0	Industrial Applications
EDA Alberta	\$25,000	\$17,500	Enabling Technologies	Cevena Bioproducts Inc.	\$1,000,000	\$1,000,000	Industrial Applications
Inno-centre Alberta	\$500,000	\$400,000	Enabling Technologies	Codena Inc.	\$10,775	\$ 0	Industrial Applications
Olds College Centre for Innovation – Research Capacity	\$2,500,000	\$1,655,266	Enabling Technologies	G.S. Technology Corporation	\$136,150	\$78,000	Industrial Applications
SciMed Laboratories Inc.	\$996,813	\$862,000	Enabling Technologies	Global Forage Alliance	\$20,490	\$20,490	Industrial Applications
SemBioSys Genetics Inc. – Pilot Scale Production of Protein A	\$2,500,000	\$1,379,000	Enabling Technologies	Kolk Farms Ltd.	\$25,000	\$25,000	Industrial Applications
University of Alberta – Commercial Supercritical Fluid Extraction of Canola	\$70,000	\$63,000	Enabling Technologies	NAS – Natural Animal Supplements Corporation	\$20,998	\$20,998	Industrial Applications
University of Alberta – Research Capacity	\$1,937,556	\$1,532,389	Enabling Technologies	Olds Ag-Tech Industries Ltd.	\$25,000	\$25,000	Industrial Applications

## Projects List, continued

CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA	CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA
Prairie Tanners Inc. (formerly P & R Trading)	\$227,058	\$212,058	Industrial Applications	Malay King – Precommercial	\$338,500	\$258,500	New & Enhanced Food Products
All in Good Taste Inc.	\$25,000	\$25,000	New & Enhanced Food Products	Nutris Inc.	\$25,000	\$16,750	New & Enhanced Food Products
Ceresan (Hole Ventures Corporation)	\$25,000	\$16,750	New & Enhanced Food Products	Of the Essence Organic Farms	\$24,582	\$24,582	New & Enhanced Food Products
EcoAg Initiatives	\$25,000	\$25,000	New & Enhanced Food Products	Orchard Mist Products Ltd.	\$25,000	\$16,750	New & Enhanced Food Products
Edelweiss Soft Cheese Manufacture Ltd.	\$58,500	\$58,500	New & Enhanced Food Products	Schroeder Milling Ltd.	\$25,000	\$25,000	New & Enhanced Food Products
FPDC – Emerging Food Technologies Seminar	\$1,425	\$ 0	New & Enhanced Food Products	Tapeko Enterprises Inc. – Precommercial	\$247,971	\$75,000	New & Enhanced Food Products
Growing Alberta	\$35,000	\$35,000	New & Enhanced Food Products	Tapeko Enterprises Inc. – Idea Builder	\$18,055	\$18,055	New & Enhanced Food Products
Kinnikinnick Foods Inc. – Precommercial	\$232,079	\$222,079	New & Enhanced Food Products	The Innovators Global Network	\$5,000	\$ 0	New & Enhanced Food Products
Kinnikinnick Foods Inc. – Start-up	\$2,500,000	\$1,900,000	New & Enhanced Food Products	Tian Fine Foods Inc.	\$25,000	\$25,000	New & Enhanced Food Products
Kitchens of India	\$25,000	\$16,750	New & Enhanced Food Products	TLC Holdings Inc.	\$25,000	\$16,750	New & Enhanced Food Products
Kool Food Inc.	\$16,750	\$16,750	New & Enhanced Food Products	University of Lethbridge – Edible Oils	\$1,200,000	\$340,000	New & Enhanced Food Products
KSL Foods Inc.	\$25,000	\$25,000	New & Enhanced Food Products	Urban Wafer Co. Inc. – Packaging Wafer Products	\$25,000	\$25,000	New & Enhanced Food Products
Lakeview Bakery	\$25,000	\$25,000	New & Enhanced Food Products	Urban Wafer Co. Inc. (formerly MMICODO Management Ltd.) – Expansion	\$148,000	\$148,000	New & Enhanced Food Products
Malay King – Idea Builder	\$24,000	\$24,000	New & Enhanced Food Products				

## Projects List, continued

CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA	CLIENT	FUNDING APPROVED	FUNDING DISBURSED	FOCUS AREA
VitalyTeas Ltd.	\$25,000	\$16,750	New & Enhanced Food Products	SemBioSys Genetics Inc.			
Wheatland Select Organic Turkey Ltd.	\$107,800	\$80,800	New & Enhanced Food Products	– Transgenic Production of Antibodies in Plants	\$2,384,000	\$2,384,000	Wellness Products
AAFRD – Rosemary Nutraceutical Industry	\$32,500	\$29,255	Wellness Products	University of Alberta – Fenugreek	\$70,000	\$63,000	Wellness Products
AB BioPharma Inc.	\$1,250,000	\$1,125,000	Wellness Products	University of Lethbridge – Disease-fighting Nutraceuticals	\$160,000	\$80,000	Wellness Products
BioLipids Inc.	\$25,000	\$25,000	Wellness Products	<b>Fund 3 (Ag Research)</b>			
CanBiocin Inc.	\$250,000	\$250,000	Wellness Products	AAFRD – Evaluation of Chicory	\$44,094	\$17,454	Food Ingredients & Fermentation Products
Ceapro Inc. – Idea Builder	\$19,750	\$19,750	Wellness Products	U of A – Production of Industrial Foaming Agents	\$90,045	\$30,015	Biowaste Value-added – SRM
Ceapro Inc. – Precommercial	\$414,882	\$389,882	Wellness Products	ARC – Creating New Opportunities for Wheat Milling and Ethanol Plant Byproducts	\$187,500	\$0	Industrial Applications
Ceapro Technology Inc. – Precommercial	\$362,250	\$362,250	Wellness Products		\$321,639	\$47,469	
Ceapro Technology Inc. – Start-Up	\$800,000	\$510,000	Wellness Products		\$31,789,081	\$21,889,007	
Cevena Bioproducts Inc.	\$1,000,000	\$900,000	Wellness Products		\$32,110,720	\$21,936,476	
Cevena Bioproducts Inc. – Start-Up	\$1,250,000	\$1,000,000	Wellness Products				
CV Technologies Inc.	\$525,000	\$508,333	Wellness Products				
Natural Farmworks Ltd.	\$200,000	\$200,000	Wellness Products				
Qeva Velvet Products Corp.	\$40,000	\$40,000	Wellness Products				