

# Industry Report Healthcare

January 19, 2007

## Investment Thesis

*Sound Potential For Explosive Growth*

## Recommendation:

- **Sonomax Hearing Healthcare Inc.** Buy (S)

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## “Sound Potential For Explosive Growth”

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## Investment Summary

We rate Sonomax Hearing Healthcare a **Speculative Buy** with a one-year share price target of **\$0.40**, implying a total return of **105%**. Sonomax is a small-cap manufacturer of a variety of custom-made instant fit hearing and communication devices. We believe Sonomax is well positioned for revenue growth. Key drivers behind this include aggressive distribution strategy under a licensee-model, successful differentiation from competitors with a first-in-class hearing protection solution and a best performance-for-price hearing aid, and strong pipeline of products.

We believe the hearing care industry offers interesting growth opportunities. Hearing loss is one of the most prevalent chronic health conditions in the US with over 10% of the population having some degree of hearing impairment.

**Overexposure to noise is the major cause of hearing loss.** Even if it is easily preventable, end users do not always comply with safety recommendations. The main reasons for not using hearing protectors include lack of comfort and convenience, high cost, and difficulty to communicate or hear important sounds. The global hearing protection market (over US\$500 million) is mature, highly consolidated and saturated with products. Changing attitudes and the constant introduction of stricter regulations should ensure the market remains dynamic. Key drivers to win market share are cost-competitiveness, product innovation, and brand name recognition.

**Seventy-five percent of those suffering from hearing loss do not actually wear a hearing aid.** Major barriers to adoption include high cost, lack of comfort or efficiency, and stigma. At the wholesale level, the global hearing aid market (over US\$3 billion) is highly consolidated with six players holding an aggregate market share of over 85%. At the retail level, the global hearing aid market (over US\$7 billion) is highly fragmented between numerous small independent practices. Key drivers to win market share in the hearing aid market are quality, affordability and service.

### Company Rating And Recommendation

Company	Ticker	Rating*	Last 1/19/2007	1-Yr Target	Dividend	ROR
Sonomax Hearing Healthcare Inc.	SHH-V	B (S)	\$0.20	\$0.40	-	105%

\*B (S) = Buy (Speculative)

Source: Bloomberg; Laurentian Bank Securities (LBS) estimates



## Sonomax Hearing Healthcare Inc. (SHH-V)

**Buy (S) – Target Price: \$0.40**

### Company Profile

Sonomax specializes in the research, development and manufacturing of custom-made instant fit hearing and communication devices based on its patented in-ear expansion technology. The company operates in three markets: hearing protection, hearing enhancement, and communication devices.

We are initiating coverage on Sonomax with a **Speculative Buy rating** and a **one-year share price target of \$0.40**. This implies a total return of 105%. Our target is based on a DCF using a WACC of 10%. We have a share risk rating of High.

We highlight the following:



Source: BigCharts.com

Market Data					
Ticker	SHH-V	Shares O/S (M)	109.2		
Rating	Buy (S)	Market Cap (M)	\$21.3		
Risk	High	Float O/S (M)	109.2		
Price	\$0.20	Float Value (M)	\$21.3		
1-Yr Target	\$0.40	Avg Daily Volume (K)	81.1		
Dividend	\$0.00	Control Blocks	-		
1-Yr ROR	105%				
Valuation	DCF, WACC = 10%				
Fully Diluted EPS (December 31 Year End)					
	Q1	Q2	Q3	Q4	Annual
F2006	(\$0.02) A	(\$0.01) A	(\$0.02) A	(\$0.01)	(\$0.06)
F2007	(\$0.01)	(\$0.01)	(\$0.01)	\$0.00	(\$0.03)
F2008	\$0.01	\$0.01	\$0.00	\$0.01	\$0.03
F2009	\$0.01	\$0.01	\$0.01	\$0.02	\$0.05
Source: Company reports; LBS estimates					

- Strong hearing care fundamentals:** Sonomax is well positioned to benefit from the growth opportunities in the hearing care market.
- Aggressive distribution strategy:** Under a licensee-model, Sonomax is building a network of strategic partnerships. During Q3/06, two major milestones were reached: 1) an agreement with Aearo Technologies, the global hearing protection leader, and 2) the opening of a first HearATLast store within a Wal-Mart.
- Competitive advantages:** Sonomax offers a first-in-class hearing protection solution and the best performance-for-price hearing aid.
- Important pipeline of products:** Sonomax should commercialize five new products in 2007.
- Solid management:** The company is led by an experienced management team which holds 12.3% of the company's share outstanding.
- Positioned for revenue growth:** Major milestones were accomplished in 2006. Free cash flow should turn positive by 2007 year-end.
- No cash and highly-levered balance sheet:** We believe the company will be forced to seek additional financing in the next months. This will likely take the form of equity.



## Sonomax Hearing Healthcare Inc.

Buy (S), Target \$0.40

We are initiating coverage on Sonomax with a **Speculative Buy** rating and a one-year share price target of **\$0.40**. This target implies a 105% return from current levels and is based on a discounted cash flow model. We have a share risk rating of High.

### Investment Thesis

Positioned For Growth

Sonomax should experience significant revenue growth and an improving balance sheet in 2007. Key drivers behind this include growth opportunities in the hearing loss industry (Appendices I, II, and III), successful differentiation from competitors with a first-in-class earplug and a best performance-for-price hearing aid, and value-added strategic partnerships.

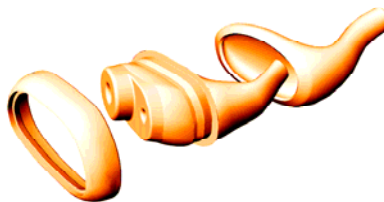
### Company Profile

Offering More Than Just Earplugs

Listed on the TSX Venture Exchange since 2001, Sonomax is specialized in the research, development, and manufacturing of intra-ear technologies. The company operates in three different markets: 1) hearing protection and hearing protector testing, 2) hearing aids, and 3) personal electronic auditory devices. Its core products and technologies are:

- **SonoCustom**, a custom-molded, instant-fit, and reusable earpiece delivered using Sonomax's unique in-ear expansion technology. Made from hypoallergenic medical-grade silicone, the SonoCustom provides a perfect seal against harmful sounds.
- **SonoPlatform**, a SonoCustom earpiece modified to provide a cavity in which a SonoModule is incorporated (Exhibit 1). The SonoModule integrates microchips, electronics, and controls; it was developed by Gennum Corporation (GND-T) exclusively for Sonomax. The SonoPlatform was introduced to the market in September 2005 and allows most in-ear applications including hearing protection, hearing enhancement, and hands free communication devices. In September 2006, the company launched Sono3, a digital hearing aid within a SonoPlatform earpiece.

Exhibit 1 – SonoPlatform



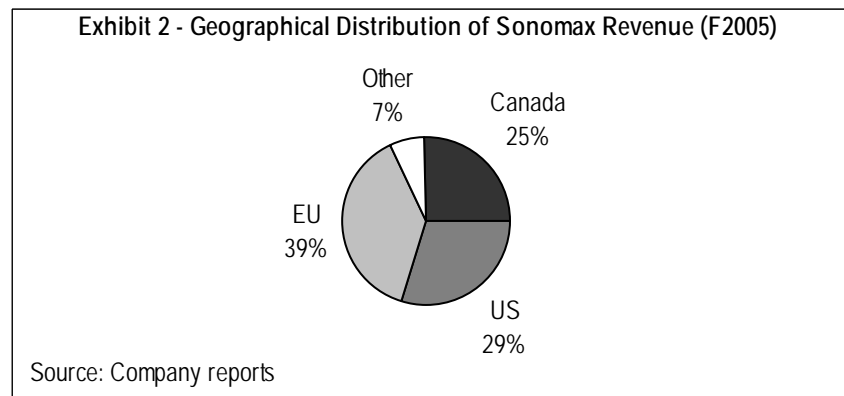
Source: Company reports



- **SonoPass**, a computer-generated validation system which measures sound outside and inside the ear to verify acceptable noise reduction. With this software, the performance of any generic earpiece can be tested.

To date, Sonomax has 26 patents and 16 trademarks granted or pending. Sonomax's products have been approved by many organizations including Health Canada and the FDA. The SonoPass software has also been validated by universities, military contractors, and governmental authorities. In 2005, Sonomax won the prestigious British Safety Industry Federation Product Innovation Award for its SonoCustom technology. There are currently over 30,000 workers using Sonomax's hearing protection solution.

In F2005, Sonomax's hearing protection solution accounted for 100% of net sales (\$1.2 million); 75% of these revenues were generated outside Canada (Exhibit 2). Given Sonomax's recent agreements with Aearo Technologies and the AtLast Group, we expect that this geographic distribution will shift more heavily towards North America in F2006.



## Objectives & Strategy

### Aggressive Distribution Strategy

Sonomax's objective is to offer a wide range of hi-tech, instantly deliverable, and affordable hearing and communication devices all derived from the same underlying product. Management's strategies include:

- 1) Continue to seek and establish strategic alliances worldwide to penetrate the hearing protection market. The main reason for such alliances is to benefit from existing distribution and sales channels. With the hearing protection market controlled by global players, their strong sales and distribution networks make it difficult for newcomers to penetrate the market. Under a licensee model, Sonomax typically exchanges territorial exclusivity for quarterly volume commitments. The most significant partnership was signed in September 2006 with Aearo Technologies, which operates in 70 countries and has a market share in excess of 40% worldwide. We further note that partnerships with industry leaders associate Sonomax with well-recognized brand names, improving credibility.



- 2) **Build up a new business concept with strategic partners to penetrate the hearing aid market.** Sonomax has entered into an exclusive partnership with the AtLast Group, a pioneer in the "made while you wait" eyeglasses (under the name LensCrafters). Sonomax and AtLast are moving into the retail of hearing aids through the launch of hearing centres, named HearAtLast, in large retail stores across Canada. The AtLast Group has a contractual partnership with Wal-Mart Canada which gives it the right to open hearing aid stores within Wal-Mart stores in Canada. In October 2006, Sonomax and the AtLast Group launched their first HearAtLast store within a Wal-Mart store in London, Ontario.
- 3) **Expand its product line.** Sonomax has integrated a variety of products into the SonoPlatform earpiece. Devices in development include: nXZEN Bluetooth Headset, SonoBTE, SonoWired, SonoHunter, and SonoMilitary (Appendix IV). These products should become available in 2007.

## Competitive Analysis

### First-In-Class Hearing Protection Devices

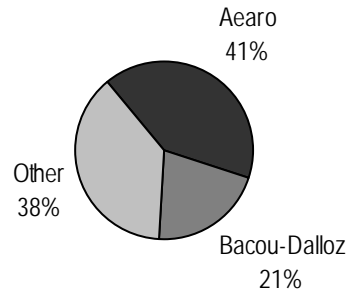
The hearing protection market is mature, and highly price sensitive (Appendix II). Changing attitudes and product innovation should ensure that the market remains dynamic. Sonomax is well positioned to benefit from these changes because of three main competitive advantages:

- **Comfort and performance:** Because it is custom-molded, the SonoCustom is comfortable and provides a perfect acoustic seal every time. A filter that welcomes sounds like voices and music while eliminating hazardous noise is selected according to the end user's noise level environment and inserted into the SonoCustom. This multi-purpose capability is an advantage for workers that need to communicate and hear important noises.
- **Instant delivery:** Compared to traditional custom-molded earplugs that take a few weeks to produce with only varying degrees of success, the SonoCustom fitting session takes about 20 minutes and the SonoPass allows on the spot verification of effectiveness. Sonomax's ability to determine if a wearer is properly protected represents a powerful competitive advantage, given increasingly stringent regulations and that no major player currently offer this service.
- **Cost-competitiveness:** The SonoCustom is priced between \$95 and \$120 and has an estimated life span of three years. Therefore, its average annual cost is between \$32 and \$40. The annual cost of foam plugs for a typical noise-exposed worker is between \$36 and \$90 per year (\$0.08 per pair; 2-5 pairs per day; 225 days per year). However, the SonoCustom price could limit the adoption since the replacement cost is higher if end users lose or do not take good care of their devices.

The hearing protection market is highly consolidated, with two global players having an aggregate market share of over 60% (Exhibit 3). To sustain end user interest, they must continuously fill their pipeline with innovative products. Hence, they establish strategic alliances with small high-tech companies that lack the distribution network. In this mindset, Aearo entered into a partnership with Sonomax to offer the SonoCustom.



Exhibit 3 - Global Hearing Protection Market Share In Dollar (F2005)



Source: Company reports; LBS estimates

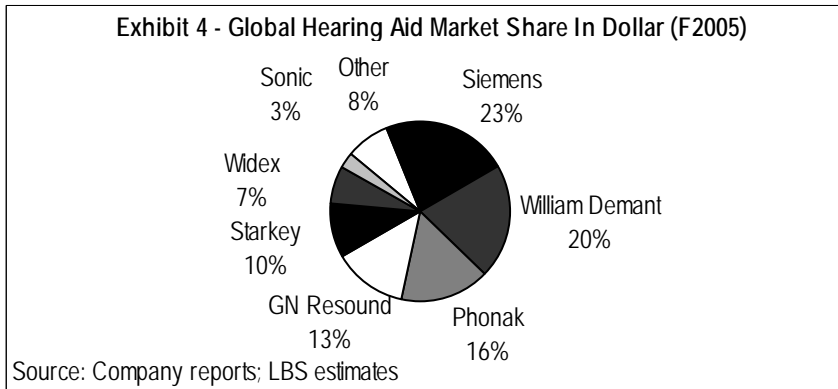
Three private companies offer custom-molded earplugs and thus compete directly with Sonomax: Custom Ear Protect, Insta-Mold, and Westone. It is difficult to determine to what extent these companies represent a threat to Sonomax since they do not divulge much information. However, it is important to note that Sonomax is not the only player in the custom-molded, instant-fit earpiece market. Nevertheless, Sonomax's numerous strategic partnerships should give the company a solid competitive advantage to succeed in this market with high barriers to entry.

### Best Performance-For-Price Hearing Aid

The hearing aid market is well positioned for growth (Appendix III). In fact, 75% of those who could benefit from a hearing aid do not actually wear one. To benefit from this opportunity, Sonomax has launched a digital hearing aid, the Sono3. Its competitive advantages include:

- **Affordability:** Digital hearing aids are typically considered as high-price low-volume products costing between \$4,000 to \$8,000. Sono3's retail price is about \$700 and like any other hearing aid, it is entitled to receive government subsidies (the Ontarian government pays 75% up to a maximum of \$500).
- **Comfort and performance:** Custom-molded with medical-grade silicone, Sono3 is comfortable, easy to insert properly and its in-ear retention is good. It has a perfect acoustic seal and a feedback cancellation program which, together, prevent feedback.
- **Instant delivery:** Sono3 is delivered on the spot in one hour. Since conventional hearing aids take several weeks to be delivered, Sonomax product has the unique advantage of greater accessibility.

Seven hearing aid manufacturers hold an aggregate market share of over 90% (Exhibit 4). To compete with these large players, Sonomax is focused on developing a new niche, with a high-tech, low-price, instant-fit hearing aid. However, with the entry of a low-price competitor in the market, large players could start a price war. In such a situation, Sonomax's distribution strategy should provide a good defense.



## Management Profile

### Solid Management Team

Since they currently own 12.3% of the company, we feel managers' and directors' interests are aligned with those of the shareholders. As at May 30, 2006, no person or institution owned or exercised control over more than 10% of the common shares of Sonomax. Key executives include (Appendix V):

- **Barry Schwartz, CEO and Chairman of the Board:** Mr. Schwartz is responsible for the creation of the strategic course of the company. He has been a professional investor/manager for over 30 years. In that period, Mr. Schwartz was Senior VP of CEMP Investments Ltd. and President, COO, and a shareholder of Claridge Properties Ltd. Mr. Schwartz sat on the Management Committee of the Claridge group of companies. In that capacity, he was involved in investments in many corporations including Cadillac-Fairview, McLeod, Young, Weir (now Scotia McLeod), and Cineplex Odeon.
- **Nick Laperle, President and COO:** Mr. Laperle is lawyer by training and expert in hearing healthcare by experience. He is the eldest son of Mary Jane Gaudet, a pioneer in the Quebec hearing aid industry and an owner of dispensing clinics since 1963, and has had the opportunity to work in the space from an early age. The result of his knowledge and contact base within the industry is an asset in his ability to lead and grow Sonomax. It has also served him well in his Board role at the Deafness Research Foundation, in the US.
- **Adam Schwartz, Executive VP:** Co-founder of Sonomax, Mr. Schwartz is responsible of R&D, Product Commercialization, Production, and the Implementation Training. He also contributes regularly to the strategic planning at the company. Mr. Schwartz is a graduate of McGill University.
- **Claude Allard, former President and director of VitaSound and Senior VP of Sonomax Consumer Division:** Mr. Allard is a former Senior Executive VP of Shoppers Drug Mart (1998-2006) where he spent years successfully implementing retail market expansion. Mr. Allard now sits on the board of directors for Sonomax.

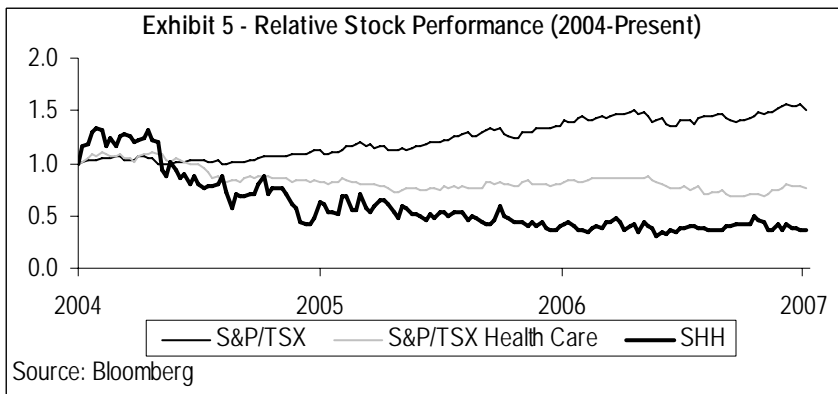


## Recent Results

### A Difficult Third Quarter

Sonomax reported disappointing results in Q3/06. Highlights include the following:

- **Revenues were down 24.6% YOY**, and reached their lowest level since Q3/04. This decrease in sales was due to a decision to hold back the shipment of the SonoCustom in Q2/06 and Q3/06 in order to send the improved version.
- **EBITDA declined to -\$1.4 million in Q3/06 from -\$1.2 million in Q3/05**. This reduction is partly attributable to higher manufacturing costs, which increased 23.8% YOY. The company continued to incur production costs related to the set up of the production lines for the new generation of SonoCustom. Also, SG&A were up by 30.2% YOY due to the cost of stock options that were issued during the quarter.
- **Net earnings, at a loss of \$1.6 million, were stable YOY**. On a per share basis, the company reported a loss of \$0.02 for Q3/06 and Q3/05. Since its operations began in 1998, Sonomax has not generated net earnings. The company shares have underperformed the sector since May 2004 (Exhibit 5).
- **Zero months of cash**. On September 30, 2006, Sonomax had no liquidity, and during the third quarter, -\$1.38 million was lost from operating activities (-\$0.98 million in Q3/05).
- **On November 23, 2006, Sonomax issued 5 million shares at a price of \$0.25, for gross proceeds of \$1.25 million**. According to the management, this cash was to be used to fund the company's working capital.





## Financial Forecast

### Positioned For Revenue Growth

We forecast revenues growth of about 530% in 2007E, 140% in 2008E, 50% in 2009E and 25% in 2010 (Exhibit 6). We believe these forecasts are conservative and below management expectations.

Exhibit 6 - Sonomax Revenue Outlook

(\$M)	2005	2006E	2007E	2008E	2009E	2010E
Hearing Protectors	1.2	1.1	4.6	8.4	12.2	15.2
Tests	0.0	0.0	1.8	3.3	4.8	6.0
Retail Division	0.0	0.0	0.5	4.7	7.6	9.5
<b>Total</b>	<b>1.2</b>	<b>1.1</b>	<b>6.8</b>	<b>16.4</b>	<b>24.6</b>	<b>30.7</b>

Source: Company reports; LBS estimates

### Important Milestones

Major milestones were achieved during 2006 and we believe everything is now in place to generate substantial sales:

- In March 2006, Sonomax concluded an important partnership with Oilind Safety, a leading US safety service supplier. Oilind has agreed to provide clients with on-site fitting and maintenance sessions.
- During Q3/06, Sonomax finalized the development of the improved version of its SonoCustom. The company expects to achieve its original 2006 sales target by making up in Q4 for the shipping that it held back in Q2 and Q3.
- In September 2006, Sonomax acquired VitaSound Audio Inc. VitaSound is a Canadian company specialized in the manufacturing and distribution of hearing aids in North America. The cost to Sonomax for this acquisition was \$100,000 payable in cash, plus a 2% royalty to a maximum of \$200,000 on sales made in the next two years to VitaSound's current customers. The acquisition enables Sonomax to accelerate the commercialization of its Sono3 while diversifying its hearing aid product line. VitaSound offers two ready-to-wear in-the-canal hearing aids: the Vitasound VSD and the Sebotek 210.
- In September 2006, Sonomax signed an important partnership with Aearo. This agreement gives Aearo an exclusive license for the SonoCustom in North America, and a global license for the SonoPass. Sonomax, in return, gains access to an international network of over 30,000 distributors as well as improved recognition and credibility. Aearo agreed to promote the SonoCustom (yellow version) as its premium product under the name CustomE-A-R, co-branded with the label "Powered by Sonomax". In February 2007, Aearo should launch a new version of the SonoPass, under the name EAR Fit validation system. As part of the agreement, Aearo has given Sonomax a US\$200,000 advance for future orders, and a further US\$185,000 for expenses incurred in the commercialization of the new licensed products.
- In October 2006, Sonomax and the AtLast Group launched their first HearAtLast store within a Wal-Mart store in London, Ontario. HearAtLast

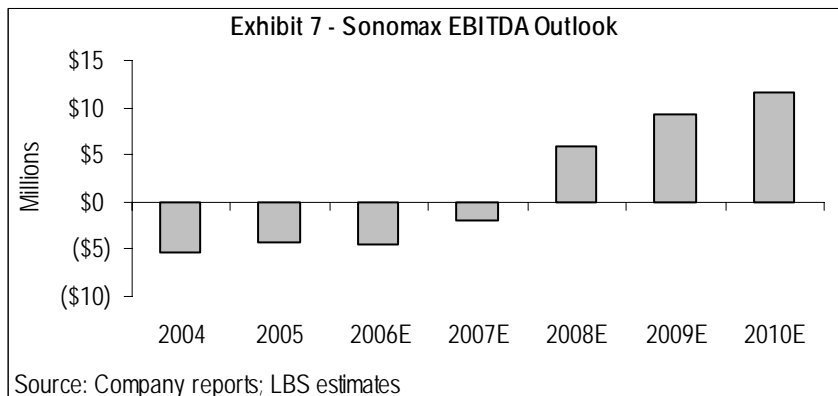


offers a wide range of digital hearing aids delivered in one hour, including the Sono3. According to Wal-Mart Canada, about 10 more HearAtLast stores within Wal-Mart are in development. This store within a store in high traffic allows mass distribution as opposed to the traditional distribution of hearing aid through independent centers. Management believes Sonomax can earned approximately \$150,000 per store. Beside this agreement with the AtLast Group, Sonomax is in discussions with Wal-Mart USA and Specsavers Opticians, a UK company similar to Lenscrafters with over 745 stores and 700 joint venture partners in Northern Europe.

- **Five personal electronic auditory products are in development (Appendix IV).** Sonomax's devices should offer enhanced performance compared to traditional devices which are typically compromised by the use of generic earbuds as the interface. Sonomax's products should be launched in 2007, via the same aggressive distribution strategies.

## The Path To Profitability

We forecast EBITDA to improve considerably in the next years (Exhibit 7). This translates into a progression from a history of negative EBITDA margins, to over 35% EBITDA margin in 2008E and subsequent years.



Key contributors to EBITDA improvement include the following:

- **Gross margins should increase and reach 70% before 2007E year-end.** Under the licensee model, Sonomax exchanges territorial exclusivity for quarterly volume commitments. Typically, the licensees pay Sonomax between \$35 to \$40 per set of earplugs. Each earpiece currently costs \$16 to produce; however, management expects to reduce direct costs to \$5 per earpiece by Q4/07, due to a combination of economies of scale and improved process efficiency. Each performance test costs \$45 to end users, and revenues are equally distributed between the three partners (Sonomax, Oilind and Aearo). We note that Sonomax should enjoy high gross margins for these tests, given that the major cost to the company (software development) has already been absorbed.
- **SG&A expenses should decrease and stabilize at 30% of revenues.** This assumption is based on: 1) the on-going efforts of Sonomax's management to reduce costs, and 2) the average SG&A expenses incurred by companies in the hearing loss industry.



- Products in the pipeline will not require large R&D spending since they are all derived from the SonoPlatform. We forecast a 5% growth in R&D given continuous adjustments/improvements to the SonoPlatform and the software.

We believe Sonomax will have positive net earnings by Q4/07E. We note that Sonomax should not pay taxes before 2011E. According to the management, Sonomax has lost-carry forwards of approximately \$25 million.

### FCF Positive by Q4/07E

Capital expenditures should increase in the upcoming quarters. Sonomax currently manufactures all of its earpieces internally. The company has a capacity of about 350,000 earpieces per annum. In 18 to 24 months, Sonomax expects to increase its production capacity to more than one million earpieces per annum. Automation of the production process should require capital expenditures of approximately \$1 million during 2007E.

Sonomax should be free cash flow positive in Q4/07E. In the meantime, we believe the company will be forced to seek additional financing since it has zero months of cash remaining. Given the levered state of the balance sheet, this will likely be in the form of equity.

### Valuation

Target of \$0.40, Total  
Return of 105%

We rate the shares of Sonomax a Speculative Buy with a one-year share price target of \$0.40, implying a total return of 105%. This is based on a discounted cash flow to the firm using a weighted average cost of capital (WACC) of 10% (Exhibit 8).

Exhibit 8 - Valuation						
\$ Million	2007E	2008E	2009E	2010E	Terminal Year	
EBIT(1-Tax Rate)	-2.3	5.4	8.7	11.2	8.7	
+ Depreciation	0.3	0.5	0.5	0.5	0.4	
+ Deferred Taxes	0.0	0.0	0.0	0.0	0.8	
- Capex	1.3	1.5	1.4	1.4	1.3	
- Additions to W/C	2.0	3.0	3.9	2.8	1.7	
= FCFF	-5.3	1.5	3.9	7.4	6.9	
Terminal Value					96.7	
PV of Equity	68.7 =	-4.9	1.2	2.9	5.1	64.4
- BV Net Debt	3.4					
- MV Prefs	0.2					
- Options/Warrants	21.4					
= Equity Value	43.7					
/ Share O/S	109.2					
= Equity Value Per Share	0.40					

Source: LBS estimates



## Comparative Analysis

We believe Sonomax is undervalued despite it having a higher price to sales ratio compared to other small Canadian medical devices companies (Exhibit 9). We forecast Sonomax will experience impressive growth in the next years and believe that should be considered when comparing the company's Price/Sales ratio to those of its peers. Therefore, to determine Sonomax's potential value while taking into account the sales growth, we calculated a Price/Sales To Growth (PSG) ratio. Sonomax has a lower PSG ratio than its comparables, making it more attractive on that basis. Based on a 2.6x Price/Sales valuation multiple, we obtain a one-year target of \$0.39 supporting our DCF based \$0.40 target price.

Exhibit 9 - Comparative Analysis

Canadian Companies	Ticker	Price (\$)	52 Weeks		Market Cap (\$M)	Tech Value <sup>1</sup> (\$M)	Burn Rate (Month)	Months Of Cash <sup>2</sup>	Price/Sales	PSG <sup>3</sup>
			Low (\$)	High (\$)						
CryoCath	CYT	2.82	1.63	6.00	107.1	114.7	1.3	11.0	1.8	6.6
Covalon	COV	0.58	0.36	0.80	32.8	27.3	0.2	22.2	5.3	1.5
Jenex Corp.	JEN	0.32	0.17	0.60	14.5	15.8	0.1	0	na	na
LMS Medical	LMZ	1.29	1.14	2.50	25.4	21.8	0.7	5.4	1.8	0.6
Orthosoft	OSH	0.73	0.30	0.84	30.2	28.0	0.1	16.7	1.4	2.4
Theralase	TLT	0.45	0.37	0.78	15.0	14.7	0.0	6.7	na	na
Victhom	VHB	0.50	0.46	1.34	25.7	32.8	0.8	9.6	na	na
<b>Average</b>					<b>35.8</b>	<b>36.4</b>	<b>0.5</b>	<b>11.9</b>	<b>2.6</b>	<b>2.8</b>
<b>Median</b>					<b>25.7</b>	<b>27.3</b>	<b>0.2</b>	<b>10.3</b>	<b>1.8</b>	<b>2.0</b>
<b>Sonomax</b>	<b>SHH</b>	<b>0.20</b>	<b>0.17</b>	<b>0.32</b>	<b>21.3</b>	<b>24.0</b>	<b>0.5</b>	<b>0</b>	<b>3.1</b>	<b>0.7</b>

<sup>1</sup>Technology Value = Market Cap - Cash + Total Debt

<sup>2</sup>Months Of Cash = Cash Reserves / Burn Rate

<sup>3</sup>PSG = Price/Sales To Growth

Source: Company reports; Bloomberg; LBS

## Sources of Risk

### Thin Working Capital Position

Sonomax has zero months of cash available. In fact, on September 30, 2006, the company had no liquidity available and during the quarter, a loss was generated from its operating activities. Therefore, its financial health in the next months will greatly depend on its ability to obtain additional financing, to maintain the support of its creditors, and to generate sufficient cash from its operations.

### Absence Of Profitability

Since the beginning of its operations in 1998, Sonomax has not realized any profit. There is no assurance that the company will achieve profitability in the future.

### Barriers To Adoption

An improved version of the SonoCustom was developed to overcome two problems: it was neither comfortable nor slippery enough. However, there is no assurance that end users will adopt the improved version. Lack of adoption could adversely affect Sonomax's revenues.



### Foreign Exchange

Sonomax faces significant foreign exchange risk given all of its production is based in Canada while over 75% of its revenues are generated in the US, the EU and other countries. The company does not currently hold any financial instruments to protect itself from this risk.

### Economic Slowdown

Downturns in North American or European economies could reduce the demand for hearing protection, hearing enhancement and other communication devices. This could negatively affect the business of Sonomax.



## Financial Statements

Exhibit 10 - Sonomax Hearing Healthcare Income Statement (F2004-2010E)											
Fiscal Year Ending December 31											
(\$Millions, except per share amounts)											
	2004	2005	Q1/06	Q2/06	Q3/06	Q4/06E	2006E	2007E	2008E	2009E	2010E
Net Sales	0.5	1.2	0.3	0.2	0.1	0.5	1.1	6.8	16.4	24.6	30.7
Cost Of Sales	0.6	0.7	0.1	0.1	0.2	0.4	0.8	2.9	4.9	7.4	9.2
General Operating & Administrative Expenses	2.2	2.3	0.5	0.7	0.8	0.7	2.7	4.4	3.3	4.9	6.1
Selling & Marketing Expenses	2.5	1.8	0.4	0.4	0.3	0.3	1.4	1.0	1.6	2.5	3.1
Research & Development Expenses	0.6	0.6	0.1	0.1	0.1	0.2	0.5	0.6	0.6	0.6	0.7
Foreign Exchange Loss (Gain)	0.1	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>EBITDA</b>	<b>(5.4)</b>	<b>(4.2)</b>	<b>(0.9)</b>	<b>(1.1)</b>	<b>(1.4)</b>	<b>(1.0)</b>	<b>(4.4)</b>	<b>(2.0)</b>	<b>5.9</b>	<b>9.2</b>	<b>11.6</b>
Amortization	0.1	0.2	0.1	0.1	0.1	0.1	0.3	0.3	0.5	0.5	0.5
Interest Expense	1.2	1.8	0.4	(0.3)	0.1	0.1	0.3	0.6	0.9	0.8	0.3
Special Items	0.0	0.0	(0.1)	0.0	0.0	0.0	(0.1)	0.0	0.0	0.0	0.0
<b>EBT</b>	<b>(6.7)</b>	<b>(6.2)</b>	<b>(1.3)</b>	<b>(0.9)</b>	<b>(1.6)</b>	<b>(1.1)</b>	<b>(4.9)</b>	<b>(2.9)</b>	<b>4.5</b>	<b>7.9</b>	<b>10.9</b>
Current Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Future Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Earnings</b>	<b>(6.7)</b>	<b>(6.2)</b>	<b>(1.3)</b>	<b>(0.9)</b>	<b>(1.6)</b>	<b>(1.1)</b>	<b>(4.9)</b>	<b>(2.9)</b>	<b>4.5</b>	<b>7.9</b>	<b>10.9</b>
After-Tax (Addback) Of Special Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Earnings From Cont Ops Before Special Items</b>	<b>(6.7)</b>	<b>(6.2)</b>	<b>(1.3)</b>	<b>(0.9)</b>	<b>(1.6)</b>	<b>(1.1)</b>	<b>(4.9)</b>	<b>(2.9)</b>	<b>4.5</b>	<b>7.9</b>	<b>10.9</b>
<b>Diluted EPS From Cont Ops Before Special Items</b>	<b>(\$0.14)</b>	<b>(\$0.11)</b>	<b>(\$0.02)</b>	<b>(\$0.01)</b>	<b>(\$0.02)</b>	<b>(\$0.01)</b>	<b>(\$0.06)</b>	<b>(\$0.03)</b>	<b>\$0.03</b>	<b>\$0.05</b>	<b>\$0.07</b>
<b>Diluted EPS</b>	<b>(\$0.14)</b>	<b>(\$0.11)</b>	<b>(\$0.02)</b>	<b>(\$0.01)</b>	<b>(\$0.02)</b>	<b>(\$0.01)</b>	<b>(\$0.06)</b>	<b>(\$0.03)</b>	<b>\$0.03</b>	<b>\$0.05</b>	<b>\$0.07</b>
Weighted Average Shares Outstanding - Basic (M)	47.4	53.8	53.2	75.6	100.7	105.7	83.8	109.2	109.2	109.2	109.2
Weighted Average Shares Outstanding - Diluted (M)	47.4	53.8	53.2	75.6	100.7	105.7	83.8	109.2	161.4	161.4	161.4
<b>Income Statement Statistics</b>											
Revenue Growth	-37%	146%	27%	-54%	-25%	10%	-8%	528%	140%	50%	25%
EBITDA Growth	na	na	na	na	na	na	na	na	na	55%	26%
Net Earnings From Cont Ops Before Spec Items Growth	na	na	na	na	na	na	na	na	na	75%	37%
Diluted EPS From Cont Ops Before Spec Items Growth	na	na	na	na	na	na	na	na	na	75%	37%
Gross Margin (Includes D&A)	-16%	45%	62%	14%	-92%	30%	25%	58%	70%	70%	70%
EBITDA Margin	-1124%	-357%	-307%	-755%	-1430%	-182%	-407%	-30%	36%	37%	38%
EBT Margin Before Special Items	-1397%	-523%	-473%	-599%	-1647%	-202%	-460%	-43%	28%	32%	35%
Net Margin From Cont Ops Before Spec Items	-1397%	-523%	-443%	-599%	-1647%	-202%	-452%	-43%	28%	32%	35%
Tax Rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Source: Company reports; LBS estimates											



## Financial Statements (continued)

Exhibit 11 - Sonomax Hearing Healthcare Balance Sheet (F2004-F2010E)											
Fiscal Year Ending December 31 (\$Millions, except per share amounts)	2004	2005	Q1/06	Q2/06	Q3/06	Q4/06E	2006E	2007E	2008E	2009E	2010E
<b>Assets</b>											
Cash	0.2	0.0	0.0	0.3	0.2	0.0	0.0	0.0	0.0	0.0	8.1
Accounts Receivable	0.3	0.6	0.2	0.2	0.5	0.6	0.6	2.3	4.5	6.8	8.5
Inventories	0.7	0.4	0.4	0.5	0.6	0.6	0.6	0.9	1.8	2.7	3.4
Other	0.3	0.5	0.4	0.5	0.5	0.4	0.4	0.6	0.9	1.1	1.9
<b>Total Current Assets</b>	<b>1.5</b>	<b>1.5</b>	<b>1.1</b>	<b>1.5</b>	<b>1.8</b>	<b>1.6</b>	<b>1.6</b>	<b>3.8</b>	<b>7.2</b>	<b>10.6</b>	<b>21.9</b>
Capital Assets	0.4	0.5	0.5	0.5	0.5	0.6	0.6	1.3	1.5	1.4	1.4
Goodwill	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	0.7	0.2	0.2	0.2	0.2	0.3	0.3	0.5	0.5	0.5	0.5
<b>Total Non-Current Assets</b>	<b>1.1</b>	<b>0.7</b>	<b>0.8</b>	<b>0.7</b>	<b>0.8</b>	<b>1.0</b>	<b>1.0</b>	<b>1.9</b>	<b>2.1</b>	<b>2.0</b>	<b>1.9</b>
<b>Total Assets</b>	<b>2.6</b>	<b>2.2</b>	<b>1.9</b>	<b>2.2</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>	<b>5.6</b>	<b>9.3</b>	<b>12.6</b>	<b>23.8</b>
<b>Liabilities &amp; Shareholders' Equity</b>											
Bank Indebtedness	0.0	0.9	0.3	0.3	0.2	0.3	0.3	5.6	4.2	0.1	0.0
Accounts Payable & Accrued Liabilities	1.1	1.7	1.8	1.1	1.2	1.1	1.1	1.4	1.8	1.4	1.7
Current Portion Of Long-Term Debt	0.1	0.0	0.0	0.0	0.0	0.2	0.2	0.7	0.7	0.7	0.7
Other	0.0	5.4	6.6	2.8	3.2	3.0	3.0	2.8	2.8	2.8	2.8
<b>Total Current Liabilities</b>	<b>1.2</b>	<b>8.1</b>	<b>8.7</b>	<b>4.1</b>	<b>4.6</b>	<b>4.5</b>	<b>4.5</b>	<b>10.5</b>	<b>9.6</b>	<b>5.0</b>	<b>5.2</b>
Long-Term Debt	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	6.2	2.1	2.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
<b>Total Non-Current Liabilities</b>	<b>6.3</b>	<b>2.1</b>	<b>2.2</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>
<b>Total Liabilities</b>	<b>7.5</b>	<b>10.2</b>	<b>10.9</b>	<b>4.4</b>	<b>4.8</b>	<b>4.7</b>	<b>4.7</b>	<b>10.7</b>	<b>9.8</b>	<b>5.1</b>	<b>5.4</b>
<b>Shareholders' Equity</b>											
Capital Stock	8.9	11.9	11.9	24.1	25.2	26.5	26.5	26.5	26.5	26.5	26.5
Contributed Surplus	1.4	1.6	2.0	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Retained Earnings	(17.7)	(24.2)	(25.5)	(30.4)	(32.4)	(33.6)	(33.6)	(36.5)	(32.0)	(24.0)	(13.1)
Other	0.0	0.0	0.0	0.0	0.0	1.4	1.4	2.5	2.7	2.8	2.8
<b>Total Shareholders' Equity</b>	<b>(4.9)</b>	<b>(8.0)</b>	<b>(9.0)</b>	<b>(2.2)</b>	<b>(2.2)</b>	<b>(2.1)</b>	<b>(2.1)</b>	<b>(5.0)</b>	<b>(0.5)</b>	<b>7.5</b>	<b>18.4</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>2.6</b>	<b>2.2</b>	<b>1.9</b>	<b>2.2</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>	<b>5.6</b>	<b>9.3</b>	<b>12.6</b>	<b>23.8</b>
<b>Balance Sheet Statistics</b>											
Net Total Debt/Equity	2%	-12%	-3%	0%	-5%	-25%	-25%	-126%	-1015%	11%	-40%
Net Total Debt/Capital	2%	-14%	-4%	0%	-6%	-33%	-33%	483%	111%	10%	-38%
Net Total Debt/LTM EBITDA	0.0x	(0.1x)	(0.0x)	(0.0x)	(0.0x)	(0.2x)	(0.2x)	(1.7x)	1.0x	0.3x	(0.3x)
EBIT Coverage	(4.7x)	(2.4x)	(2.4x)	3.8x	(11.9x)	(19.5x)	(18.0x)	(3.8x)	6.0x	11.5x	44.1x
ROE (Annualized)	656%	349%	60%	71%	116%	208%	226%	58%	-339%	132%	66%
Book Value	(\$0.10)	(\$0.15)	(\$0.15)	(\$0.02)	(\$0.02)	(\$0.02)	(\$0.02)	(\$0.05)	(\$0.00)	\$0.07	\$0.17

Source: Company reports; LBS estimates



## Financial Statements (continued)

Exhibit 12 - Sonomax Hearing Healthcare Statement Of Cash Flows (F2004-F2010E)											
Fiscal Year Ending December 31 (\$Millions, except per share amounts)	2004	2005	Q1/06	Q2/06	Q3/06	Q4/06E	2006E	2007E	2008E	2009E	2010E
<b>Operating Activities</b>											
Net Income (Loss) For The Year	(6.7)	(6.2)	(1.3)	(0.9)	(1.6)	(1.1)	(4.9)	(2.9)	4.5	7.9	10.9
Non-Cash Items:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation & Amortization	0.2	0.6	0.1	0.1	0.1	0.1	0.3	0.3	0.5	0.5	0.5
Future Income Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Special Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.5	0.7	0.1	0.1	0.2	(0.2)	0.3	(0.2)	0.0	0.0	0.0
<b>Operating Cash Flow</b>	<b>(6.0)</b>	<b>(4.9)</b>	<b>(1.0)</b>	<b>(0.7)</b>	<b>(1.3)</b>	<b>(1.2)</b>	<b>(4.3)</b>	<b>(2.8)</b>	<b>5.0</b>	<b>8.4</b>	<b>11.4</b>
Decrease (Increase) In Non-Cash Working Capital	(0.9)	0.4	0.6	(1.0)	0.0	(0.4)	(0.8)	(2.0)	(3.0)	(3.9)	(2.8)
<b>Net Cash Provided By Operating Activities</b>	<b>(6.9)</b>	<b>(4.5)</b>	<b>(0.5)</b>	<b>(1.7)</b>	<b>(1.3)</b>	<b>(1.6)</b>	<b>(5.1)</b>	<b>(4.8)</b>	<b>2.1</b>	<b>4.6</b>	<b>8.5</b>
<b>Investing Activities</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Expenditures	(0.1)	(0.3)	(0.0)	(0.0)	(0.1)	(0.1)	(0.2)	(1.0)	(0.7)	(0.4)	(0.4)
Disposal Of Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Cash Provided By (Used In) Investing Activities</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.0)</b>	<b>(0.0)</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(1.0)</b>	<b>(0.7)</b>	<b>(0.4)</b>	<b>(0.4)</b>
<b>Financing Activities</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Advance (Repayment) Of Long-Term Debt	7.9	0.7	0.9	(0.8)	(0.1)	0.2	0.3	0.5	0.0	0.0	0.0
Issuance Of Common Stock	0.0	2.9	0.0	3.2	1.5	1.3	6.0	0.0	0.0	0.0	0.0
Other	(0.7)	0.5	0.0	(0.5)	(0.2)	0.0	(0.7)	0.0	0.0	0.0	0.0
<b>Net Cash (Used In) Provided By Financing Activities</b>	<b>7.2</b>	<b>4.1</b>	<b>0.9</b>	<b>2.0</b>	<b>1.2</b>	<b>1.4</b>	<b>5.6</b>	<b>0.5</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Effects Of Exchange Rate Changes On Cash	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash From Discontinued Operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Increase (Decrease) In Net Cash</b>	<b>0.2</b>	<b>(0.6)</b>	<b>0.5</b>	<b>0.3</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>0.3</b>	<b>(5.3)</b>	<b>1.4</b>	<b>4.2</b>	<b>8.1</b>
Net Cash At Beginning Of Period	0.1	0.2	(0.9)	(0.2)	0.1	(0.1)	(0.9)	(0.3)	(5.6)	(4.2)	(0.1)
Net Cash At End Of Period	0.2	(0.9)	(0.2)	0.1	(0.1)	(0.3)	(0.3)	(5.6)	(4.2)	(0.1)	8.1
<b>Free Cash Flow</b>											
Operating Cash Flow	(6.0)	(4.9)	(1.0)	(0.7)	(1.3)	(1.2)	(4.3)	(2.8)	5.0	8.4	11.4
Change In Working Capital	(0.9)	0.4	0.6	(1.0)	0.0	(0.4)	(0.8)	(2.0)	(3.0)	(3.9)	(2.8)
Capital Expenditures	(0.1)	(0.3)	(0.0)	(0.0)	(0.1)	(0.1)	(0.2)	(1.0)	(0.7)	(0.4)	(0.4)
<b>Free Cash Flow</b>	<b>(7.0)</b>	<b>(4.8)</b>	<b>(0.5)</b>	<b>(1.7)</b>	<b>(1.4)</b>	<b>(1.7)</b>	<b>(5.3)</b>	<b>(5.8)</b>	<b>1.4</b>	<b>4.2</b>	<b>8.1</b>
<b>Free Cash Flow Per Share</b>	<b>(\$0.15)</b>	<b>(\$0.09)</b>	<b>(\$0.01)</b>	<b>(\$0.02)</b>	<b>(\$0.01)</b>	<b>(\$0.02)</b>	<b>(\$0.06)</b>	<b>(\$0.05)</b>	<b>\$0.01</b>	<b>\$0.03</b>	<b>\$0.05</b>
Diluted Shares Outstanding	47.4	53.8	53.2	75.6	100.7	105.7	83.8	109.2	161.4	161.4	161.4

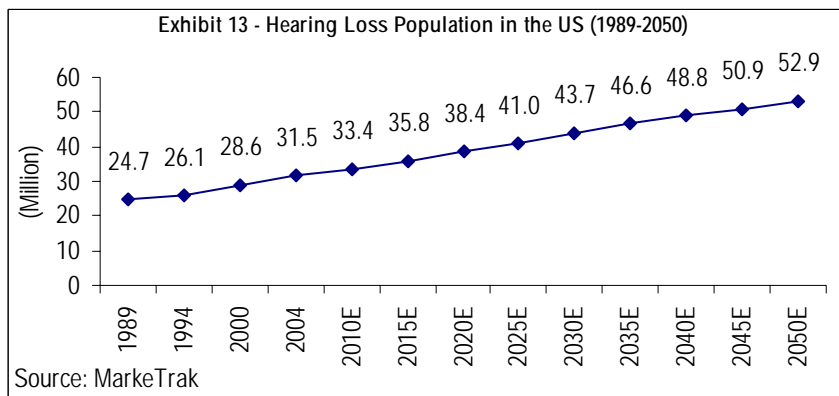
Source: Company reports; LBS estimates



## Appendix I – Hearing Loss Backgrounder

### Increasing Worldwide Prevalence Of Hearing Loss

Hearing loss is one of the most prevalent chronic health conditions in the US. More than 31 million Americans or 10% of the population have some degree of hearing loss. The prevalence of hearing trouble in the European Union (EU) and in Australia is similar to that in the US. Hearing loss affects people of all ages, in all segments of the population, and across all socioeconomic levels. However, incidence increases greatly with age. According to the National Institute on Deafness and Other Communication Disorders (NIDCD), one-third of Americans older than 60 and half of those older than 85 have trouble hearing. Moreover, because of the increased exposure to excessive noise, people suffer from hearing loss at younger and younger ages. In its MarkeTrak survey (2005), the Better Hearing Institute (BHI) found that almost 15% of baby boomers have a hearing problem. As this population group reaches retirement age, the number of hearing impaired people is expected to climb rapidly and reach nearly 53 million in 2050 (Exhibit 13).

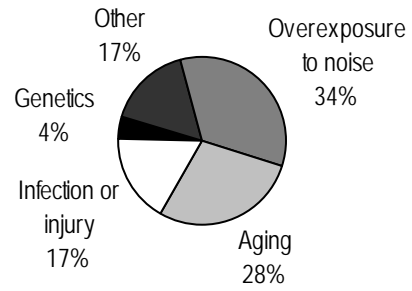


Overexposure to noise is the major cause of hearing loss (Exhibit 14). There are three types of hearing loss and several causes:

- **Conductive hearing loss** occurs when sound is not conducted efficiently through the outer and middle ear to the inner ear. This may be caused by many conditions including buildup of earwax, punctured eardrum, infection, or birth defect. Conductive hearing loss can often be medically or surgically treated.
- **Sensorineural hearing loss** develops when hair cells in the inner ear or the auditory nerve are damaged. It is a permanent loss that may be caused by aging (condition known as presbycusis), noise, infection, trauma, tumors, ototoxic drugs or heredity.
- **Mixed hearing loss** is a combination of both conductive and sensorineural hearing loss.



Exhibit 14 - Causes of Hearing Loss



Source: The Hearing Foundation of Canada



## Appendix II – Changing Attitudes In The Hearing Protection Market

### Noise Induced Hearing Loss Is A Widespread But Often Underestimated Problem

Over 10 million Americans have irreversible noise-induced hearing loss (NIHL) and 30 million more are exposed to hazardous sound levels every day. According to the National Institute for Occupational Safety and Health (NIOSH), NIHL is recognized as the most common occupational hazard and it is the second most self-reported work illness or injury in the US. Nonetheless, even if NIHL is typically work-related, it may also occur in recreational activities (like shooting and snowmobiling) or at home.

Even if NIHL is easily preventable by wearing adequate hearing protection, end users do not always comply with safety recommendations. Indeed, according to the National Safety Council, construction workers wear hearing protection between 36 to 61 percent of the time they are necessary. Not surprisingly, 44 percent of carpenters and 48 percent of plumbers reported that they have perceived hearing loss. The main reasons for not using hearing protectors include lack of comfort and convenience, high cost, and difficulty to communicate or hear important sounds.

### Market Saturation

Hundreds of hearing protection products are available on the market. There are disposable foam earplugs, pre-molded reusable earplugs, custom-molded earplugs, canal caps, and earmuffs (passive and communication enabled). There are advantages and limitations associated with the use of either earplugs or earmuffs (Exhibit 15).

Exhibit 15 – Comparison Of Hearing Protection	
Earplugs	Earmuffs
<ul style="list-style-type: none"> <li>· Reduce noise 15-30 dB.</li> <li>· Better for low frequency noise.</li> <li>· Small and easily carried.</li> <li>· Convenient to use with other personal protection equipment.</li> <li>· Comfortable in hot and humid work areas.</li> <li>· Convenient for use in confined work areas.</li> <li>· Difficult to insert properly.</li> <li>· Require more time to fit.</li> <li>· Require good hygiene practices.</li> <li>· May irritate the ear canal.</li> <li>· Difficult to see and monitor usage.</li> <li>· Less expensive.</li> </ul>	<ul style="list-style-type: none"> <li>· Reduce noise 15-30 dB.</li> <li>· Better for high frequency noise.</li> <li>· Less portable and heavier.</li> <li>· May interfere with the wearing of other personal protection equipment like glasses and hat.</li> <li>· Less comfortable in hot and humid work areas.</li> <li>· Less convenient for use in confined work areas.</li> <li>· Easy to fit.</li> <li>· May be worn with minor ear infections.</li> <li>· High visibility.</li> <li>· More expensive.</li> <li>· More durable.</li> <li>· Have replaceable parts.</li> </ul>
Source: Canadian Centre for Occupational Health and Safety	



Approximately two-thirds of the earplugs sold in the world are disposable. Pre-molded earplugs, which come in several sizes, are generally more costly and considered less comfortable than expandable foam earplugs. Custom-molded earplugs are more complicated to make, less available, more difficult to use, and more expensive compared to other earplugs. However, they have been adopted in many workplaces because they are comfortable to wear for long periods of time. Canal caps, which are semi-inserted earplugs attached to headbands, are more convenient in workplaces where noise is intermittent but are less effective against loud noise. Combined use of both earplugs and earmuffs adds 10-15 dB more protection.

### Price Competition

End users are highly price sensitive due to limited product differentiation. This challenge is forcing manufacturers to improve their productivity and cost competitiveness. Many companies are looking for low-cost regions such as China to outsource their production activities or to relocate their production facilities. At the same time, low-priced products from Asia represent a major threat to their market share.

### Changing Attitudes

Recent trends suggest that end users are exercising more discretion in selecting their personal protection equipment, looking for comfort and style. End users want hearing protection that does not make it difficult to communicate or hear important sounds. They are also more aware about health and safety issues. This trend towards fashion and health consciousness results in faster replacement rates and greater acceptance and compliance amongst workers about using hearing protection devices. Even employers are changing their attitudes, realizing that the cost of personal protection equipment is far lower than potential costs due to productivity loss and accidents. These changes in perception are increasing the demand and thus represent a growth opportunity. Hearing protection manufacturers are thus competing on the basis of product characteristics (such as design, functional performance, and agency approvals), service, and brand name recognition. Large companies are also offering head-to-toe protection packages in one stop shops to further attract end users.

Cost-competitiveness and product innovation are key drivers to win market share in this mature market. Efforts to build brand loyalty and to improve customer service should also pay off.

### Changing Regulations

Industry employers must adhere to numerous health and safety regulations. In the US, the Occupational Safety and Health Administration (OSHA) is responsible for defining minimum safety workplace requirements. For example, whenever employee noise exposures equal or exceed an 8-hour time-weighted average sound level of 85 decibels, the OSHA requires employers to implement a hearing conservation program. Part of this program is to provide ear protective devices to all employees. Hearing protection manufacturers must also be compliant with standards issued by the OSHA as well as the non-governmental American National Standards Institute (ANSI). In the EU, directives such as the 86/188/EEC define the minimum requirements to protect workers from the hazards of noise.

The constant introduction of stricter regulations ensure the market remains dynamic despite its saturation. According to researchers at John Hopkins University, severe to profound hearing loss is expected to cost society US\$200,000 in reduced work productivity over the lifetime of a hearing-impaired person. Thus, high health care costs are driving new legislation for better hearing protection. More severe legislation increases the number of end-users who need to use hearing protectors and accelerate product replacement. The introduction of regulations in emerging markets like Middle East, Asia, and Latin America could further expand the hearing protection market.



**Global Consolidation**

In the recent years, market globalization has driven many mergers and acquisitions of hearing protection companies (Exhibit 16). This global consolidation has created large players offering a broader range of products covering head-to-toe protection. Nevertheless, about two-third of the market remains relatively fragmented with an important number of private and relatively small specialized manufacturers. According to estimates from the major players, in 2005, the personal protection equipment market was approximately US\$13-15 billion while the global hearing protection segment was more than US\$500 million.

**Exhibit 16 – Hearing Protection Competitors**

Company	Status	Foam Earplugs	Pre-molded Earplugs	Custom-molded Earplugs	Banded Earplugs	Earmuffs
3M (MMM)	Public	x	x		x	x
Aearo	Private	x	x	x	x	x
Bacou-Dalloz (DAL)	Public	x	x		x	x
Custom Ear Protect	Private			x		
David Clark	Private					x
Elvex	Private	x	x		x	x
Gentex	Private					x
Insta-Mold	Private			x		
Lendell	Private	x				
Mouldex-Metric	Private	x	x		x	x
Mine Safety (MSA)	Public	x	x		x	x
Norcross	Private	x	x			x
Sensgard	Private				x	
Tasco	Private	x	x		x	x
Westone	Private			x		

Source: Company reports

**Aearo Technologies is the world's largest hearing protection company and a major player in the personal protection equipment market.** Aearo's products are sold in more than 70 countries under the brand names E-A-R and Peltor. The company offers disposable and reusable earplugs, passive earmuffs, and communication headsets with hearing protection. Aearo has concluded a partnership with Sonomax to distribute custom-molded earplugs. During its fiscal year 2005, Aearo's hearing protection division generated sales of US\$207.5 million which represented a global market share of approximately 40%. In March 2006, a management buy out of Aearo Technologies was concluded.

**Bacou-Dalloz Group (DAL-FR) is number two worldwide for hearing protection.** In 2001, after the merger of Bacou Group and Christian Dalloz, the group became a world leader in the personal protection equipment industry with over 6,000 employees in 20 countries. The hearing protection products are gathered under two brand names: Bilsom for passive and communicative earmuffs, and Howard Leight for disposable, reusable, and banded earplugs. During fiscal year 2005, DAL's hearing division generated 86.8 million Euros in sales for a global market share of over 20%.



Beside Sonomax, only three private companies offer custom-molded earplugs:

- 1) **Custom Ear Protect Inc.** is a Canadian company describing itself as North America's largest exclusive custom fit hearing protector manufacturer. The company offers on-site fittings of its hearing protection devices, the dB Blocker, at industrial sites by certified mobile technicians. Custom Ear Protect also offers a FlashTest which measure the hearing noise reduction in 10 minutes.
- 2) **Insta-Mold Products Inc.** is an American company involved in the research and development of the newest silicone technologies for many applications in the hearing health industry. The company offers custom-fitted, made on the spot earpieces for noise protection, hearing enhancement, telecommunication devices, and water activities.
- 3) **Westone** is a US custom earmold laboratory that describes itself as the world's largest manufacturer of custom made products for the ear. Over the years, the company has developed specific earmolds for many applications including hearing amplification, hearing protection, musicians and audiophiles, communications, and swimmers.

### High Barriers To Entry

Large integrated players make it difficult for new entrants to penetrate the hearing protection market. The barriers are not technological but rather in the distribution and sales networks. Indeed, a newcomer could enter the market with an innovative product but would find it difficult to compete with large players in terms of price and brand name recognition. To penetrate the market, many small and specialized manufacturers are therefore looking for partnerships with large players. This is a win-win strategy as small players gain access to a huge network and large players fill their pipeline with the latest product innovations.

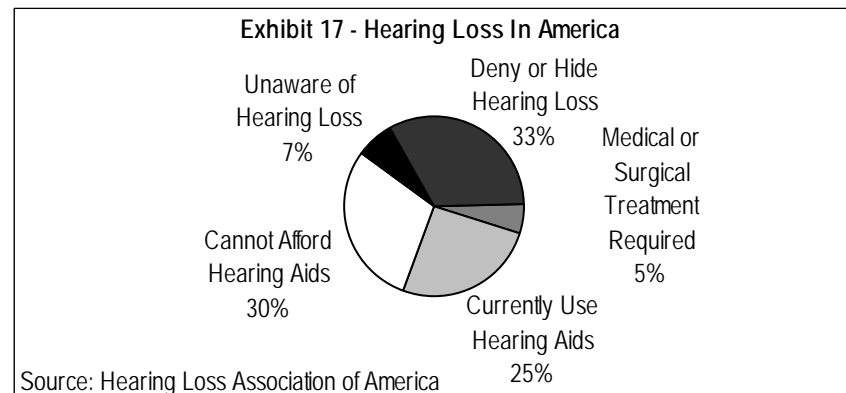


## Appendix III – Hearing Aids: A Low Volume High Margin Market

### Growth Opportunity

Only a minority of Americans (5%) with hearing loss could be successfully treated medically or surgically (Exhibit 17). The remainder of those with hearing loss require hearing aids but no more than 25% currently use them. Because Medicare does not cover hearing aids, 30% of hearing-impaired Americans can not afford hearing devices. Thus, almost three out of four people who could benefit from a hearing aid actually do not wear one.

Over three million Canadians have hearing loss. However, according to the Hearing Foundation of Canada, only one in six who could benefit from a hearing aid actually wear one. It is estimated that almost 60% of people older than 65 have hearing loss requiring hearing devices.



### Styles Of Hearing Aids

A hearing aid is an electronic, battery-operated device that brings amplified sounds to the ear. Every hearing aid has a microphone which receives and converts sound waves to electrical signals, an amplifier which increases the loudness of the signals, and a receiver which delivers the signals into the ear. There are over 1,000 types and models of hearing aids. Five basic styles exist (Exhibit 18) and are detailed below:

1. **In-the-canal (ITC) or completely-in-the-canal (CIC) aids** are contained in a tiny case that fits partly or completely into the ear canal. They are used for mild or moderate hearing loss. Canal aids are the smallest hearing aids available on the market and thus offer an evident cosmetic advantage. However, they may be difficult to adjust and remove, may not be able to hold additional devices (like telecoil), and may be damaged by earwax.
2. **In-the ear (ITE) aids** are contained in a shell made of plastic that fits completely in the outer ear. They are used for mild to severe hearing loss. These ITE aids are larger and, therefore, easier to handle and able to hold additional devices. However, they may be damaged by earwax and may cause feedback (whistle sound) if they are not adjusted properly. The majority of hearing aids sold today are ITE and canal aids.
3. **Behind-the-ear (BTE) aids** are contained in a plastic case and worn behind the ear. The case is connected to a plastic earmold by a clear tube. They can be used for all degrees of hearing loss and for persons of all ages. Because of their size,



they are easy to manipulate but are less aesthetic. BTE aids can also cause feedback.

4. **Open-fits aids** are mini-BTE aids which have been recently introduced on the market by all major hearing aid companies. These aids fit instantly and reduce the occlusion effect (amplification of the user's own voice when their ears are plugged up). However, they are limited to individuals with mild loss for high frequency noise. Open-fits aids now constitute more than 15% of the hearing aid market and this percentage is expected to grow in the upcoming years.
5. **Body aids** are attached to a belt and connected to the ear by a wire. They are used for profound hearing loss.



## Analog Versus Digital Technology

Hearing aids can be distinguished by their technology, even if they are the same style. Three types of technology are used:

1. **Analog/Adjustable aids** have conventional electronic circuitry and amplify all sounds (speech and noise) the same way. They are designed with a particular frequency response and therefore have no flexibility for different sound settings. They are generally the least expensive aids (US\$1,500 to US\$2,500).
2. **Analog/Programmable aids** have conventional electronic circuitry but sounds going in are programmed before coming out. They are designed for more than one sound settings but users must adjust the setting manually. They are less expensive than digital aids (US\$2,000 to US\$6,000).
3. **Digital aids** have computer-styled circuitry and sounds going in are programmed before coming out. They offer numerous sound settings, are usually self-adjusting, reduce feedback, and can be highly customized. However, they are the most expensive aids (US\$4,000 to US\$8,000).

## End Users' Major Concerns

The hearing aid cost is a major barrier to adoption for people suffering from hearing loss. According to a survey from the Ear Foundation (2006), less than one-fourth of baby boomers that have been told by a professional that they should wear a hearing aid actually do. Of those who do not, about 45% said it is because of cost or because insurance does not cover it. Over 60% of individuals with hearing loss need two hearing aids and each device can cost from US\$800 to US\$20,000, depending on style, technology and features. According to a 2004 survey published in the Hearing



Review, the average cost of a hearing aid is about US\$1,800. Medicare does not cover hearing aids and Medicaid does only for qualifying children. Some US insurance companies cover the costs of a hearing aid. In Canada, assistance with hearing aids vary among provinces. As an example, in Québec, the Régie de l'assurance maladie gives one free hearing instrument when hearing loss is greater than 45 dB. In Ontario, the Assistive Devices Program pays 75% up to a maximum of \$500 of the cost of the hearing aid. Canadian insurance companies give, in average, \$300 to \$500 per hearing aid every five years.

**Another obstacle to wider use of hearing aids is stigma.** Hearing impaired people often wait many years before buying a hearing aid because of denial and embarrassment. Of baby boomers that have been told they should wear a hearing aid but choose not to, 16% said it is because they do not like the way they look or they do not want to be seen wearing one.

**Other common concerns when selecting a hearing aid are acoustic seal, retention, insertion, and comfort.** Most manufacturers allow a trial period (30 to 60 days) during which devices can be returned for a refund. In addition, laws in more than 60% of the US require a trial period for all hearing aid sales. Nevertheless, of baby boomers that have been told they should wear a hearing aid but choose not to, 11% said it is because it does not work well, and 5% said it is not comfortable.

**Finally, features are also important when choosing a hearing aid.** Conjoint use with assistive devices is becoming popular; approximately 30% of hearing aids in use today are equipped with telecoil.

**Therefore, key factors for success in the hearing aids market are the products characteristics (performance, comfort, cosmetic aspect, fitting), after-sale support, and service.** There is virtually no brand recognition among hearing-aids.

## Consolidation Among Manufacturers

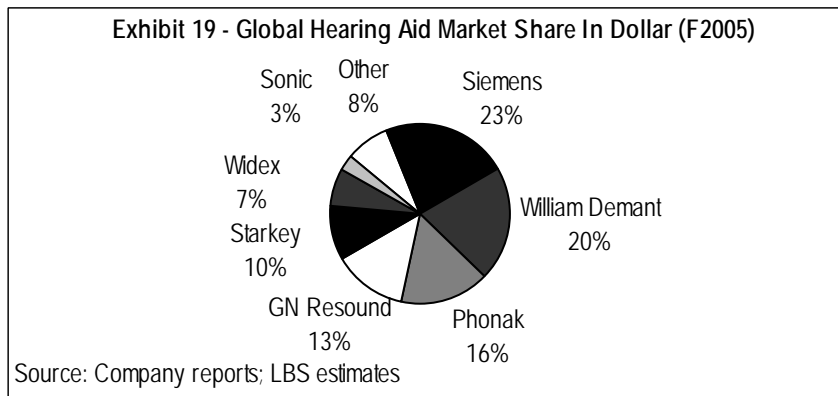
**At the wholesale level, the worldwide hearing aid market is worth more than US\$3 billion.** The Hearing Industries Association estimates that hearing aid sales increased by approximately 5% annually from 2003 to 2005 and similar growth is expected over the next few years. Sales growth can be attributed to demographic changes, increases in average selling prices, innovation in the high-end segment, and replacement of analog by digital in the low-end segment.

**The hearing aid market is highly consolidated.** Indeed, the six largest players hold an aggregate market share of over 85% (Exhibit 19). Siemens (SIE-LN) is the largest manufacturer of hearing instruments in the US and worldwide. It does not own any retail businesses but manufactures approximately one in four hearing instruments sold worldwide. William-Demant (WDH-KO) is number two in the global hearing instruments market with three well-recognized brand names (Oticon, Bernafon, and Tego). Starkey Laboratories is the largest hearing aid manufacturer in the US. This private company has six divisions (Audibel, Micro-Tech, NuEar, Omni, Qualitone, and Starkey) and facilities on every continent.

**In October 2006, Phonak Group (PHBN-EB) announced that it has entered into an agreement with GN Store Nord (GN-KO) to buy its subsidiary, GN ReSound.** Phonak offers hearing instruments under multiple brand names, including Phonak and Unitron Hearing, in more than 70 countries. GN Resound is the world's fourth largest manufacturer of hearing instruments and sells its hearing devices under three brand names: Resound, Beltone, and Interton. Phonak expects the transaction to close in the



first half of 2007. Following the acquisition, Phonak will become the number one industry player with a market share of almost 30%.



## Numerous Retailers

The majority of hearing aid manufacturers rely upon large and/or small independent distributors to sell their products. The hearing aid market at the retail level is estimated to be over US\$7 billion worldwide, and US\$3.7 billion in the US. Hearing aid retailers compete on the basis of quality, price and service. The US hearing care industry is highly fragmented with more than 10,000 practitioners providing hearing care products and services. In Canada, the traditional hearing aid distribution system is made up of small independent practices where associations are limited to two or three centers. However, several manufacturers have begun to consolidate the distribution side of their business and this changing attitude has accelerated growth for large distributors. Major retailers include:

1. **Amplifon Group (AMP-MI)** is the world leader in the distribution and customized fitting of hearing aids. In addition to Italy, where it holds a market share of 45%, Amplifon is present in many regions including Western Europe and North America. The company owns a network of franchised centers (Miracle Ear and National Hearing Center) and company-owned centers (Sonus) in the US and Canada. Amplifon has a market capitalization of about US\$1.6 billion.
2. **Audika Group (ADI-FR)** is the leading provider of hearing correction consulting and solutions in France with over 320 centers in 77 different regions and a 13% market share. Audika has a market capitalization of about US\$247 million.
3. **HearUSA (EAR-A)** provides hearing care to patients through its 146 company-owned hearing care centers located in large populated areas in the US as well as in Ontario. It has an important strategic partnership with Siemens. HearUSA has a market capitalization of US\$44 million.
4. **Belton Electronics** is a global hearing aid distributor owned by the GN Resound Group. It distributes its products through a network of more than 1,300 locations in North America. The company also sells its hearing aids in 50 countries worldwide.
5. **Large discount retailers**, such as Costco, also sell hearing aids, often at low prices.



## Appendix IV – Sonomax Pipeline

### Large And Late-Stage Pipeline

In the upcoming months, Sonomax should expand its line of personal electronic auditory devices. Products in development include:

- 1) **nXZEN Bluetooth Headset** (Exhibit 20): In collaboration with Gennum, Sonomax has developed a Bluetooth headset based on Sonomax's expansion technology. The device is now available in the London HearAtLast store and full-production is expected to start in January 2007.
- 2) **SonoWired**: Sonomax is developing earphones and protection for the music and entertainment industry. The traditional devices are not comfortable, often fall out, and do not offer a good acoustic seal to ambient noise. As a consequence, end users turn up the volume to levels that can lead to hearing loss. The custom molded SonoWired should overcome these weaknesses. The product launch is expected for spring 2007.
- 3) **SonoHunter**: Developed for hunters, this protective device amplifies nature sounds but limits gun noise. It should be launched in summer 2007. Sonomax is currently in discussions with an important provider of sporting equipment to distribute the product.
- 4) **SonoBTE**: A behind-the-ear (BTE) hearing aid connected to a SonoPlatform earmold is being developed for kids and for severe hearing loss. It should be available in the HearAtLast stores in February 2007. Furthermore, Sonomax is in discussions with Godisa, the only manufacturer of hearing aids on the African continent. Sonomax and Godisa would make available the SonoBTE to developing countries. Each hearing aid would cost \$75 and last 4 years (\$60 for the BTE device, \$10 for the SonoPlatform, and \$15 for the batteries and a solar charger). The first shipment of SonoBTE is expected during summer 2007.
- 5) **SonoMilitary**: Derived from the SonoHunter, a SonoPlatform for military purpose is also being developed. This protective device should be launched during summer 2007 in partnership with Aearo.

Exhibit 20 – SonoPlatform With BlueTooth Technology



Source: Sonomax



## Appendix V – Management Profile

### Board of Directors

- **Barry Schwartz, CEO and Chairman of the Board**
- **Nick Laperle, LLB, President and COO**
- **Adam Schwartz, BA, Executive VP**
- **Claude Allard, Senior VP of Sonomax Consumer Division**
  
- **Peter Brennan, Managing Director, Palmer Brennan LLC:** Mr. Brennan is a securities analyst as well as being a seasoned investment portfolio manager, with particular expertise in small cap and emerging growth companies. He is co-founder of Palmer Brennan LLC, a New York based investment management firm, and past president of Noyes Partner Incorporated, a registered NASD broker-dealer and investment management firm. From 1981-1984 he was an insurance and technology analyst at Schroder Capital Management. Mr. Brennan is currently a member and Chairman of the Corporate Governance Committee of the New York Society of Security Analysts and is on the Capital Markets Policy Council of the CFA Center for Financial Market Integrity.
  
- **Kévork Kokmanian, Director, Compliance and Performance, ING Investment Management Inc.:** Mr. Kokmanian is co-founder and VP Finance at ARX Capital where he specializes in small cap companies. His accounting background has also made him very knowledgeable in internal operational systems. Mr. Kokmanian serves on the Sonomax Compensation Committee.
  
- **Alexander Koningsberg, Lawyer, Independent Consultant:** Mr. Koningsberg is a senior partner at the law firm of Lapointe Rosenstien. His legal career dates back to 1963, establishing himself as an expert in the subjects of franchising and international licensing. Mr. Koningsberg serves on the Sonomax Compensation Committees.
  
- **Peter J. Malouf, President, P.J. Malouf & Co. Inc:** Mr. Malouf is a Montreal businessman and investor whose accomplishments date back to the 1970's when, as a senior executive at United Asbestos Corporation, he played a critical role in the Companies expansion in Northern Ontario, re-financing, and fighting off a hostile take over. Mr. Malouf is an original Sonomax board member, the Chairman of the Compensation Committee and a member of the Audit Committee.
  
- **Zygmunt Marcinski, International Tax Consultant:** Mr. Marcinski is a self-employed, Montreal based, business advisor. His expertise include asset management and multi-jurisdictional tax issues. He is a former Montreal partner of Coopers and Lybrand. Mr. Marcinski currently serves as the Chairman of the Sonomax Audit Committee.
  
- **Robert Raich, Managing Partner Spiegel Sohmer:** Mr. Raich joined Spiegel Sohmer in 1976, where he specializes in tax law. During his career, Mr. Raich has taught tax courses at the college and university levels. He has also given courses to the CICA and to other professional bodies. Mr. Raich has served on a number of boards and is currently on the Board of Directors of Labopharm Inc. (DDS-T). Mr. Raich is a member of Labopharm's Audit Committee and previously served on its HR Committee.



- **Alain Lavallée BSA, CMA, MBA, VP Finance and CFO:** Mr. Lavallée has an extensive background and expertise in Financial Statement Reporting, Budgeting, ERP Systems and Financial and Operational Accounting. He was formerly the Financial Accounting Director for Parmalat, Dairy and Bakery Inc-Quebec Fluid Division from 2001-2006, and previously, the Controller for Crane Canada Inc.
- **Alvin Schacter, CA., Consultant:** Mr. Schacter was a partner at Schwartz Levitsky Feldman where he served as COO from 2001 to 2004. Prior to 1994, he was President of SLF Consultants, a division of Schwartz Levitsky Feldman.

## Senior Management

- **Barry Schwartz, CEO and Chairman of the Board**
- **Nick Laperle, LLB, President and COO**
- **Adam Schwartz, BA, Executive VP**
- **Claude Allard, Senior VP of Sonomax Consumer Division**
- **Michael C. Turcot, BEng [Mech], MBA, PEng, VP Product, Research and Development:** Mr. Turcot is a project engineer and operational expert. He has successfully executed assignments around the world for such companies as Canadian Pacific Railway and Dominion Textiles. Mr. Turcot has 20 years of manufacturing management experience in a variety of environments. Mr. Turcot holds an engineering degree from Queens University and an MBA in operational management from McGill University. He is responsible for all Product R&D at Sonomax.
- **Philippe Chevalier, BA, MSc, Director of Training & Accreditation:** Mr. Chevalier is a professional educator and management skills coach who has lectured at the University of Montreal's Business School and has set up training programs for such companies as Alcan, Pratt and Whitney, and the Cirque du Soleil. His work experience, in combination with his Master's degree in Health Care administration, makes him an ideal candidate to direct the creation and administration of Sonomax's Training programs.
- **Jérémie Voix, PEng, PhD, Chief Technology Officer:** Mr. Voix is an acoustic engineer with field experience in industrial noise reduction projects. He holds a Bachelor of Fundamental Physics from University of Lille (France) and a Master of Applied Sciences in Acoustics from Sherbrooke University. He was recently granted his PhD from the École de Technologie Supérieure Montréal, with the mention "Excellent." Sonomax recently appointed him as Chief Technology Officer, where his role will include the short term (tactical) and long term technology direction (strategic) as well as the Business-focused oversight of R&D.
- **Jason Petrakis, Director of Production:** Mr. Petrakis is a highly experienced project engineer with extensive management experience. He previously held a coveted position at Technicolor Canada where he was Director of Production from 2000-2005 serving such clients as Walt Disney and Paramount Pictures exclusively for Canada.

## APPENDIX – Important Disclosures

Company	Ticker	Disclosures*
Sonomax Hearing Healthcare Inc.	SHH-V	V

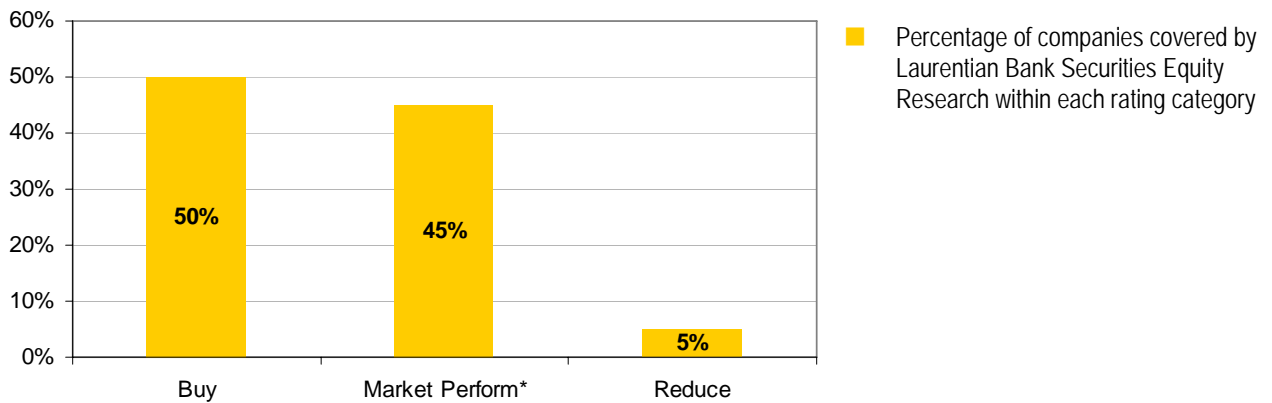
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