

## Management's Responsibility for Financial Statements

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report have been prepared by, and are the responsibility of, the management of The Westaim Corporation. Financial information contained throughout this annual report is consistent with the financial statements. These financial statements have been prepared in accordance with generally accepted accounting principles, using management's best estimates and judgements when appropriate. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements. The Audit Committee, which is comprised of three Directors, none of whom is an officer of the Company, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors who approve the consolidated financial statements.

The consolidated financial statements have been audited by Deloitte & Touche LLP, the independent auditors, in accordance with generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

### Signed

**Barry M. Heck**

President and  
Chief Executive Officer

February 20, 2003

### Signed

**G.A. (Drew) Fitch**

Senior Vice President and  
Chief Financial Officer

## Auditors' Report

To the Shareholders of **The Westaim Corporation**

We have audited the consolidated balance sheets of The Westaim Corporation as at December 31, 2002 and 2001 and the consolidated statements of loss, deficit and cash flow for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

**Signed**

**Deloitte & Touche LLP**

**Chartered Accountants**

January 30, 2003

**CONSOLIDATED BALANCE SHEETS**

(thousands)	December 31 2002	December 31 2001
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 77,631	\$ 138,373
Short-term investments	25,250	-
Accounts receivable	14,114	18,152
Inventories (Note 5)	13,939	18,510
Other	858	929
	131,792	175,964
Capital assets (Note 6)	45,265	44,833
Deferred charges (Note 7)	2,461	2,085
Future income taxes (Note 8)	5,730	12,115
Investments (Note 9)	500	3,182
	\$ 185,748	\$ 238,179
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 19,220	\$ 17,943
Provision for site restoration (Note 10)	7,749	7,175
Deferred licensing revenue (Note 11)	565	4,439
	27,534	29,557
Commitments and contingencies (Note 18)		
<b>Shareholders' equity</b>		
Capital stock (Note 12)	373,128	372,598
Contributed Surplus (Note 12)	403	-
Deficit	(215,317)	(163,976)
	158,214	208,622
	\$ 185,748	\$ 238,179

Approved on behalf of the Board:

**Signed**

Ian W. Delaney

Director

**Signed**

Guy J. Turcotte

Director

## CONSOLIDATED STATEMENTS OF LOSS AND CONSOLIDATED STATEMENTS OF DEFICIT

(thousands)	Year Ended	
	December 31 2002	December 31 2001
Revenue	\$ 49,063	\$ 50,267
Costs		
Manufacturing	24,787	25,551
Selling, general and administrative	8,454	11,711
Research and development (Note 13)	25,692	16,924
Depreciation and amortization	5,849	5,551
Divisional loss	(15,719)	(9,470)
Corporate costs	(6,686)	(7,750)
Interest income	2,206	7,727
Gain on sale of assets (Note 14)	-	20,122
Equity loss (Note 9)	(3,410)	(18,687)
Loss from continuing operations before income taxes	(23,609)	(8,058)
Income tax expense (Note 8)		
Current	(101)	(75)
Future	(6,385)	(295)
	(6,486)	(370)
Loss from continuing operations	(30,095)	(8,428)
Loss from discontinued operations net of income taxes (Note 4)	(19,667)	(59,031)
Net loss for the year	\$ (49,762)	\$ (67,459)
Loss per common share (Note 20)		
Continuing operations - basic and diluted	\$ (0.39)	\$ (0.11)
Net loss - basic and diluted	(0.64)	(0.87)
Weighted average number of shares outstanding (thousands)	77,924	77,741
Deficit at beginning of year	\$ (163,976)	\$ (96,517)
Change in accounting policy (Note 3)	(1,579)	-
As restated	(165,555)	(96,517)
Net loss	(49,762)	(67,459)
Deficit at end of year	\$ (215,317)	\$ (163,976)

## CONSOLIDATED CASH FLOW STATEMENTS

(thousands)	Year Ended	
	December 31 2002	December 31 2001
<b>OPERATING ACTIVITIES</b>		
Loss from continuing operations	\$ (30,095)	\$ (8,428)
Items not affecting cash		
Depreciation and amortization	5,849	5,551
Provision for site restoration costs	1,120	3,070
Future income taxes	6,385	295
Loss (gain) on sale of assets	422	(20,122)
Deferred licensing revenue	(4,270)	(4,272)
Equity loss on investments	3,410	18,687
Other items	(479)	194
Cash used in continuing operations before non-cash working capital changes	(17,658)	(5,025)
Changes in continuing operations non-cash working capital		
Accounts receivable	629	6,899
Inventories	3,280	(5,535)
Other	(52)	(949)
Accounts payable and accrued liabilities	(823)	(5,782)
Site restoration expenditures	(546)	(585)
Deferred licensing revenue	396	386
Cash used in continuing operations	(14,774)	(10,591)
Cash (used in) provided from discontinued operations	(11,179)	15,683
Total cash (used in) provided from operating activities	(25,953)	5,092
<b>INVESTING ACTIVITIES</b>		
Capital expenditures - continuing operations	(7,218)	(5,675)
Capital expenditures - discontinued operations	(478)	(2,144)
Short-term investments	(25,250)	-
Deferred charges	(948)	(629)
Proceeds on sale of assets (Note 14)	-	23,127
Investments	(728)	(6,384)
Cash (used in) provided from investing activities	(34,622)	8,295
<b>FINANCING ACTIVITIES</b>		
Issuance of common shares	151	467
Repurchase of common shares	(318)	-
Cash (used in) provided from financing activities	(167)	467
Net (decrease) increase in cash and cash equivalents	(60,742)	13,854
Cash and cash equivalents at beginning of year	138,373	124,519
Cash and cash equivalents at end of year	\$ 77,631	\$ 138,373

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1 BASIS OF PRESENTATION

The Westaim Corporation ("the Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporation Act (Alberta).

The consolidated financial statements include the accounts of the Company, and its principal subsidiaries, iFire Technology Inc. ("iFire"), Nucryst Pharmaceuticals Corp. ("Nucryst"), Surface Engineered Products Corporation ("SEP"), and Neomet Limited.

All amounts are expressed in thousands except per share data.

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

a) Principles of consolidation

The financial statements of entities, which are controlled by the Company, referred to as subsidiaries, are consolidated. Entities which are not controlled, but over which the Company has the ability to exercise significant influence are accounted for using the equity method of accounting. Investments in other entities are accounted for using the cost method.

b) Use of estimates

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the year. Significant estimates include the provision for site restoration, provision for discontinued operations, future income taxes, and useful lives of capital assets. Actual results could differ from those estimates.

c) Translation of foreign currencies

Transactions in foreign currencies are translated into Canadian dollars at rates of exchange at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. Foreign operations are considered financially and operationally integrated and are translated into Canadian dollars using the temporal method of translation. Gains or losses resulting from the translation adjustments are included in income. Foreign exchange losses included in divisional loss and interest income in 2002 amounted to \$326 (2001 gains - \$865).

d) Revenue recognition

Revenue is generally recognized when the product has been delivered. Specific revenue recognition policies for each of the Company's operating segments are as follows:

**Continuing operations**

**Ambeon** - Revenue is generally recognized at the time of shipment. Under certain consignment contracts, revenue is recognized on the date that the product is used by the customer.

**Nucryst Pharmaceuticals** - Revenue from direct sales to third parties is recognized upon delivery. For products manufactured under license, revenue is recorded at the date of shipment at actual cost plus an agreed markup, plus a royalty based on a percentage of sales revenue earned by the licensee on sales to third parties. Revenue relating to the achievement of milestones under licensing agreements is recognized when the milestone event has occurred.

**iFire Technology** - The Company recognizes revenue from licensing fees over the term that services are being rendered. Deferred licensing revenue represents amounts received under agreements for which the process of earning the revenue has not been completed. Royalties are recognized when earned in accordance with the terms of the specific agreement.

**Discontinued operations**

**Coinage Products** - Revenue is generally recognized on delivery to and acceptance by third party customers. Under certain contracts, revenue is recognized at time of shipment.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)**

**SEP** – For certain products and services, revenue is recognized on the percentage of completion basis, as specific critical events occur. In some instances, product is sold on the basis of achieving defined performance standards. In these cases, revenue is not recognized until these performance standards have been achieved. In addition, a provision for potential warranty expense is provided for at the time of sale, based on warranty terms and prior claims experience.

## e) Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities at the date of acquisition of 90 days or less and are recorded at cost.

## f) Short-term investments

Short-term investments consist of money-market instruments with maturities of less than one year. As at December 31, 2002 the Company held short-term investments recorded at a cost of \$25,250 which reflects current market values. At December 31, 2001 the Company held no short-term investments.

## g) Inventory valuation

Finished products, raw materials, materials in process, spare parts and operating materials are valued at the lower of average cost and net realizable value.

## h) Research and development costs

Research costs are expensed as incurred and significant project development costs are capitalized in accordance with Canadian generally accepted accounting principles once the Company has determined that commercialization criteria concerning the product or process have been met. Amortization of these costs over their estimated useful life commences with the successful commercial production or use of the product or process. On an ongoing basis, Management reviews the unamortized balance to ensure that the deferred development costs continue to satisfy the criteria for deferral and amortization.

As at December 31, 2002 and 2001, no research and development costs have been capitalized.

## i) Government assistance

Government assistance towards research and development expenditures related to capital assets used for research and development is credited against the cost of the related capital asset and all other assistance is credited against the related expenses as incurred.

## j) Capital assets

i) **Property, Plant and Equipment** – Property, plant and equipment are stated at cost. Depreciation and amortization is calculated using a straight-line method based on estimated useful lives of the particular assets which do not exceed 20 years for buildings and 10 years for equipment.

ii) **Carrying Value** – The Company evaluates the carrying value of property, plant and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable, and recognizes an impairment charge when it is probable that estimated future non-discounted cash flows of the underlying assets will be less than the carrying value of the assets.

## k) Site restoration costs

Site restoration costs have been estimated taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and the possible uses of the site. The estimated amount of future restoration costs is reviewed regularly based on available information. Where the forecasted net restoration costs exceed existing provisions, an additional expense is recognized in the period.

## l) Derivative financial instruments

Derivative financial instruments are utilized by the Company in the management of commodity price, interest rate, and foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Company enters into hedges of its commodity price exposure on nickel raw material inventory and anticipated future sales by entering into nickel forward contracts, when deemed appropriate. Gains and losses on nickel forward contracts used to hedge nickel raw material inventory and anticipated future sales are accrued under inventory on the balance sheet and recognized in the income statement when the underlying product is sold.

The Company also enters into forward agreements in order to reduce the impact of fluctuating interest rates on its short-term investments and fluctuating foreign currency exchange rates on anticipated future cash flows. These forward agreements are not designated as hedges. They require the exchange of payments without the exchange of the notional principal amount on which payments are based. These instruments are recorded at the lower of cost or market.

#### m) Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values.

Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the period of realization.

#### n) Stock-based compensation plans

The Company and certain of its subsidiaries have stock-based compensation plans, which are described in Note 12. No compensation expense is recognized for these plans when stock options are issued. Any consideration paid by option holders for the purchase of stock is credited to capital stock. If plan entitlements are repurchased from the holder, the consideration paid is charged to retained earnings. Any obligation related to increases in the value of Deferred Share Units is accrued when the change in value occurs, with an offset to the Statement of Loss.

Effective January 1, 2002, the Company and its subsidiaries adopted Section 3870 of the Handbook of the Canadian Institute of Chartered Accountants (CICA) with respect to the accounting and disclosure of stock-based compensation, which recommends that awards to employees be valued using a fair value method of accounting. These new rules also require that companies account for stock appreciation rights ("SARs") and similar awards to be settled in cash or other assets, by measuring compensation expense on an ongoing basis, as the amount by which the quoted market price exceeds the exercise price at each measurement date.

As permitted under Section 3870, the Company has elected to account for stock options by measuring compensation expense as the excess, if any, of the quoted market value of the stock at the date of grant over the exercise price. For stock options in subsidiary companies, compensation expense is measured as the excess, if any, of the fair value of the subsidiary's stock at the date of grant over the exercise price.

Under CICA 3870, companies that elect a method other than the fair value method of accounting are required to disclose pro forma net income and earnings per share information, using a pricing model such as the Black-Scholes model, as if the fair value method of accounting had been used. These new rules do not apply to pre-existing awards except for those awards that call for settlement in cash or other assets, in which case, the cumulative liability of these awards at the date of implementation is charged to deficit with a corresponding increase to accounts payable and accrued liabilities.

#### o) Earnings per share

Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the period plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (CONTINUED)

p) Employee future benefits

All employee future benefits are accounted for on an accrual basis. The transitional obligation of \$1,338 resulting from the adoption of CICA 3461 in 2000 is being amortized to pension expense on a straight-line basis over eight years which is the average remaining service period of active employees expected to receive benefits under the pension plan.

Post retirement benefit costs for the Company's defined benefit pension plan are actuarially determined using the projected benefit method prorated on service. The estimated market value of the pension plan assets is actuarially determined based on a five-year moving average. Experience gains and losses, and amounts arising as a result of changes in assumptions and plan amendment are amortized on a straight-line basis over the expected average remaining life of the employee group.

q) Discontinued operations

Business segments, where a formal plan of disposal has been approved, are accounted for as discontinued operations. The results of discontinued operations are reported separately, disclosing the results of operations prior to the measurement date (date the plan to discontinue operations was formally approved) and the net gain or loss from discontinued operations. The net gain or loss from discontinued operations includes both actual or estimated gain or loss on disposal and the actual or estimated results from operations, if any, between the measurement date and the disposal date. Net gains are only recognized when realized.

r) Deferred charges and other intangible assets

Effective January 1, 2002, the Company adopted on a prospective basis new CICA 3062, Goodwill and Other Intangible Assets, the provisions of which replace the amortization of goodwill and indefinite life assets with requirements for an annual impairment test. Any material decline in fair value from carrying value will be charged to expense in the period that impairment has been determined. There is no material impact on the consolidated financial statements resulting from this change either in the current period or the prior period presented. At present, the Company has no indefinite life assets. Organization costs are amortized over 5 years and patents are amortized over 10 years.

### 3 CHANGE IN ACCOUNTING POLICIES

#### Stock-based compensation

Effective January 1, 2002, the CICA introduced new accounting and disclosure requirements with respect to stock-based compensation, which requires that awards to employees be valued using a fair-value method of accounting. These new rules also require enterprises to account for SARs and similar awards to be settled in cash or other assets by measuring, on an ongoing basis, the amount by which the quoted market price exceeds the exercise price at measurement date (Note 2n).

These new rules do not apply to pre-existing awards except for those awards that call for settlement in cash or other assets, in which case, the cumulative liability of these awards at the date of implementation is charged to deficit with a corresponding increase to accounts payable and accrued liabilities. The cumulative liability of the SARs of the Company's subsidiaries at January 1, 2002, amounting to \$1,579, was charged to deficit with a corresponding increase to accounts payable and accrued liabilities (Note 12).

### 4 DISCONTINUED OPERATIONS

On May 28, 2002 the Board of Directors of the Company approved the closing of the Coinage division and the selling of the Ethylene Coatings business. Accordingly, the results from operations of these businesses, including the estimated cost of shutdown of the Coinage division and disposition or shutdown of the Ethylene Coatings business, have been accounted for on a discontinued basis. The Coinage division was shut down in July 2002. It is expected that the Ethylene Coatings business will be shutdown in the first quarter of 2003.

As a result, the Company recorded a loss from discontinued operations of \$16,518 in the second quarter of 2002 and an additional loss of \$3,149 in the fourth quarter of 2002 for a total loss of \$19,667, of which \$7,526 remains in accounts payable and accrued liabilities as at December 31, 2002.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 4 DISCONTINUED OPERATIONS (CONTINUED)

Amounts included in the consolidated balance sheets relating to discontinued operations are as follows:

	December 31, 2002	December 31, 2001
Accounts receivable	\$ 2,178	\$ 5,587
Inventories	353	1,645
Other assets	32	154
Accounts payable and accrued liabilities	(10,383)	(8,283)
Net working capital	\$ (7,820)	\$ (897)
Capital assets	\$ 8,478	\$ 9,468

The results of discontinued operations are summarized as follows:

	Year Ended December 31, 2002	Year Ended December 31, 2001
Revenues to May 28, 2002	\$ 6,454	\$ 18,616
Revenues subsequent to May 28, 2002 and estimated future revenues	3,829	-
Total revenue from discontinued operations	\$ 10,283	\$ 18,616
Divisional losses to May 28, 2002	\$ (3,908)	\$ (24,344)
Divisional losses subsequent to May 28, 2002 and estimated future divisional losses	(6,676)	-
Costs relating to shutdown and disposition	(9,083)	-
Write down of carrying value of assets (Note 15)	-	(34,687)
Net loss from discontinued operations	\$ (19,667)	\$ (59,031)

The net loss from discontinued operations is after deduction of depreciation of \$636 for the year ended December 31, 2002 (2001 - \$3,427). The net loss for the year ended December 31, 2002 also includes provisions for workforce reduction and other shutdown and asset disposal costs totaling \$9,083. All expected future losses from the Ethylene Coatings business were included in the net loss from discontinued operations recorded during 2002.

Net loss per common share from discontinued operations was \$(0.25) for the year ended December 31, 2002 (2001 - \$(0.76)). No tax provisions were recorded with respect to these businesses during these periods and no future income tax benefit has been recognized with respect to non-capital and capital losses carried forward associated with discontinued operations.

### 5 INVENTORIES

	December 31, 2002	December 31, 2001
Raw materials	\$ 4,407	\$ 3,009
Materials in process	1,946	3,626
Finished product	6,555	9,551
Spare parts and operating materials	678	679
Continuing operations	13,586	16,865
Discontinued operations	353	1,645
	\$ 13,939	\$ 18,510

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****6 CAPITAL ASSETS**

December 31, 2002	Cost	Accumulated Depreciation and Amortization	Net Book Value
Nucryst Pharmaceuticals	\$ 5,816	\$ 1,294	\$ 4,522
iFire Technology	24,349	10,441	13,908
Ambeon	22,216	9,324	12,892
Other	13,973	8,508	5,465
Continuing operations	66,354	29,567	36,787
Discontinued operations	42,795	34,317	8,478
	\$ 109,149	\$ 63,884	\$ 45,265

December 31, 2001	Cost	Accumulated Depreciation and Amortization	Net Book Value
Nucryst Pharmaceuticals	\$ 3,304	\$ 948	\$ 2,356
iFire Technology	22,853	8,917	13,936
Ambeon	20,906	7,690	13,216
Other	13,370	7,513	5,857
Continuing operations	60,433	25,068	35,365
Discontinued operations	61,132	51,664	9,468
	\$ 121,565	\$ 76,732	\$ 44,833

Included in continuing operations capital assets is construction in progress of \$4,572 (2001 - \$2,076) that is not currently subject to depreciation. Depreciation on continuing operations capital assets was \$5,473 (2001 - \$5,356).

**7 DEFERRED CHARGES**

	December 31, 2002	December 31, 2001
Patents	\$ 3,950	\$ 3,193
Organization costs	-	1,448
	3,950	4,641
Less accumulated amortization	(1,489)	(2,556)
Continuing operations	\$ 2,461	\$ 2,085

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 8 INCOME TAXES

The following is a reconciliation of income taxes, calculated at the Canadian combined federal and provincial income tax rate, to the income tax provision included in the consolidated statements of loss.

	Year Ended December 31, 2002	Year Ended December 31, 2001
Loss from continuing operations before income taxes	\$ (23,609)	\$ (8,058)
Items not subject to tax	3,410	18,687
Unrecognized tax losses	36,540	-
Recognition of previously unrecognized tax losses	-	(11,268)
	16,341	(639)
Combined basic Canadian federal and provincial tax rate	39.12%	41.62%
Expected income tax expense (recovery)	6,393	(266)
Increase (decrease) related to:		
Large corporations and capital taxes	103	203
Difference between statutory rate and subsidiary tax rates	(43)	(80)
Income tax rate change	-	538
Other	33	(25)
	\$ 6,486	\$ 370
Classified as:		
Current	\$ 101	\$ 75
Future	6,385	295
Income tax expense	\$ 6,486	\$ 370

Income taxes are recognized for future income tax consequences attributed to estimated differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases.

The net future income tax asset is comprised of:

	December 31, 2002	December 31, 2001
Future income tax assets:		
Tax benefit of loss carry-forwards and tax credits	\$ 68,218	\$ 57,245
Provisions and reserves	5,851	5,928
Capital, intangible and other assets	13,024	6,995
Less: valuation allowance	(77,831)	(54,172)
	9,262	15,996
Future income tax liabilities:		
Capital, intangible and other assets	(3,350)	(3,442)
Other	(182)	(439)
	(3,532)	(3,881)
Future income tax assets, net	\$ 5,730	\$ 12,115
Classified as:		
Current asset	\$ -	\$ -
Long-term asset	5,730	12,115
Future income tax assets, net	\$ 5,730	\$ 12,115

The future income tax asset valuation allowance is in respect of tax loss carry-forwards and tax credits primarily relating to subsidiaries involved in technology development.

For income tax purposes the Company had non-capital loss carry-forwards relating to operations in various jurisdictions of approximately \$158,102 at December 31, 2002 (2001 - \$135,415) and accumulated capital losses of \$5,747 (2001 - \$3,588) which are available to offset income of specific entities of the consolidated group in future periods. The non-capital loss carry-

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****8 INCOME TAXES (CONTINUED)**

forwards will expire at various times to the end of 2022. The Company also had research and development tax credits of approximately \$25,398 at December 31, 2002 (2001 – \$22,404) which will expire at various times to the end of 2012. Cash taxes relating to continuing operations paid during the year amounted to \$383 (2001 – \$563)

**9 INVESTMENTS**

	December 31, 2002	December 31, 2001
Investments – shares – cost basis	\$ 500	\$ 2,362
Investments – shares – equity basis	–	820
	\$ 500	\$ 3,182

The Company records impairment losses if there has been an impairment in the value of investments that is other than temporary in nature. During the year, provisions totaling \$2,435 (2001 – \$1,299) were recorded against the investments.

**10 PROVISION FOR SITE RESTORATION**

Changes in the provision are as follows:

	Year Ended December 31, 2002	Year Ended December 31, 2001
Provision at beginning of year	\$ 7,175	\$ 4,689
Additional provisions required	1,120	3,071
Site restoration expenditures incurred	(546)	(585)
Provision at end of year	\$ 7,749	\$ 7,175

The provision relates primarily to site restoration associated with the discontinuance of DS nickel production as well as soil and groundwater reclamation and remediation, based on periodic independent estimates of these costs.

**11 LICENSING AGREEMENT**

In 2000, iFire entered into a non-exclusive licensing agreement with a third party. The licensing fee is being recognized as revenue over three years, the term that services are being rendered under the agreement. Deferred licensing revenue represents the unamortized portion of cash received. In addition, iFire is entitled to royalties from future commercial sales of products by the third party utilizing the technology. These receipts vary in amount based on certain factors and are contingent upon the successful development and commercialization of the iFire technology in products produced by the third party.

**12 CAPITAL STOCK****Share Capital**

The Company's authorized share capital consists of an unlimited number of common shares, Preferred A shares and Preferred B shares. Changes in the Company's common shares outstanding during 2002 and 2001 are as follows:

	2002		2001	
	Number	Stated Capital	Number	Stated Capital
Common Shares				
Balance at beginning of year	77,786,915	\$ 372,598	77,719,698	\$ 372,131
Employee Share Purchase Plan	72,843	151	67,217	467
Repurchase of shares	(150,500)	(721)	–	–
Compensation expense	323,529	1,100	–	–
Balance at end of year	78,032,787	\$ 373,128	77,786,915	\$ 372,598

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 12 CAPITAL STOCK (CONTINUED)

#### Stock-based compensation plans

**Employee and Director stock option plan** – The Company maintains an Employee and Director Stock Option Plan under which the Company may grant options for up to 11,000,000 shares of common stock of the Company at an exercise price equal to the market price of the Company's stock at the date of grant. Options awarded are exercisable for a period of 10 years and vest as to one third of the grant on each of the first, second and third anniversaries after the date of the grant. The Company maintains a Directors and Officers Share Purchase Program under the provisions of the Stock Option Plan. Under the Share Purchase Program, Directors and designated officers may be granted one option for each common share purchased, to a cumulative 50,000 options. Options, equal to the net purchases of common shares by the optionee during the calendar year, vest at the end of the calendar year in which the purchases were made. Any options issued under this program which do not vest at year-end are cancelled.

A summary of the status of the Company's stock option plans as at December 31, 2002 and 2001 and changes during the years ending on those dates is presented below:

	2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	5,245,399	\$ 9.74	4,684,999	\$ 9.61
Granted	420,200	\$ 5.22	560,400	\$ 10.81
Outstanding at end of year	5,665,599	\$ 9.41	5,245,399	\$ 9.74

The following table summarizes information about stock options outstanding as at December 31, 2002:

Range of Exercise Prices	Number Outstanding Dec.31,2002	Weighted Average Remaining Contractual Life	Options Outstanding		Options Exercisable	
			Weighted Average Exercise Price	Number Exercisable Dec.31, 2002	Weighted Average Exercise Price	
\$1 – \$6	1,546,900	5.1 years	\$ 4.56	1,171,900	\$ 4.23	
\$6 – \$15	2,485,370	6.6 years	\$ 8.13	1,987,315	\$ 7.70	
> \$15	1,633,329	7.3 years	\$ 15.93	1,088,886	\$ 15.93	
\$1 – \$16	5,665,599	6.4 years	\$ 9.41	4,248,101	\$ 8.85	

**Deferred share unit plan** – During 2001, the Company implemented a Deferred Share Unit Plan (DSUs) for the outside Directors of the Company. DSUs are issued at the market value of the Company's shares at the date of grant and vest upon death or retirement of the Director. Directors may elect to receive additional DSUs in lieu of fees, which are issued at 90% of the market value of the Company's shares at the date of grant. As at December 31, 2002 a liability of \$210 (2001 – \$93) has been accrued with respect to issued DSUs.

**Employee share purchase plan** – Under the Employee Share Purchase Plan, employees are entitled to subscribe for common shares of the Company, to a maximum value of five percent of their annual compensation. Payment for these shares is made over a 24 month period at a price per share equal to the lesser of the market value at the offering date and the market value at the end of the purchase period. The market value at the offering date of July 15, 2002 was \$3.60 (July 16, 2001 – \$10.09). At December 31, 2002 there were outstanding purchase arrangements with employees having an aggregate value of \$323 (2001 – \$606). During the year ended December 31, 2002, 72,843 shares were issued under this Plan at an average price of \$2.08 (2001 – 67,217 shares at \$6.94).

**Subsidiary stock-based compensation plans** – The Company also maintains equity incentive plans for certain employees of its technology subsidiaries, Surface Engineered Products Corporation, Nucrust Pharmaceuticals Corp. and iFire Technology Inc., under which stock options have been granted representing 4.57% to 4.90% of the outstanding shares of the respective subsidiaries. Subsidiary stock options vest evenly over a 3-year period and expire after 10 years from the date of grant. The exercise prices of stock options granted are not less than the fair value of the subsidiary's stock at the time of the grant. During the year, the Company issued 323,529 shares and recorded compensation expense of \$1,100.

SARs have been granted to employees of certain technology subsidiaries. SARs vest over time and may be settled with cash, shares of the subsidiary or shares of the Company, at the Company's option. The exercise prices of SARs granted are not less

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****12 CAPITAL STOCK (CONTINUED)**

than the fair value of the subsidiary's stock at the time of the grant. In 2001, the total liability upon exercise of these SARs was capped at \$1,950 and holders of SARs received options to purchase shares of the subsidiary with terms comparable to the original SARs.

Effective January 1, 2002 net changes in the value of SARs, measured as the amount by which quoted market prices or fair value exceeds the exercise price at the measurement date, is recognized as compensation expense over the SAR's vesting period. The cumulative liability as at January 1, 2002 amounting to \$1,579 was charged to deficit with a corresponding increase to accounts payable and accrued liabilities. As at December 31, 2002 the liability has been reduced to \$Nil, as the market value of the subsidiaries' SARs is less than their exercise price.

**Pro forma accounting for stock-based compensation**

Effective January 1, 2002 the CICA recommends that stock-based compensation be accounted for using a fair value methodology. As permitted under the new rules, the Company and its subsidiaries have elected to measure compensation expense as the difference, if any, between the quoted market value or fair value of the stock at the date of grant and the exercise price at the date of grant. The exercise price of options granted by the Company and its subsidiaries is not less than the market value at the date of grant and, consequently, no compensation expense has been recorded.

If compensation costs for options for common shares of the Company and for common shares of subsidiaries issued on or after January 1, 2002 had been determined based on the fair value methodology, using the Black-Scholes option pricing model, the Company's net loss and loss per share would have been increased to the pro forma amounts indicated below:

	Year Ended December 31, 2002
Net loss applicable to common shareholders as reported	\$ (49,762)
Pro forma net loss applicable to common shareholders	(50,389)
Loss per common share as reported (basic and diluted)	(0.64)
Pro forma loss per common share (basic and diluted)	(0.65)

The fair value of each option grant by the Company and its subsidiaries was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 5.18%, an average life of 7.0 years and a volatility of 59.5%. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

**Normal course issuer bid**

In June 2002, the Company filed a normal course issuer bid which entitles the Company to acquire up to 3,889,000 common shares between June 19, 2002 and June 18, 2003. The purchases are made on the open market at the time of any particular purchase.

During the year, the Company repurchased 150,500 shares through its normal course issuer bid at an average price of \$2.12 for an aggregate consideration of \$318. The amount by which the average carrying value exceeded the cost of reacquiring the shares, amounting to \$403, has been credited to contributed surplus.

**Shareholder rights plan**

The Company has a Shareholder Rights Plan under which one Right has been issued for each outstanding common share of the Company. The Rights expire on March 9, 2005. Each Right may be exercised eight trading days after a triggering event, which is determined when a person (an "Acquiring Person") has acquired or has commenced a takeover bid to acquire 20% or more of the common shares, other than by an acquisition pursuant to a takeover bid permitted by the Shareholder Rights Plan.

Upon occurrence of a triggering event, as described above, each Right entitles the holder, other than an Acquiring Person, to purchase for \$75 that number of common shares of the Company having an aggregate market price of \$150.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 13 TECHNOLOGY PARTNERSHIPS CANADA AGREEMENT

On March 26, 2001, iFire entered into a research and development contribution agreement with the Government of Canada through Technology Partnerships Canada ("TPC"). Under this agreement, TPC has agreed to contribute 28.371% of eligible research and development costs and related capital expenditures incurred by iFire until April 30, 2003, to a maximum of \$30,000.

Under the terms of the agreement, iFire will pay a royalty to TPC equal to 1.065% of eventual commercial sales of the technology under development. In addition, TPC received warrants to purchase common shares of iFire exercisable for an additional consideration of \$6,283. The warrants expire on April 30, 2007 and, as at December 31, 2002, represented approximately 0.5% of the current outstanding common shares of iFire. Under certain circumstances after December 31, 2004, TPC may put the warrants to iFire in consideration for their fair market value at that date, or for a 0.255 percentage point increase in the royalty rate, at the option of iFire.

Contributions are recorded as a reduction of the cost of the applicable capital asset or credited to the statement of operations of iFire as determined by the nature of the expenditure being funded. In 2002, contribution claims totaling \$9,063 (2001 - \$14,490) have been recorded. Of this amount, \$8,061 (2001 - \$12,894) has been credited to research and development expense and \$1,002 (2001 - \$1,596) has been credited to capital assets. As at December 31, 2002, the Company has recorded a receivable of \$2,080 (2001 - \$4,444) for contribution claims relating to expenditures in 2002.

### 14 NUCRYST PHARMACEUTICALS AGREEMENT WITH SMITH & NEPHEW PLC

On May 8, 2001, Nucryst entered into a series of agreements relating to its Acticoat™ burn dressing and wound care products with Smith & Nephew plc. Under these agreements, Nucryst sold its North American burn dressing business and entered into an exclusive global licensing agreement for the sale and marketing of Acticoat™ burn and wound care dressings. Nucryst will receive royalties based on Smith & Nephew's future sales of these products as well as milestone payments for the achievement of certain regulatory and sales targets. Under a collaborative agreement, the two companies will work together to develop new wound care products and obtain additional regulatory approvals. Nucryst will continue to manufacture Acticoat™ products for Smith & Nephew under a long term manufacturing agreement.

The Company recorded a gain on the sale of the North American burn dressing business of \$20,122 in 2001.

### 15 WRITE DOWN OF CARRYING VALUE OF ASSETS

In late 2001, as a result of projected operating losses arising from uncertainty regarding the ability to secure future coin blank and other coinage-related contracts, the Company assessed the recoverability of the tangible and intangible assets related to the Coinage operating segment. Profitability in prior years resulted from contracts from certain customers at significant volumes that are no longer available. The Company projected the undiscounted future net cash flows from use of these assets, together with their residual values, to be less than their carrying amounts.

Due to a significant downturn in the global ethylene industry, as well as changes to the manufacturing process resulting in surplus manufacturing equipment, in late 2001 the Company assessed the recoverability of the tangible and intangible assets related to the Ethylene Coatings business, and projected that the undiscounted future net cash flows from the use of these assets, together with their residual values, to be less than their carrying amounts.

Accordingly, in December 2001 the Company recorded a provision for asset impairment totaling \$34,687, of which \$27,651 related to property, plant and equipment, and \$7,036 related to other assets. The provision relating to other assets includes \$2,497 in spare parts associated with the property, plant and equipment and a \$4,000 reduction in future income tax assets. These businesses were accounted for as discontinued operations in 2002 (Note 4).

Estimates of such undiscounted future net cash flows from use, together with residual values, are subject to significant uncertainties and assumptions. Actual results could, therefore, vary significantly from such estimates.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****16 PENSION PLANS**

The Company maintains defined contribution pension plans for its salaried and hourly employees. These plans were funded \$1,117 during the year ended December 31, 2002 (2001 – \$1,311).

The Company also maintains a defined benefit plan. The number of participants and retirees in this plan is not material. At December 31, 2002, the plan assets had a market value of \$2,041 (2001 – \$2,277) which is offset by the actuarial present value of the benefit obligation of \$2,706 (2001 – \$2,686), creating a plan deficit of \$665 (2001 – \$409) and an accrued benefit liability of \$Nil (2001 – \$76). The Company funds the plan in amounts that are neither less than the minimum statutory funding requirements nor more than the maximum amount that can be deducted for income tax purposes.

**17 DERIVATIVE FINANCIAL INSTRUMENTS**

From time to time, the Company hedges its exposure to contracted nickel sales, raw material purchases and certain produced inventory which are at price risk, through the use of nickel forward contracts traded Over the Counter with counterparties under terms governed by the London Metal Exchange (“LME”) policies. Settlements are based on LME prices, unless other prices are negotiated. At December 31, 2002, there were deferred losses of \$269 and unrealized losses of \$75 (2001 – deferred gains of \$195 and unrealized losses of \$441) on these hedges which are offset by unrecognized gains in physical inventory and raw material costs.

The unrealized commodity positions at December 31, 2002 totaled 312 tonnes (2001 – 678 tonnes) and expire on varying dates to March 2003.

From time to time, the Company reduces its exposure to foreign currency and interest rate fluctuations by entering into forward transactions. Gains are recognized upon realization, losses when identified, and both are included in interest income. At December 31, 2002 and December 31, 2001 there were no unrecognized gains or losses on open foreign exchange contracts. The open positions at December 31, 2002, which expire in January, 2003 were 61 Euro and \$2,600 U.S. (2001 – 1,917 Euro and \$5,947 U.S.).

At December 31, 2002 there were accrued losses on open forward rate agreement contracts of \$290. The cumulative notional amount of these open positions at December 31, 2002 amounted to \$100,000. These contracts expire on varying dates to September 2003. At December 31, 2001 there were no open forward rate agreement contracts.

**18 COMMITMENTS AND CONTINGENCIES****Commitments**

The Company is committed to capital expenditures of \$3,409 (2001 – \$1,664) and to future annual payments under operating leases as follows:

2003	2004	2005	2006	2007
\$1,217	\$1,162	\$1,049	\$638	\$14

**Contingencies**

The Company and its subsidiaries are party to legal proceedings in the ordinary course of their businesses. Management does not expect the outcome of any of these proceedings to have a material effect on the Company’s financial position or operating results.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 19 FINANCIAL INSTRUMENTS

#### Fair value of financial instruments

The carrying value of the Company's interest in financial instruments approximates their fair value. The estimated fair value approximates the amount for which the financial instruments could currently be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Certain financial instruments lack an available trading market and, therefore, fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instrument.

#### Interest rate risk

Interest rate risk reflects the sensitivity of the Company's financial results and condition to movements in interest rates. For 2002 a 1% decrease in interest rates would have reduced earnings before income taxes by \$922. Conversely, a 1% increase in interest rates would have increased earnings before taxes by a similar amount.

#### Foreign currency risk

The Company is exposed to currency risks as a result of its export to foreign jurisdictions of goods produced in Canada. These risks are partially covered by purchases of goods and services in the foreign currency and by forward exchange contracts.

#### Credit risk

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and short-term investments, accounts receivable, and forward contracts. Cash and short-term investments are placed with major financial institutions or invested in the commercial paper of large organizations. Concentrations of credit risk with respect to receivables are limited due to the large number of customers and their dispersion across geographic areas.

### 20 EARNINGS PER SHARE

In calculating earnings per share under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculation as the assumed exercise of the Company's stock options does not result in an adjustment to income. The reconciliation of the denominator in calculating diluted earnings per share is as follows:

	Year Ended December 31, 2002	Year Ended December 31, 2001
Weighted average number of common shares outstanding		
- basic earnings per share	77,923,525	77,740,607
Effect of dilutive securities	17,550	3,032,981
Weighted average number of common shares outstanding		
- diluted earnings per share	77,941,075	80,773,588

The impact of all dilutive securities on earnings per share is anti-dilutive as at December 31, 2002 and 2001.

### 21 SEGMENTED INFORMATION

The Company is managed using three operating segments, which have been determined based on the nature of the products produced: Nucryst Pharmaceuticals, iFire Technology and Ambeon. In May, 2002 the Company announced its intention to close the Coinage division and to seek a strategic buyer for its Ethylene Coatings business. As a result, these businesses have been accounted for as discontinued operations (Note 4).

The Nucryst Pharmaceuticals segment researches, develops and commercializes medical devices and pharmaceutical products based on noble metal nanocrystalline technology. The iFire Technology segment has developed a proprietary flat-panel full color solid state display technology with applications in both the large screen and small graphic display markets. Ambeon is dedicated to marketing and commercializing coating solutions and products for customers in the aerospace, electronics, catalysis and other markets.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****21 SEGMENTED INFORMATION (CONTINUED)**

The accounting policies of the reportable segments are the same as those described in Note 2. Included in other non-cash assets of \$14,812 at December 31, 2002 (2001 - \$14,101) are the investments disclosed in Note 9 and future income tax assets that cannot be allocated to a particular segment. Non-cash assets excludes short-term investments.

Year Ended December 31, 2002	Revenue	Divisional Earnings (Loss)	Depreciation and Amortization	Capital Expenditures	Non-cash Assets December 31, 2002
Nucryst Pharmaceuticals	\$ 8,344	\$ (6,985)	\$ 554	\$ 2,416	\$ 9,759
iFire Technology	4,270	(16,915)	2,642	2,909	17,184
Ambeon	36,449	9,026	1,618	1,166	30,071
Other	-	(845)	1,035	727	14,812
Continuing operations	49,063	(15,719)	5,849	7,218	71,826
Discontinued operations	10,283	(19,667)	636	478	11,041
	\$ 59,346	\$ (35,386)	\$ 6,485	\$ 7,696	\$ 82,867

Year Ended December 31, 2001	Revenue	Divisional Earnings (Loss)	Depreciation and Amortization	Capital Expenditures	Non-cash Assets December 31, 2001
Nucryst Pharmaceuticals	\$ 9,835	\$ (6,220)	\$ 408	\$ 546	\$ 5,998
iFire Technology	4,272	(10,052)	2,874	1,459	19,167
Ambeon	36,160	7,729	1,480	3,228	43,686
Other	-	(927)	789	442	14,101
Continuing operations	50,267	(9,470)	5,551	5,675	82,952
Discontinued operations	18,616	(23,255)	4,006	2,144	16,854
	\$ 68,883	\$ (32,725)	\$ 9,557	\$ 7,819	\$ 99,806

Direct export shipments for continuing operations amounted to \$43,851 (2001 - \$44,508). These exports were to customers in the United States \$28,767 (2001 - \$30,723), Europe \$9,117 (2001 - \$11,587), Asia \$5,927 (2001 - \$2,157) and South America \$40 (2001 - \$41).

In 2002, Ambeon recorded revenue from a customer of \$9,791 (2001 - \$10,883), which represents 20.0% (2001 - 21.7%) of revenue from continuing operations of the Company.

**22 COMPARATIVE FIGURES**

Certain 2001 figures have been reclassified to conform to the presentation of the current year.