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WARNEX

First Quarter Report

WARNEX INC

MANAGEMENT'S DISCUSSION AND ANALYSIS

2004 FIRST QUARTER ENDED MARCH 31, 2004

MANAGEMENT DISCUSSION AND ANALYSIS

Management's discussion and analysis provides a review of the performance of our company and should be read in conjunction with the audited financial statements for the quarter ended March 31, 2004 and the related notes appearing elsewhere in this document. This discussion and analysis compares the performance for fiscal 2004 with that of 2003 and also discloses additional information to help better understand our business. This includes a review of the opportunities, issues and risks that may impact future operations.

The enclosed financial statements have been prepared in accordance with the Canadian Generally Accepted Accounting Principles («GAAP»). All dollar figures are in Canadian dollars unless otherwise indicated.

Additional information relating to our company, including the Annual Information Form (AIF) and the 2003 Annual Management Discussion & Analysis, is available on SEDAR at www.sedar.com.

FORWARD LOOKING STATEMENTS

Management's discussion and analysis contains certain forward looking statements with respect to our company. These forward-looking statements by their nature necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by these forward-looking statements. We consider the assumptions on which these forward-looking statements are based to be reasonable but caution the reader that these expectations regarding future events, many of which are beyond our control, may ultimately prove to be incorrect since they are subject to risks and uncertainties that affect us. You will find herein below certain risks and uncertainties affecting us.

OVERVIEW

Warnex Inc. is a genomics-based biotechnology company, whose shares are traded on the Toronto Stock Exchange (TSX) under the symbol WNX. The strategic focus of the company is quality control for the agri-food, environmental and pharmaceutical markets. Our business model combines innovative genomic research and development projects that offer significant growth potential with the discipline and sustainability from profitable analytical and bioanalytical subsidiaries.

The focus of the Company is centered on Genevision™, a technology platform for the detection of food borne pathogens. Using DNA markers, this leading-edge technology provides a robust, rapid, accurate and automated genomics-based detection system that can be readily deployed in a manufacturing plant. An e-link offers complete on-line support through the Internet, enabling centralized management of the quality control process. The technology can also be employed to detect genetically modified food (GMOs) and, using proprietary Molecular Bar Codes, offers a complete traceability solution.

STRATEGIC BUSINESS UNITS

We have organized our operations into four strategic business units:

Business Unit	Activity
Analytical Services	Provides quality control services to the pharmaceutical, food and cosmetics industries. Services provided include traditional chemistry, microbiology, chromatography and method development and validation.
Bioanalytical Services	Provides advanced Mass Spectrometry technology to pharmaceutical and biotechnology companies in order to assist them in their development of new pharmaceutical products.
Research & Development	Focused on the ongoing research and development of our Genevision technology platform. Our group of more than 25 highly qualified genomic researchers continues the development of our technology, as well as the transfer of the technology to the Diagnostics group for manufacture and commercialization.
Diagnostics	Responsible for the manufacturing, validation and sales of the Genevision technology. The sales and marketing group has been very active since fall 2003 and we have signed our first Canadian and American customers. The manufacturing group commenced operations in Q4, 2003.

CORPORATE HIGHLIGHTS

OPERATING HIGHLIGHTS

- Received Canadian regulatory approvals for our *E. coli* O157 test. This test became the third Warnex test to be granted "Laboratory Procedure" status by Health Canada after *Listeria monocytogenes* and *Salmonella*.
- Signed up our first distributor for Europe, Foss Italia S.P.A., which is a wholly owned subsidiary of Foss A/S (based in Denmark) a leading international provider of rapid and accurate analytical quality control solutions for the agricultural, food, pharmaceutical and chemical industries, with offices in 21 countries. As part of the agreement, Foss Italia has exclusivity for Italy and has ordered three Genevision systems to start the promotion of the technology throughout its Italian customer network.
- Concluded a licence agreement with PHRI for molecular beacons. The use of primers with molecular beacons in a real-time PCR assay confers two, not just one, level of specificity to the Genevision pathogen detection technology. In other words, the system double-checks its results for the client.
- Joined Texas A&M Institute of Food Science and Engineering. We are the first Canadian company to join this partnership program, which will give us access to world-class researchers.
- Completed the construction of a new chromatography laboratory.

BALANCE SHEET

- Total assets of \$23.1 million and shareholders equity of \$16.7 million
- \$1.1 million invested in fixed assets
- \$5.6 million in cash and marketable securities

- \$4.0 million bank financing facility, with only \$500,000 utilized to date

STATEMENT OF OPERATIONS

- Revenue growth of 30% from \$1.7 million to \$2.2 million
- Profit generated by the Analytical and Bioanalytical divisions totaled \$0.8 million (2003-\$0.3 million)
- Net loss of \$1.6 million (2003 - \$1.1 million), including \$0.6 million in R&D and \$0.9 million in marketing and selling expenses for the Genevision technology
- Loss of \$0.04 per share compared with \$0.03 per share in 2003

MANAGEMENT OBJECTIVES

Our goal is to become a leader in the sale of genomics-based diagnostics. We have developed a novel technology, tailored it to the needs of a large and sophisticated marketplace with unique requirements, and invested in key marketing and customer service initiatives to support commercial growth.

2004 Objectives	
•	Expand our market penetration of the Genevision technology
•	Obtain regulatory validations in the U.S.
•	Expand the number of tests available on our technology platform, build our DNA marker library and make continuous improvements to the Genevision Technology
•	Continue revenue growth from our profitable analytical and bioanalytical service businesses

FINANCIAL PERFORMANCE

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDING MARCH 31, 2004 COMPARED TO THE THREE MONTHS ENDING MARCH 31, 2003.

The following table provides selected financial data from the quarterly financial statements:

	Revenue			Net profit (net loss)		
	Q1 2004	Q1 2003	Variance	Q1 2004	Q1 2003	Variance
Analytical	1,091,188	868,444	222,744	255,526	(9,390)	264,916
Bioanalytical	955,162	767,064	188,098	517,552	318,441	199,111
R&D	20,916	1,108	19,808	(640,266)	(476,386)	(163,880)
Diagnostic	117,904	-	117,904	(866,719)	(320,700)	(546,019)
Management	40,924	74,950	(34,027)	(831,895)	(619,113)	(212,782)
Other					1,779	(1,779)
Total	2,226,094	1,711,566	514,527	(1,565,802)	(1,105,369)	(460,433)

For the three-month period ended March 31, 2004, revenue reached \$2,226,094 (2003 - \$1,711,566), an increase of 30% over last year. The analytical division increased revenue by 26% from \$0.9 million to \$1.1 million. The bioanalytical division increased revenue by 25% from \$0.8 million to \$1.0 million. These increases are due to organic growth and demonstrate our commitment to provide our clients with a superior level of service and a dedication to quality.

Gross margins for the three-month period ended March 31, 2004 amounted to \$735,062 (2003-\$475,186). The increase in gross margin is due to additional sales in Analytical and Bioanalytical services while salaries are similar to last year.

Selling, administrative, research and development and financial expenses are summarized as follows:

	2004	2003	Variance
Administrative and selling expenses	1,526,225	1,000,326	525,899
Research & Development	660,575	477,042	183,533
Financial	114,064	104,966	9,098
Total	2,300,864	1,582,334	718,530

Selling and administrative expenses amount to \$1,526,225 for the three-month period ended March 31, 2004, (2003-\$1,000,326). The \$525,899 increase is mainly due to \$157,568 in salaries, \$101,591 in marketing and promotional expenses as we intensify the commercial roll-out of the Genevision technology and \$167,513 of upfront fee for a licence.

Financial expenses increased by \$9,098 to reach \$114,064 (2003-\$104,966).

Research & development expenses increased by 38% compared to last year to \$660,575 (2003-\$477,042). We have maintained the ongoing investment needed to gain regulatory approvals for the Genevision technology and continued to increase our portfolio of markers and improve our detection platform. We have joined the Texas A&M Institute of Food Science and Engineering. We are the first Canadian company to join this partnership program, which will give us access to world-class researchers. We also received Canadian regulatory approvals for our *E. coli* O157 test. This test became the third Warnex test to be granted "Laboratory Procedure" status by Health Canada after *Listeria monocytogenes* and *Salmonella*.

For the three-month period ended March 31, 2004, the net loss amounted to \$1,565,802 or \$0.04 per share (2003- \$1,105,369 or \$0.03 per share), and is mainly explained by our investments of \$0.9 million in selling and marketing and related activities for the Genevision technology and \$0.6 million in R&D as we aim to become a leader in the food diagnostics market. We have developed a unique technology, tailored it to the

needs of sophisticated food suppliers with unique demands, and invested in key marketing and customer service initiatives to support commercial growth.

BALANCE SHEET

The balance sheet as at March 31, 2004 shows total assets of \$23.1 million (December 2003-\$23.8 million), working capital of \$5.5 million (December 2003-\$7.8 million), shareholders' equity of \$16.7 million (December 2003-\$18.2 million) and cash and unused banking facilities of \$7.6 million (December 2003-\$9 million).

We also invested \$1.1 million in fixed assets, of which \$0.9 million was invested in laboratory equipment to support continued growth in the Analytical and Bioanalytical subsidiaries.

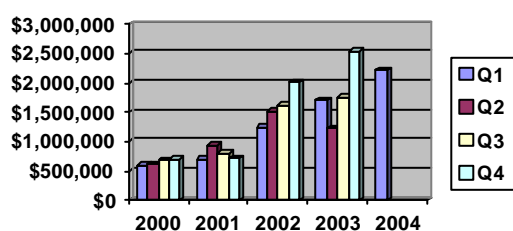
SUMMARY OF QUARTERLY RESULTS

The following table highlights selected quarterly information regarding the Statement of Earnings:

	Revenue			Net loss			Net loss per share		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
Q1	2,226,094	1,711,566	1,246,743	1,565,802	1,105,369	322,466	0.04	0.03	1,105,369
Q2		1,239,376	1,512,278		1,656,947	262,987		0.04	1,656,947
Q3		1,747,954	1,611,727		990,109	540,500		0.02	990,109
Q4		2,534,306	2,024,822		1,251,144	879,177		0.03	1,251,144
Total	2,226,094	7,233,202	6,395,570	1,565,802	5,003,569	2,005,130	0.04	0.12	5,003,569

We have maintained a steady growth in revenue since 2000 with record revenue of \$2,534,306 in the fourth quarter of 2003. The revenue for the first quarter of 2004 is 30% higher than last year and is our all time second best quarter. We have leveraged these revenues into significant investments in research and development and in the selling and marketing of the Genevision technology.

Revenue per quarter



LIQUIDITY AND CAPITAL RESOURCES

To date, Warnex has financed its research and development, and capital expenditures associated with R&D and the manufacturing of the Genevision technology primarily through private placements of common shares, the issuance of convertible debentures and the receipt of investment tax credits earned on eligible expenditures. Since its inception, the company has raised \$22.1 million from equity-based transactions and an additional \$3.0 million from the issuance of convertible debentures.

The commercial operations of Warnex's service subsidiaries have been financed through their own internally generated cash flows and through the use of commercial banking facilities.

Warnex's Board of Directors has implemented an investment policy regulating the investment activities of cash resources. The company invests solely in liquid, high-grade securities with varying maturity dates. As at March 31, 2004, the company has \$5,568,898 invested in cash and in such securities, \$2 million of which is restricted cash and \$372,436 of R&D tax credits. In addition, we have a \$4 million banking facility.

Management believes that Warnex's existing working capital, unused commercial banking facilities and ongoing cash flow from operations will generate sufficient amounts of cash in the short-term and the long-term to maintain the Company's capacity to meet its planned growth and fund development activities. Nonetheless, management has elected to seek additional equity or debt funding in order to maintain a solid balance sheet.

RELATED PARTY TRANSACTIONS

During the quarter, the Company paid rent in the amount of \$87,018 (2003-\$65,961) to a company owned by a director.

These transactions are measured at the exchange amount, which is the amount of consideration determined and agreed to by the related parties. The Company has a policy that any of the above type of transactions must be approved by the non-related members of the board of directors.

CRITICAL ACCOUNTING ESTIMATES

The \$7.4 million of goodwill results from the acquisition of the minority shareholder interest of 35% of Warnex Research Inc. in 2002. The Company assesses on an ongoing basis, and at least annually, whether a provision for permanent impairment in the value of goodwill should be adjusted to earnings. In 2003, we assessed the value of goodwill by projecting discounted cash flows and concluded that the value of goodwill as at December 31, 2003 was not impaired. We believe that this estimate is still adequate as at March 31, 2004.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2004, the Company adopted the new recommendations of the CICA regarding the stock-based compensation and uses the fair value-based method to record stock options awarded after January 1, 2002. The fair value of the stock options is evaluated on the grant date using the Black-Scholes model. The cost is recognized on a straight-line basis over the three-year vesting period as an increase to the compensation expense and to contributed surplus. When the options are exercised, the proceeds and the contributed surplus are credited to common share paid-up capital.

In accordance with the transitional provisions of these new recommendations, prior periods were not restated and an adjustment was made to the deficit opening balance of the current period to reflect cumulative effect of the change on prior periods for stock options granted between January 1, 2002 and December 31, 2003.

No compensation expense is recognized for stock options issued prior to January 1, 2002. Any consideration paid by employees for the exercise of stock options granted prior to 2002 is credited to capital stock.

Prior to 2004, the Company elected to account for its share options as capital transactions. If the share options had been accounted for based on the fair value method as it is in 2004, the 2003 pro forma net loss and pro forma loss per share would have been as follows:

	2004	2003
Net loss		
- As reported	\$1,565,802	\$1,105,369
- Pro forma	\$1,565,802	\$1,127,568
Basic loss per share		
- As reported	\$0.04	\$0.03
- Pro forma	\$0.04	\$0.03

The pro forma figures omit the effect of stock options granted prior to January 1, 2002.

The table below provides details regarding the effect of compensation cost for stock options granted on contributed surplus:

Three months ended March 31	2004	2003
Balance, beginning of period	\$ -	\$ -
Compensation cost for stock options granted between January 1, 2002 and December 31, 2003	229,140	-
Compensation cost for stock options granted in 2004	67,901	-
Balance, end of period	\$ 297,041	\$ -

Also, in the first quarter of 2004, the Company adopted a new accounting principle contained in Section 3063 of the CICA Handbook, "Impairment of long-lived Assets". Under this new accounting standard, when events or changes of situations result in a long-term loss of value for non-cash assets, impairment must be recorded during that year. Management believes that the adoption of this new standard has no effect on the Company's results, financial situation or cash flows.

OUTSTANDING SHARE DATA

As at December 31, 2003, the fully diluted number of shares are as follows:

Instrument	Nominal	Fully diluted
Issued and outstanding common shares	43,674,383	43,674,383
Options Issued	1,375,002	1,375,002
Share warrants (note 1)	4,607,143	4,607,143
Convertible debentures (note 2)	3,000,000	1,714,285
Fully diluted shares		51,370,813

Note 1: All share warrants expire in July 2004.

Note 2: We used the 2004 \$1.75 conversion factor to estimate proportionate number of common shares related to convertible debentures.

The 1,050,000 share warrants due March 12, 2004 were not exercised. As at March 31, 2004, the Company has 4,607,143 share warrants outstanding, exercisable at a price of \$1.50 until July 10, 2004. In 2002, the Company issued non-secured debentures in the amount of \$3,000,000 bearing interest at a rate of 12% annually, maturing July 10, 2008, and convertible into common shares of the Company. The interest on the debentures was capitalized until July 9, 2003 and added to the cost of the debentures for the period of July 2002 to July 2003. The capitalized interest is paid in 60 monthly payments from August 2003.

The capital of each debenture is convertible upon request of its holder into common shares of the Company, subject to the following date and value conditions:

July 10, 2003 – December 31, 2004:	\$ 1.75
January 1, 2005 – December 31, 2005:	\$ 2.00
January 1, 2006 – December 31, 2006:	\$ 4.00
January 1, 2007 – July 10, 2007:	\$ 6.00

The Company has the right to force the conversion of part of the debentures up to a total amount of \$2,000,000 from January 1, 2004 to December 31, 2004 in the event that the average market price of the common shares of the Company for a period of 21 business days prior to the conversion notice by the Company to the debenture holder is at least 30% higher than the conversion price at that date. Finally, the Company will have the right to force the conversion of the remaining portion of the debentures from

January 1, 2005 to July 10, 2007 in the event that the average market price of the common shares of the Company for a period of 21 business days prior to the conversion notice by the Company to the debenture holder is at least 25% higher than the conversion price at that date.

According to section 3860 of the CICA handbook, we are required to separately value the debt component and the equity portion of the debentures, i.e. the value of the option to convert debentures into common shares. The value of the debt component of the convertible debentures has been determined by discounting the future capital and interest payments until July 10, 2008, at a discount rate that represents the borrowing rate available to the Company for similar debentures having no conversion rights. The remaining portion of the net proceeds of the debentures is \$332,000 and is therefore presented in the balance sheet as part of shareholders' equity.

The interest expense related to the debt component has been charged to earnings and the allocation related to the equity component, \$10,996 (2003-\$9,824), has been charged to the deficit and disclosed as interest on the equity component of the convertible debentures.

CORPORATE GOVERNANCE

Warnex believes that a high standard of corporate governance is not only fundamental to its success, but serves as a competitive advantage.

The Board of Directors has the ultimate responsibility to represent the shareholders of Warnex so as to protect the assets of the Corporation and to maximize shareholder value. Its role is not to manage the day-to-day operations of Warnex, this being delegated to the management of the Corporation and, where appropriate, to various committees of the Board.

Warnex has been a leader in adapting and maintaining the best practices of corporate governance. For example, the Chairman of the Board, Richard Laferrière is an independent director. The Chief Executive Officer of Warnex is Mark Busgang and is responsible for the implementation of the business plan and the overall management of the Corporation; we have adopted a Code of Ethics; Mark Busgang is the only related director on the Board of Directors, which meets regularly without the related director being present; and there are no related directors on any committee of the Board, except for the Executive Committee.

The Toronto Stock Exchange (TSX) has established corporate governance guidelines for companies listed on the Exchange. Warnex believes that its governance practices comply with current TSX guidelines.

RISK AND UNCERTAINTIES

Warnex has made substantial efforts to minimize the risks associated with any research and development project. Our service groups provide positive cash flow and profits, which cover a significant portion of the operating costs of the Warnex corporate group. As such, we do not believe that the corporate viability of Warnex is at risk.

The risk factors inherent with our Genevision project are based on our ability to continue to develop additional markers and enhance the technology platform, as well as to manage the commercial rollout of the technology. As with any technology platform, Genevision will require ongoing funding to maintain its technological lead. While the Company has adequate cash resources to finance R&D for 2 years, there is no guarantee that additional funds will be available if required.

OUTLOOK

We expect to continue to incur losses on a consolidated basis in 2004. While our services are expected to continue to provide profits and positive cash flow, the costs associated with ongoing research and development, as well as the development of sales, marketing and manufacturing operations for the Genevision technology, will lead to overall operating losses and negative cash flow.

Critical events in 2004 will be regulatory approval in the United States for the Genevision technology for several key pathogens and the broader commercial acceptance of the Genevision technology.

Signed for management, this 13 day of May 2004.

Mark Busgang
President & CEO

Denis Pellerin, CA
Vice President and CFO

WARNEX INC.
INTERIM CONSOLIDATED BALANCE SHEET
(Unaudited)

	March 31 2004	December 31 2003
Assets		
Current		
Cash	\$2,671,155	\$2,847,373
Marketable Securities	2,897,743	4,145,429
Accounts receivable	1,628,241	1,822,507
Inventory	292,204	101,295
Income taxes credits receivable	372,436	305,736
Prepaid expenses	146,284	202,543
	8,008,063	9,424,883
Capital assets	7,734,667	6,955,210
Goodwill	7,373,083	7,373,083
	\$23,115,813	\$23,753,176
Liabilities		
Current		
Accounts payable	\$2,255,451	\$1,305,510
Current portion of long-term debt	216,835	215,327
Current portion of convertible debentures	71,605	71,605
	2,543,891	1,592,442
Long-term debt	1,019,296	1,075,343
Liability component of convertible debentures	2,900,718	2,924,586
	6,463,905	5,592,371
Shareholders' equity		
Capital stock (note 5)	29,059,509	29,059,509
Equity component of convertible debentures	332,000	332,000
Contributed surplus (note 5)	297,041	
Deficit	(13,036,642)	(11,230,704)
	16,651,908	18,160,805
	\$23,115,813	\$23,753,176

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF EARNINGS
(Unaudited)

	Three months ended March 31		Three months ended March 31	
	2004	2003	2004	2003
Revenue	\$2,226,094	\$1,711,566	\$2,226,094	\$1,711,566
Cost of goods sold (note 4)	1,491,032	1,236,380	1,491,032	1,236,380
Gross margin	735,062	475,186	735,062	475,186
Operating expenses (note 4)				
Selling, general and administrative	1,526,225	1,000,326	1,526,225	1,000,326
Finance charge s	114,064	104,966	114,064	104,966
Research expenditures, net of tax credits	660,575	477,042	660,575	477,042
	2,300,864	1,582,334	2,300,864	1,582,334
Loss from continuing operations	1,565,802	1,107,148	1,565,802	1,107,148
Loss (Profit) from discontinued operations	-	(1,779)	-	(1,779)
Net loss	\$1,565,802	\$1,105,369	\$1,565,802	\$1,105,369
Basic and fully diluted net loss per share from continuing operations	\$0.04	\$0.03	\$0.04	\$0.03
Basic and fully diluted net loss per share	\$0.04	\$0.03	\$0.04	\$0.03
Weighted average number of shares outstanding	43,674,383	43,253,739	43,674,383	43,253,739

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF DEFICIT
(Unaudited)

	Three months ended March 31		Three months ended March 31	
	2004	2003	2004	2003
Balance, beginning of period				
As previously reported	\$11,230,704	\$6,185,059	\$11,230,704	\$6,185,059
Change in accounting policy regarding stock-based compensation (note 2)	229,140	-	229,140	-
As restated	11,459,844	6,185,059	11,459,844	6,185,059
Interest on equity component of convertible debentures	10,996	9,824	10,996	9,824
Net loss	1,565,802	1,105,369	1,565,802	1,105,369
Balance, end of period	\$13,036,642	\$7,300,252	\$13,036,642	\$7,300,252

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF CONTRIBUTED SURPLUS
(Unaudited)

	Three months ended March 31		Three months ended March 31	
	2004	2003	2004	2003
Balance, beginning of period				
As previously reported	\$ -	\$ -	\$ -	\$ -
Change in accounting policy regarding stock-based compensation (note 2 and 5)	229,140	-	229,140	-
As restated	\$229,140	\$ -	\$229,140	\$ -
Compensation cost for stock options granted in 2004	67,901	-	67,901	-
Balance, end of period	\$297,041	\$ -	\$297,041	\$ -

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

	Three months ended March 31		Three months ended March 31	
	2004	2003	2004	2003
Operations (note 6)				
Net loss	\$(1,565,802)	\$(1,105,369)	\$(1,565,802)	\$(1,105,369)
Items not affecting cash:				
Amortization	310,968	285,030	310,968	285,030
Compensation cost for stock options	67,901	-	67,901	-
Interest on equity component of convertible debentures	(10,996)	(9,824)	(10,996)	(9,824)
	(1,197,929)	(830,163)	(1,197,929)	(830,163)
Net change in non-cash working capital items	942,856	447,111	942,856	447,111
	(255,073)	(383,052)	(255,073)	(383,052)
Financing activities				
Proceeds from long-term debt	-	2,515	-	2,515
Repayment of long-term debt	(54,538)	(71,170)	(54,538)	(71,170)
Liability component of convertible debentures	(23,868)	88,768	(23,868)	88,768
Issue of shares	-	61,725	-	61,725
	(78,406)	81,838	(78,406)	81,838
Investing activities				
Decrease in short-term investments	-	138,648	-	138,648
Decrease in marketable securities	1,247,686	1,215,672	1,247,686	1,215,672
Acquisition of capital assets	(1,090,425)	(1,069,964)	(1,090,425)	(1,069,964)
	157,261	284,356	157,261	284,356
Increase (decrease) in cash and cash equivalents	(176,218)	(16,858)	(176,218)	(16,858)
Cash and cash equivalents, beginning of period	2,847,373	389,290	2,847,373	389,290
Cash and cash equivalents, end of period	\$2,671,155	\$372,432	\$2,671,155	\$372,432

1. Significant accounting policies

The accompanying unaudited financial statements are prepared in accordance with Canadian generally accepted accounting principles for interim financial statements and do not include all the information required for complete financial statements. They are consistent with the policies outlined in the Company's audited financial statements for the year ended December 31, 2003 except for the accounting of stock-based compensation as described below. The interim financial statements and related notes should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2003. When necessary, the financial statements include amounts based on informed estimates and best judgments of management. The results of operations for the interim periods reported are not necessarily indicative of results to be expected for the year.

2. Change in accounting policies

Stock-based compensation

Effective January 1, 2004, the Company adopted the new recommendations of the CICA regarding the stock-based compensation and uses the fair value-based method to record stock options awarded after January 1, 2002. The fair value of the stock options is evaluated on the grant date using the Black-Scholes model. The cost is recognized on a straight-line basis over the three-year vesting period as an increase to the compensation expense and to contributed surplus. When the options are exercised, the proceeds and the contributed surplus are credited to common share paid-up capital.

In accordance with the transitional provisions of these new recommendations, prior periods were not restated and an adjustment was made to the deficit opening balance of the current period to reflect cumulative effect of the change on prior periods for stock options granted between January 1, 2002 and December 31, 2003.

No compensation expense is recognized for stock options issued prior to January 1, 2002. Any consideration paid by employees for the exercise of stock options granted prior to 2002 is credited to capital stock.

3. Significant accounting policies

Use of estimates

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 as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions also affect revenues and expenses during the period reported. Actual results could differ from these estimates.

Revenue recognition

Revenue from analytical services is recorded at the time the test is completed.

Revenue from bioanalytical services is recorded using the percentage of completion method, whereby revenue and profit are based on a ratio of costs incurred to total estimated costs of the project.

Revenue from diagnostic products is recorded at the time the title of ownership is transferred to the client.

Cash and cash equivalents

The cash and cash equivalents consist of bank accounts, short-term investments with maturity dates of three months or less and are carried at the lower of cost or market value.

Inventory

Inventory is valued at the lower of cost and net realizable value. Cost is determined on the first-in first-out basis.

Warnex Inc.

Notes to Interim Consolidated Financial Statements (unaudited)

March 31, 2004 and 2003

Research and development tax credits

The Company uses the accrual method of accounting to charge research and development tax credits to earnings. These tax credits arise as a result of incurring qualified scientific research and development expenditures.

Capital assets

Capital assets are recorded at cost and amortized as follows:

Declining-balance method	
Telephone equipment	20%
Furniture and fixtures	20%
Lab equipment	20%
Machinery and equipment	20%
Computer software	20%
Computer equipment	30%
Straight-line method	
Leasehold improvements	over the term of the lease

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is no longer amortized but is subject to at least an annual assessment for impairment by applying a fair value test. The Company assesses on an ongoing basis whether a provision for permanent impairment in the value of goodwill should be adjusted to earnings. This is determined mainly by analyzing whether the projected discounted cash flows exceed the net book value of goodwill.

Foreign exchange

The Company follows the temporal method to translate its foreign currency balances and transactions into Canadian dollars. Under this method, monetary assets and liabilities are translated at the rates of exchange in effect at the end of the reporting period and the other balance sheet items and income statement items are translated at the monthly average exchange rates in effect at that time. Exchange gains and losses are included in net earnings for the period.

Stock options

The Company uses the fair value-based method to record stock options awarded after January 1, 2002. The fair value of the stock options is evaluated on the grant date using the Black-Scholes model. The cost is recognized on a straight-line basis over the three-year vesting period as an increase to the compensation expense and to contributed surplus. When the options are exercised, the proceeds and the contributed surplus are credited to common share paid-up capital. No compensation expense is recognized for stock options issued prior to January 1, 2002. Any consideration paid by employees for the exercise of stock options granted prior to 2002 is credited to capital stock.

Loss per share

Loss per share is calculated using the weighted average number of shares outstanding during the year. Diluted loss per share is computed using the treasury stock method, giving effect to the exercise of all dilutive elements. The diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of these elements.

Warnex Inc.**Notes to Interim Consolidated Financial Statements (unaudited)**

March 31, 2004 and 2003

Long-lived assets

Effective January 1, 2004, the Company adopted the new recommendations of the CICA regarding long-lived assets. These assets comprise capital assets and are reviewed for impairment when certain events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability test is performed using discounted future net cash flows that are directly associated with the asset's use and eventual disposition. The amount of the impairment, if any, is measured as the difference between the carrying value and the fair value of the impaired assets. No impairment charges were recorded upon adoption of this new standard.

4. Information relating to the consolidated statement of earnings

	2004
a) The following items are included in cost of goods sold:	
Amortization, capital assets	180,305
Gain on foreign exchange	(25,602)
b) The following items are included in operating and R&D expenses:	
Amortization, capital assets	130,663
Interest and bank charges	4,888
Interest on long-term debt	20,815
Interest on convertible debentures	88,361
Gain on foreign exchange	(106)
Recovery of loan receivable	(21,429)
Research and development expenses (includes amortization of \$57,354)	727,275
Research and development tax credits	(66,700)

5. Capital stock**a) Authorized:**

An unlimited number of the following classes of shares:

- Preferred shares, issuable in series, without nominal or par value.
- Common shares, voting, without nominal or par value.

b) Issued and fully paid

The issued and fully paid capital stock consists of common shares as follows:

	Three months ended		Three months ended	
	March 31, 2004		March 31, 2004	
	Number	Amount	Number	Amount
Balance, beginning of period	43,674,383	\$29,059,509	43,674,383	\$29,059,509
Issued	-	-	-	-
Costs of issuance	-	-	-	-
Redeemed	-	-	-	-
Balance, end of period	43,674,383	\$29,059,509	43,674,383	\$29,059,509

5. Capital stock...cont'd

c) Contributed surplus

The table below provides details regarding the contributed surplus:

	Three months ended March 31		Three months ended March 31	
	2004	2003	2004	2003
Balance, beginning of period	\$ -	\$ -	\$ -	\$ -
Compensation cost for stock options granted between January 1, 2002 and December 31, 2003	229,140	-	229,140	-
Compensation cost for stock options granted in 2004	67,901	-	67,901	-
Balance, end of period	\$ 297,041	\$ -	\$ 297,041	\$ -

d) Common stock option plan

The Company has in place an Incentive Stock Option Plan. The Plan provides that the terms of the option and the option price shall be fixed by the directors, subject to the price restrictions imposed by the Exchange. The stock options are granted only to directors, officers, consultants, employees and other key personnel of the Company or its subsidiaries and only upon the recommendation of the directors of the Company.

The maximum number of common shares that are issuable under the Plan cannot exceed 4,348,773, i.e 10% of the number of outstanding common shares at the time when the plan was amended.

Stock options granted under the Incentive Stock Option Plan may not be for a period longer than 10 years and the exercise price must be paid in full upon exercise. During 2003, the Company amended its stock option plan changing the period from 5 years to 10 years.

As at March 31, 2004, the Company has granted options to purchase 1,375,002 (2003 – 1,197,334) common shares at various exercise prices, each pursuant to the Incentive Stock Option Plan of the Company, expiring no later than the year 2014.

The changes to the number of stock options outstanding are as follows:

Three months ended March 31, 2004	Number of shares	Weighted-average exercise price (\$)
Balance, beginning of period	1,198,334	0.98
Granted	200,000	1.35
Exercised	-	-
Cancelled	23,332	1.24
Balance, end of period	1,375,002	1.03

5. Capital stock...cont'd

Stock options outstanding are as follows:

Range of Exercise price of outstanding options	Number	Weighted- average remaining life (years)	Weighted-average exercise price (\$)
\$0.40 - 0.80	240,000	1.98	0.53
0.84 - 0.92	301,500	9.34	0.86
1.00 - 1.20	302,834	2.89	1.06
1.25 - 1.35	480,668	8.47	1.33
1.50 - 1.70	50,000	1.99	1.52
	1,375,002	6.06	1.03

During the quarter, the Company granted 200,000 options to purchase common shares. The weighted average grant date fair value of options granted during the quarter amounted to \$1.16 per option. The weighted average value of each option granted in 2003 was \$1.18 and \$1.02 in 2002. The fair value of each option granted was determined using the Black-Scholes option pricing model and the following weighted average assumptions:

Risk-free interest rate	2004 options 4.42%
Expected life	10 years
Expected volatility in the market price of the shares	88%
Expected dividend yield	0%

Prior to 2004, the Company elected to account for its share options as capital transactions. If the share options had been accounted for based on the fair value method as it is in 2004, the 2003 pro forma net loss and pro forma loss per share would have been as follows:

	2004	2003
Net loss		
- As reported	\$1,565,802	\$1,105,369
- Pro forma	\$1,565,802	\$1,127,568
Basic loss per share		
- As reported	\$0.04	\$0.03
- Pro forma	\$0.04	\$0.03

The pro forma figures omit the effect of stock options granted prior to January 1, 2002.

e) Share warrants

The 1,050,000 share warrants due March 12, 2004 were not exercised. As at March 31, 2004, the Company has 4,607,143 share warrants outstanding, exercisable at a price of \$1.50 until July 10, 2004.

Warnex Inc.**Notes to Interim Consolidated Financial Statements (unaudited)**

March 31, 2004 and 2003

6. Information relating to the consolidated statements of cash flows

a) Net change in non-cash working capital items is comprised of the following:

Accounts receivables	\$194,266
Inventory	(190,909)
Investment tax credits receivable	(66,700)
Prepaid expenses	56,259
Accounts payables	949,940
	<u>\$942,856</u>

7. Segmented information

For the three-month period ended March 31, 2004, the Companies operated in Canada in the following industries:

	Revenue	Net earnings (loss)	Amortization	Capital assets and goodwill	Total assets
Analytical services	\$1,091,188	\$255,526	\$86,645	\$1,906,718	\$3,074,714
Bioanalytical services	955,162	517,552	62,449	1,924,622	3,002,259
Research & development	20,916	(640,266)	57,354	8,627,151	8,981,672
Manufacturing diagnostic products	117,904	(866,719)	59,513	1,469,681	1,567,150
Management services	40,924	(831,895)	45,007	1,179,579	6,490,018
Sales agency	-	-	-	-	-
	<u>\$2,226,094</u>	<u>\$(1,565,802)</u>	<u>\$310,968</u>	<u>\$15,107,751</u>	<u>\$23,115,813</u>

8. Financial instruments**Fair value**

The estimated fair value of certain financial instruments shown on the balance sheet is equivalent to their carrying amount because they are realizable in the short-term or items whose carrying amount approximates the fair value. The financial instruments include cash, marketable securities, accounts receivable and accounts payable.

The fair value of long-term debt approximates market value and corresponds to those the Company would currently obtain for loans with similar maturity dates and terms. Considering the due dates of the long-term debt as at March 31, 2004, the fair value has been established at its carrying amount.

Credit risk

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of each new customer. The Company establishes an allowance for doubtful accounts that corresponds to the credit risks of its specific customers, historical trends and economic circumstances.

Interest rate risk

The Company has a line of credit at variable interest rates. Consequently, the Company is exposed to interest rate risk as a result of potential rate fluctuations.

A portion of the long-term debt is at fixed interest rates, which are not subject to interest rate fluctuations, and accordingly minimizes its interest rate exposure.

Currency risk

The Company realizes some of its sales and purchases in foreign currencies. Consequently, it is exposed to fluctuations of these currencies. As at March 31, 2004, assets and liabilities in other currencies are the following:

	US Dollars	Euro
Cash	91,513	-
Accounts receivable	582,929	190
Accounts payable	21,825	6,128

9. Comparative figures

Certain figures in the 2003 financial statements have been restated to conform to the presentation in the current year.