

Normiska Corporation
Consolidated Financial Statements
October 31, 2004 and 2003

Normiska Corporation

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October 31, 2004 and 2003

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Auditors' Report

To the Shareholders of
Normiska Corporation

We have audited the consolidated balance sheets of Normiska Corporation as at October 31, 2004 and 2003 and the consolidated statements of operations and deficit and cash flows for the years 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 audits.

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 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed: *"Moore Stephens Cooper Molyneux LLP"*

Chartered Accountants

Toronto, Ontario
December 8, 2004

Normiska Corporation

Consolidated Balance Sheets

October 31, 2004 and 2003

	2004	2003 (Restated - see note 4)
Assets		
Current assets		
Accounts receivable	\$ 1,025,762	\$ 1,172,351
Inventory	1,269,184	2,541,138
Prepaid expenses	129,435	133,166
	2,424,381	3,846,655
Bog development costs (note 6)	990,194	1,152,144
Deferred costs (note 7)	-	133,878
Property, plant and equipment (note 8)	5,070,409	5,203,300
	\$ 8,484,984	\$ 10,335,977
Liabilities		
Current liabilities		
Bank indebtedness	\$ 34,007	\$ 2,193,055
Accounts payable and accrued liabilities	1,281,387	1,744,233
Term loans (note 9)	125,000	1,325,000
Demand loans (note 10)	3,149,256	125,000
Due to related parties (note 11)	534,560	-
Current portion of long-term debt (note 12)	492,114	133,277
	5,616,324	5,520,565
Long-term debt (note 12)	573,275	123,526
Convertible debt (note 13)	350,000	350,000
Convertible debenture (note 14)	150,000	150,000
	6,689,599	6,144,091
Shareholders' equity		
Share capital (note 15)	5,431,838	5,240,588
Deficit	(3,636,454)	(1,048,702)
	1,795,384	4,191,886
	\$ 8,484,983	\$ 10,335,977

The accompanying notes are an integral part of these financial statements.

Approved on behalf of the Board

Signed: "John M. Arnold"

Signed: "Peter J. Goodwin"

Normiska Corporation

Consolidated Statements of Operations and Deficit for the years ended October 31, 2004 and 2003

	2004	2003 (Restated - see note 4)
Sales	\$ 5,914,186	\$ 8,546,649
Cost of goods manufactured		
Raw materials, site and processing costs	3,387,973	4,130,554
Labour	779,306	954,805
	4,167,279	5,085,359
Distribution and selling costs	1,396,291	1,827,309
	5,563,570	6,912,668
Gross profit	350,616	1,633,981
Administrative expenses		
Salaries and benefits	406,600	381,295
Office	341,417	308,863
Professional fees	53,182	91,085
Marketing and product development	24,758	116,071
	825,957	897,314
(Loss) income before the undernoted	(475,341)	736,667
Interest - long-term debt	262,899	223,846
Interest - other	50,250	42,885
Amortization of plant and equipment	359,001	333,135
Amortization of deferred costs	-	50,252
Amortization of bog development costs	74,114	73,471
Loss on disposal of equipment	38,484	-
Write-off of bog development costs	87,158	-
Restructuring costs (note 17)	1,240,505	-
	2,112,411	723,589
(Loss) income before provision for income taxes	(2,587,752)	13,078
Provision for future income taxes (note 18)	-	520,000
Net loss for the year	(2,587,752)	(506,922)
Deficit, beginning of year	(1,048,702)	(541,780)
Deficit, end of year	\$ (3,636,454)	\$ (1,048,702)
Loss per share (note 19)		
Basic loss per share	\$ (0.25)	\$ (0.06)
Diluted loss per share	\$ (0.25)	\$ (0.06)

The accompanying notes are an integral part of these financial statements.

Normiska Corporation

Consolidated Statements of Cash Flows for the years ended October 31, 2004 and 2003

	2004	2003 (Restated - see note 4)
Cash flow from operating activities		
Net loss for the year	\$ (2,587,752)	\$ (506,922)
Items not affecting cash		
Amortization	433,115	456,858
Write-off of deferred costs	133,878	-
Provision for future income taxes	-	520,000
Loss on disposal of equipment	38,484	-
Write-off of bog development costs	87,158	-
Expenses accrued as due to related parties	152,100	-
	(1,743,017)	469,936
Net change in non-cash working capital balances <i>(note 20)</i>	959,428	481,876
	(783,589)	951,812
Cash flow from investing activities		
Additions to plant and equipment	(108,414)	(595,615)
Expenditures on deferred costs	-	(70,501)
Proceeds on disposal of equipment	21,100	-
	(87,314)	(666,116)
Cash flow from financing activities		
(Decrease) increase in bank indebtedness	(2,159,048)	143,864
Proceeds from convertible debenture	-	150,000
Repayment of convertible debenture	-	(137,831)
Proceeds from related party loans	382,460	-
Proceeds from long-term debt	929,150	-
Repayment of long-term debt	(297,164)	(246,729)
Proceeds from term loan	-	125,000
Repayment of term loan	(1,200,000)	(320,000)
Proceeds from demand loan	3,024,255	-
Issue of common shares	191,250	-
	870,903	(285,696)
Increase in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$ -	\$ -

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

1. Nature of Operations and Going Concern

Normiska Corporation ("the Company") was incorporated on January 17, 1997 under the laws of Ontario. The Company expands vermiculite and perlite at its plant in Lachine, Quebec. The Company is also developing and harvesting sphagnum peat moss at its bogs in the Fort Frances area, as well as processing pine bark into compost and mulch in Fort Frances, Ontario. All of the above products are sold to the horticultural industry for use in soil-less growing mediums, soil conditioning and landscaping products.

The Company incurred a net loss of \$2,975,645 as at October 31, 2004 and has an accumulated deficit of \$3,549,296. Working capital is not sufficient to meet current obligations. Accordingly, the Company's ability to continue as a going concern depends on its ability to achieve profitability, maintain current financing and obtain new sources of financing. Management is actively pursuing additional sources of financing and business opportunities for the Company.

The consolidated financial statements have been prepared assuming the Company will be able to realize its assets and discharge its liabilities in the normal course of business as a going concern. These financial statements do not include any adjustments to the carrying values of assets and liabilities that may be necessary should the Company be unable to continue as a going concern.

2. Significant Accounting Policies

Basis of presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

Principles of consolidation

On August 31, 1997, the Company acquired 100% of the issued and outstanding shares of Normiska Peat Inc. ("Peat"), a company which was previously controlled by the shareholders of the Company. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Peat. All significant intercompany accounts and transactions have been eliminated.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management judgement include estimating the useful lives of property, plant and equipment and bog development costs, as well as assessing the recoverability of inventories, long-lived assets and future income tax assets. The reported amounts and note disclosures are determined to reflect the most probable set of economic conditions and planned course of action. Actual results could differ from these estimates.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

2. Significant Accounting Policies - continued

Measurement uncertainty - continued

The Black Scholes option valuation model used by the Company to determine fair values, was developed for use in estimating the fair value of freely traded options. In addition, this model requires the input of highly subjective assumptions including future stock price volatility and expected time until exercise. Because the Company's outstanding stock options have characteristics which are significantly different from those of traded options, and because changes in any of the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of the fair value of its stock options.

Inventory

Raw materials are valued at the lower of cost and replacement cost. Finished goods are valued at the lower of cost and net realizable value. Cost is determined using the weighted average cost method.

Bog development costs

These costs consist of the direct costs of opening, draining and grooming portions of the bog. Also included are costs related to the acquisition and maintenance of the site and the lease such as royalties, land taxes, insurance and legal fees. Initial costs related to the development of the bark by-product/peat processing facility and the development of the products to be produced have been deferred. These costs are being amortized on a straight-line basis over twenty years following completion of the development phase of each portion of the bog. Any costs related to the research on the products to be produced are written off in the year these costs are incurred.

Deferred marketing costs

These costs consist of acquiring marketing data, communicating with potential product users and investigating product delivery costs. These costs are being amortized on a straight-line basis over three years.

Deferred financing costs

These costs consist of charges related to debt financing. These costs are amortized on a straight-line basis over the term of the related debt.

Property, plant and equipment

Property, plant and equipment are recorded at cost. Amortization is provided over the related assets' estimated useful lives using the following methods and annual rates:

Building	-	20	years straight line
Bark Pad	-	20	years straight line
Office improvements	-	3	years straight line
Perlite plant equipment	-	10	years straight line
Bark and peat facility equipment	-	20	years straight line
Equipment under capital lease	-	10 - 20	years straight line
Automobile	-	3	years straight line
Computer equipment	-	3	years straight line
Furniture and fixtures	-	5	years straight line

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

2. Significant Accounting Policies - continued

Impairment of long-lived assets

Effective November 1, 2003, the Corporation adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3063, Impairment of Long-Lived Assets. Under this standard, long-lived assets held for use are reviewed for impairment when events or changes in circumstances indicate that its carrying value may not be recoverable. When the carrying value is not recoverable from future cash flows on an undiscounted basis and the carrying value exceeds the assets' fair value, an impairment loss is recorded for the excess of carrying value over fair value. The adoption of these recommendations had no impact on the results of operations for the year 2004.

Revenue recognition

Revenue is recognized when goods are shipped, all significant risks and rewards of ownership have passed to the customer and collection is reasonably assured.

Earnings (loss) per share

The basic earnings (loss) per share has been calculated based upon the weighted average number of common shares outstanding during the year. The treasury stock method is used to calculate diluted earnings per share and assumes any option proceeds would be used to purchase common shares at the average market price during the year. Stock options and warrants outstanding are not included in the computation of diluted earnings per share if their inclusion would be anti-dilutive.

Stock-based compensation

The Company has in effect a stock-based compensation plan, which is described in note 16. All stock-based awards granted to non-employees are measured and recognized using a fair value-based method. Stock-based awards granted to employees on or after November 1, 2003 are accounted for using the fair value-based method as described in note 3. For stock-based awards granted to employees prior to November 1, 2003, pro forma disclosure of net earnings (loss), pro forma basic earnings (loss) per share and pro forma diluted earnings (loss) per share were provided as if these awards were accounted for using the fair value-based method. Fair value is calculated using the Black Scholes model with the assumptions described in note 16. Consideration paid on the exercise of stock options is credited to share capital.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs.

Reclassifications

Certain amounts from prior years have been reclassified to conform to the current year's presentation.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

3. Change in Accounting Policy

Stock-based compensation

Effective November 1, 2003 the Company prospectively adopted the fair value based method for stock-based compensation in accordance with the recommendation of Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", issued by the CICA. Under the new policy, compensation expense for stock options and amounts paid to employees and consultants is accounted for using the fair value-based method as described in note 2. The adoption of these recommendations had no impact on the results of operations for the year 2004.

4. Restatements

In connection with the preparation of the Company's fiscal 2004 annual results, the Company determined that it's previously published financial statements for the year ended October 31, 2003 reflected an overstatement in the likely realization of the future tax asset. The following presents the details of amounts restated in the 2003 comparative figures:

Future tax asset decrease of	\$	520,000
Deficit increase of	\$	520,000
Net income decrease of	\$	520,000
Basic and diluted loss per share increase of	\$	0.06

This restatement has no effect on the current year.

5. Results by Business Segments

The Company manufactures and markets products used in the manufacture of soil-less growing mediums and soil augmentation products. The Company evaluates the performance of its products based on geographic markets: Canada and United States.

The management of the Company evaluates the performance of each geographic segment based on income (loss) from operations before interest, amortization and incomes taxes.

The accounting policies used in these business segments are the same as those described in the summary of significant accounting policies.

	Canada	United States	2004 Total
Sales	\$ 3,781,474	\$ 2,132,712	\$ 5,914,186
Cost of goods manufactured	(2,672,119)	(1,495,160)	(4,167,279)
Distribution and selling costs	(463,370)	(932,921)	(1,396,291)
Gross profit	645,985	(295,369)	350,616
Administrative expenses	(529,084)	(296,873)	(825,957)
Income (loss) before the undernoted	116,901	(592,242)	(475,341)
Interest	(200,224)	(112,925)	(313,149)
Amortization	(224,584)	(208,531)	(433,115)
Loss on disposal of equipment	(38,484)	-	(38,484)
Write-off of bog development costs	(8,080)	(79,078)	(87,158)
Restructuring costs	(114,999)	(1,125,506)	(1,240,505)
Loss before income taxes	\$ (469,470)	\$ (2,118,282)	\$ (2,587,752)

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

5. Results by Business Segments - continued

	Canada	United States	2003 Total
Sales	\$ 5,297,366	\$ 3,249,283	\$ 8,546,649
Cost of goods manufactured	(4,068,287)	(1,017,072)	(5,085,359)
Distribution and selling costs	(931,928)	(895,381)	(1,827,309)
Gross profit	297,151	1,336,830	1,633,981
Administrative expenses	(466,603)	(430,711)	(897,314)
Income (loss) before the undernoted	(169,452)	906,119	736,667
Interest	(170,708)	(96,023)	(266,731)
Amortization	(223,860)	(232,998)	(456,858)
Income (loss) before income taxes	\$ (564,020)	\$ 577,098	\$ 13,078

All property, plant and equipment are located in Canada at October 31, 2004 and 2003.

6. Bog Development Costs

	Cost	Accumulated Amortization	2004 Net Book Value
Development	\$ 1,390,303	\$ 400,109	\$ 990,194

	Cost	Accumulated Amortization	2003 Net Book Value
Development	\$ 1,492,499	\$ 340,355	\$ 1,152,144

In 2004, the Company wrote-off bog development costs with a net book value of \$87,158.

7. Deferred Costs

	Cost	Accumulated Amortization	2003 Net Book Value
Marketing	\$ 140,343	\$ 140,343	\$ -
Financing	189,320	100,896	88,424
Thamesville start up	45,454	-	45,454
	\$ 375,117	\$ 241,239	\$ 133,878

In 2004, the Company wrote-off all deferred costs as a part of the corporate restructuring that took place during the year. Amortization of deferred costs amounted to \$NIL (2003 - \$113,765) and is included in cost of goods manufactured.

Normiska Corporation

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

8. Property, Plant and Equipment

			2004
	Cost	Accumulated Amortization	Net Book Value
Land	\$ 558,478	\$ -	\$ 558,478
Building	484,016	128,027	355,989
Bark Pad	438,283	109,281	329,002
Office improvements	20,407	18,915	1,492
Equipment	4,859,778	1,511,535	3,348,243
Equipment under capital lease	564,438	96,524	467,914
Automobile	15,749	15,749	-
Computer equipment	94,330	88,280	6,050
Furniture and fixtures	18,349	15,108	3,241
	\$ 7,053,828	\$ 1,983,419	\$ 5,070,409
			2003
	Cost	Accumulated Amortization	Net Book Value
Land	\$ 558,478	\$ -	\$ 558,478
Building	410,676	106,206	304,470
Bark Pad	438,283	87,367	350,916
Office improvements	20,407	15,334	5,073
Equipment	4,725,870	1,196,531	3,529,339
Equipment under capital lease	619,453	189,190	430,263
Automobile	15,749	15,140	609
Computer equipment	94,330	71,639	22,691
Furniture and fixtures	15,565	14,104	1,461
	\$ 6,898,811	\$ 1,695,511	\$ 5,203,300

9. Term Loans

	2004	2003
Bank of Montreal demand term loan repayable with interest at prime rate plus 1.5% and monthly principal payments of \$26,667, secured by a general security agreement. (i)	\$ -	\$ 1,200,000
Rainy River Future Development Corporation demand term loan bearing interest at prime rate plus 3.0%, requiring minimum payments of \$3,054 per month. The loan is secured by a charge on specific inventory. (ii)	125,000	125,000
	\$ 125,000	\$ 1,325,000

(i) The Bank of Montreal term loan was acquired by three private lenders in exchange for demand loans as part of the restructuring.

(ii) Rainy River Future Development Corporation has agreed to take shares of the Company to settle the outstanding balance subsequent to the year end.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

10. Demand Loans

	2004	2003
Loans repayable on demand bearing interest at 8% per annum secured by a general security agreement.	\$ 3,024,256	\$ -
Loans repayable, unsecured, due on demand bearing interest at 9% per annum.	125,000	125,000
	\$ 3,149,256	\$ 125,000

Included in the demand loans is a loan for \$1,572,600 that is payable to two shareholders of the Company and a \$50,000 loan is payable to a party related to an officer of the Company.

11. Due to Related Parties and Related Party Transactions

During the year, the Company entered into loan and other agreements with officers and shareholders of the Company. The loans are unsecured. The terms of the agreements are as follows:

	2004	2003
Promissory note bearing interest at 8% per annum, with no specific terms of repayment and is secured by a general security agreement (i)	\$ 105,000	\$ -
Loans bearing no interest with no specific terms of repayment and is secured by a general security agreement (i)	80,000	-
Loans bearing interest at 8% per annum, due August, 2005 and is secured by a general security agreement (i)	197,460	-
Restructuring fee payable (ii)	83,700	-
Financing fee payable (iii)	68,400	-
	\$ 534,560	\$ -

(i) The general security agreements are subordinated to the security agreement covering the \$3,024,256 demand loans (note 10).

(ii) A restructuring fee payable to a shareholder of the Company for corporate reorganization services that were provided during the year.

(iii) A 7% financing fee payable to the lenders of the loans totaling \$120,000 and a 15% financing fee payable to the lenders of the loans totaling \$397,460. The total of these fees is \$68,400.

In addition, the Company had the following related party transactions:

- a) During 2003, a shareholder advanced \$300,000 to the Company to help finance the purchase of inventory and charged a 10% financing fee. The advance was repaid by October 31, 2003.
- b) During 2004, the Company paid consulting fees of \$37,823 to officers of the Company. These transactions were conducted in the normal course of business and are measured at the exchange value, which is the amount of consideration established and agreed to by the parties.
- c) Total interest paid and accrued on all related party advances and loans from related parties totaled to \$112,949 (2003 - \$16,500).

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

12. Long-Term Debt

	2004	2003
Promissory note (US \$450,000) bearing no interest, repayable at \$30,450 (US \$25,000) quarterly, due June 2009 and is secured by a general security agreement	\$ 557,179	\$ -
Term loan bearing interest at 8% per annum, due August 2005 and is secured by a general security agreement (i)	200,000	-
Term loan bearing interest at 10% per annum, with no specific terms of repayment and is secured by a general security agreement (i)	40,000	-
Equipment loans repayable at interest rates ranging from 8.5% to 10.67% per annum, requiring monthly payments of \$9,107. Specific equipment has been pledged as security.	10,310	95,006
Promissory note bearing no interest, with no specific terms of repayment	34,100	41,000
Capital lease obligations repayable at interest rates ranging from 5% to 6.65% per annum, over terms of 36 to 60 months and requiring monthly payments of \$8,027.	223,800	120,797
	1,065,389	256,803
Less: Current portion	492,114	133,277
	\$ 573,275	\$ 123,526

Principal payments required on long-term debt are as follows:

2005	\$ 492,114
2006	210,676
2007	172,636
2008	121,800
2009	68,163
	\$ 1,065,389

(i) The general security agreements are subordinated to the security agreement covering the \$3,024,256 demand loans (note 10).

13. Convertible Debt

Convertible debt has no fixed terms of principal repayment. Interest is calculated at prime rate plus 2% per annum. The debt is convertible into common shares of the Company at the lender's option at any time the Company issues a prospectus at the maximum discount allowed by the Ontario Securities Commission.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

14. Convertible Debenture

On September 5, 2003 the Company issued a convertible debenture due on September 5, 2008 for \$150,000 to a shareholder. Interest at the rate of 8% per annum, calculated semi-annually, is payable quarterly in arrears on the last day of November, February, May and August until 2006. From then, the Company is required to make quarterly installments of \$20,476 including principal and interest.

The holder of the debenture has the option to convert it in whole or in part in multiples of \$1,000 into common shares of the Company at a price of \$0.22 per share.

15. Share Capital

Authorized		
Unlimited	Common shares	
Issued	Shares	Amount
Balance at October 31, 2002 and 2003	9,209,344	\$ 5,240,588
Issued on reduction of loan (i)	1,500,000	191,250
Balance at October 31, 2004	10,709,344	\$ 5,431,838

(i) On March 12, 2004, the Company issued 1,500,000 common shares valued at \$191,250 in consideration for the reduction of the Bank of Montreal loan as part of the corporate restructuring.

16. Stock-Based Compensation

The Company has in effect a Stock Option Plan ("the Plan") that provides for the potential grant of up to 2,250,000 options to directors, officers, employees and service providers. The terms of the awards under the Plan are determined by the Board of Directors. A summary of the status of the Company's stock option plan as of October 31, 2004 and 2003 and changes during the years ending on those dates is presented below.

	2004		2003	
	Number of Options	Weighted-Average Exercise Price	Number of Options	Weighted-Average Exercise Price
Outstanding, beginning of year	1,990,000	\$ 0.39	875,000	\$ 1.00
Granted	-	\$ -	1,385,000	\$ 0.17
Expired	(330,000)	\$ 0.29	(250,000)	\$ 1.00
Cancelled	(600,000)	\$ 0.17	(20,000)	\$ 0.75
Outstanding, end of year	1,060,000	\$ 0.54	1,990,000	\$ 0.39

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

16. Stock-Based Compensation - continued

The weighted average remaining contractual life and weighted average exercise price of options outstanding and of options exercisable as at October 31, 2004 are as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Exercise Price
\$ 0.17	630,000	\$ 0.17	3.90	630,000	\$ 0.17
\$0.90 - \$1.15	430,000	\$ 1.07	0.36	430,000	\$ 1.07
	1,060,000	\$ 0.54	2.47	1,060,000	\$ 0.54

Pro forma stock option disclosure

The fair value of stock options granted in the prior year were estimated at \$0.02 per option using the Black-Scholes model for pricing options. The following assumptions were used:

	2003
Risk free interest rate	3.80 %
Dividend yield	NIL
Expected stock volatility	22 %
Expected life	5 years

The weighted-average fair value of the stock options re-valued in the prior year were estimated at \$0.01 per option using the Black-Scholes model for pricing options. The following weighted-average assumptions are used:

	2003
Risk free interest rate	2.42 %
Dividend yield	NIL
Expected stock volatility	22 %
Expected life	1.40 years

Had the fair value based method been used for stock options granted and re-valued in the year 2003, the Company's net loss for the year ended October 31, 2003 would have increased by \$35,500. There would be no change to the basic loss per share and exercise of the outstanding stock options would still be anti-dilutive.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

17. Restructuring Costs

During the year the Company incurred \$1,240,505 in restructuring costs related to the corporate reorganization that occurred during the year. These restructuring costs are as follows:

Write-down of inventory	\$	914,203
Write-off of current year financing costs		110,269
Write-off of deferred financing costs		88,424
Restructuring fees		83,700
Write-off of Thamesville deferred costs		45,454
Write-off of current year Thamesville expenditures		35,124
Reduction of accounts payable on restructuring		(36,669)
	\$	1,240,505

18. Income Taxes

a) Provision for Income Taxes

The reconciliation of income taxes attributable to operations computed at the statutory tax rates to income tax provision, using a statutory tax rate of 34.44% (2003 - 36.62%) at October 31, 2004 and 2003, are as follows:

	2004	2003 (Restated - see note 4)
Income tax payable (recoverable) at statutory rate	\$ (891,143)	\$ 4,789
Increase (decrease) resulting from:		
Change in valuation allowance	-	520,000
Amortization in excess of CCA	150,924	119,670
Non deductible expenses	237,927	2,803
Non-capital loss carryforward (utilized)	502,292	(127,262)
Provision for income taxes	\$ -	\$ 520,000
Provision for income taxes - current	\$ -	\$ -
- future	\$ -	\$ 520,000

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

18. Income Taxes - continued

b) Future Income Taxes

Significant components of the Company's future tax assets are as follows as at October 31, 2004 and 2003:

	2004	2003 (Restated - see note 4)
Long-Term		
Plant and equipment - difference between book value and tax value	\$ 288,204	\$ 169,937
Non-capital loss carryforwards	947,560	255,832
Deferred costs - difference between book value and tax value	26,963	32,293
Other	75,914	16,989
Future Income Tax Assets, before valuation allowance	1,338,641	475,051
Valuation allowance	(1,338,641)	(475,051)
Net Future Income Tax Assets	\$ -	\$ -

The timing of the utilization of the future income tax assets is undeterminable. Consequently, a full valuation allowance has been provided against future value of the assets.

c) Tax Loss Carry-Forwards

The Company has \$2,151,000 of non-capital losses carried forward available to reduce future taxable income. The non-capital losses expire as follows:

2006	\$ 174,000
2007	322,000
2009	196,000
2014	1,459,000
	\$ 2,151,000

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

19. Loss Per Share

The following table sets forth the computation of basic and diluted loss per common share:

	2004	2003 (Restated - see note 4)
Numerator:		
Net loss attributable to common shareholders		
- basic and diluted	\$ (2,587,752)	\$ (506,922)
Denominator:		
Weighted average common shares outstanding		
- basic and diluted	10,170,988	9,209,344
Basic loss per common share	\$ (0.25)	\$ (0.06)
Diluted loss per common share	\$ (0.25)	\$ (0.06)

The conversion of the convertible debentures and certain of the stock options outstanding at October 31, 2004 and 2003 are anti-dilutive.

20. Supplementary Cash Flow Information

	2004	2003
Net change in non-cash working capital items:		
Accounts receivable	\$ 146,589	\$ 63,609
Inventory	1,271,954	471,753
Prepaid expenses	3,731	(23,280)
Accounts payable and accrued liabilities	(462,846)	(30,206)
Net change in non cash working capital	\$ 959,428	\$ 481,876
Other information:		
Interest paid	\$ 225,030	\$ 266,731
Income and capital taxes paid	\$ 8,980	\$ 11,963

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

21. Commitments and Contingencies

(iv) Crown lease and royalties on the peat bog land

Under a crown lease which was legally transferred to Peat in March 1992, Peat is committed to annual lease payments of \$1,130. This lease extends to December 2024. In addition to this annual rental, Peat is required to pay royalties of \$0.20 per cubic metre of peat removed from the premises. On November 15, 1991, with governmental approval, Peat acquired the crown lease from Frederick J. Atkinson. As consideration for this transfer, Peat, during the years 1992, 1993 and 1994, paid Mr. Atkinson a total of \$50,000. In fiscal 1995, and thereafter, the Company is committed to make annual payments of the greater of \$5,000 or a sum equal to 5% of net profits derived from the peat operations.

(v) Use of peripheral lands

Under two agreements with owners of lands bordering on the peat bog land, Peat is committed to annual lease payments of \$200 plus \$0.20 per cubic metre of peat removed from the premises. Should there be no production in any given year, an advance royalty of \$500 must be paid, to be deducted from future royalties. One agreement, dated November 23, 1993, relates to the area of the peat bog located on the south half of Lot 1, concession 3, Township of Burris, Ontario. The other agreement, dated October 29, 1993, relates to the area of the peat bog located on the north half of Lot 1, Concession 3, Township of Burris, Ontario.

(vi) Bark supply agreement

In September 1997, the Company signed a twenty year "Surplus Bark Supply Agreement" with Abitibi Consolidated Inc. ("ACI") whereby ACI, for the initial three years, paid a fee to the Company of \$3.75 per cubic metre of bark waste removed from its Fort Frances mill site with a minimum of 100,000 cubic metres and a maximum of 225,000 cubic metres per annum. In 2001, the Company and ACI have negotiated a new fee equal to the Company's cost to transport the bark waste to its facilities.

(vii) Lease and royalty on peat bog land

Peat entered into an agreement with ACI on September 1, 1999 where Peat has an exclusive right and privilege to remove, process and sell any peat within upon or under the premise subject to an agreed rent and royalty. This lease extends to June 30, 2009. Rent for the terms are as follows:

<i>July 1, 2004 to June 30, 2005</i>	minimum of \$35,000
<i>July 1, 2005 to June 30, 2009</i>	minimum of \$50,000

In addition to the rent, a royalty on all peat removed from the premises at a rate of \$0.20 per cubic metre for the first 100,000 cubic metres and \$0.40 per cubic metre for each metre in excess of 100,000 cubic metres is payable to ACI.

Notes to Consolidated Financial Statements

October 31, 2004 and 2003

21. Commitments and Contingencies - continued

(viii) **Remuneration of an officer**

Subject to regulatory approval, the President of the Company, effective October 1, 2004, has been granted remuneration of 60,000 common shares per month for twelve months and a bonus of 500,000 shares at the end of twelve months of employment valued at \$0.064 per share. None of these shares were issued as of October 31, 2004.

(ix) **Operating leases**

At October 31, 2004, the Company was committed to rental lease payments for its premises and equipment lease payments in the following amounts:

	Rental	Equipment	Total
2005	\$ 52,459	\$ 112,494	\$ 164,953
2006	15,400	92,805	108,205
2007	12,833	37,915	50,748
	<u>\$ 80,692</u>	<u>\$ 243,214</u>	<u>\$ 323,906</u>

22. Financial Instruments

Credit risk

The Company is exposed to credit risk on the accounts receivable from clients. In order to reduce its credit risk, the Company has adopted credit policies which include the regular review of outstanding accounts receivable. The Company does not have a significant exposure to any individual clients or counterparty.

Fair value

The carrying amount of accounts receivable, bank loans, accounts payable and accrued liabilities approximates their fair value because of the short-term maturities of these items. The carrying value of loans payable approximate fair value based on current rates at which the Company could borrow funds with similar remaining maturities. The fair value of loans payable to related parties cannot be reasonably determined due to their related party nature, the absence of secondary markets and the significant cost of obtaining appraisals.

Interest rate risk

The Company has debts which bear interest at floating rates. These financial instruments constitute a risk to which the Company is exposed in the event of a fluctuation of the prime rate. The Company does not enter into any interest rate hedging transactions to counter exposures to increases in interest rates.