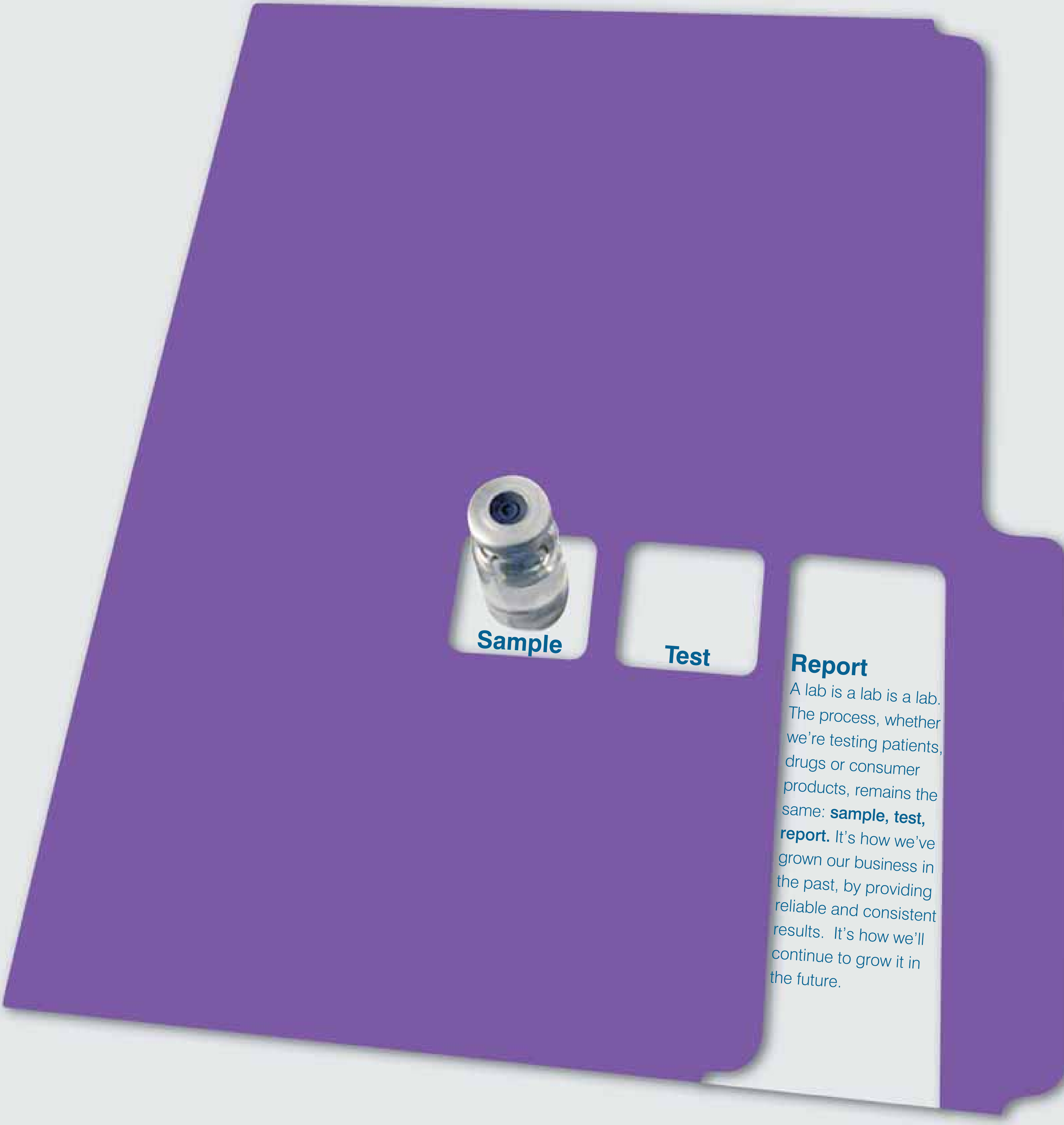
Laboratory Services
Our roots... our future.



WARNEX

Second Quarter 2010

Management's 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 unaudited financial statements for the quarter ended June 30, 2010, and the related notes appearing elsewhere in this document. This discussion and analysis compares the performance for the second quarter of 2010 with that of 2009 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. Information contained herein includes any significant developments as at August 11, 2010, the date on which the MD&A was approved by the Company's Board of Directors.

The enclosed financial statements have been prepared in accordance with the Canadian generally accepted accounting principles (GAAP). All figures are in Canadian dollars unless otherwise indicated.

Additional information relating to our Company, including the Annual Information Form (AIF), is available on SEDAR at www.sedar.com.

Forward-Looking Statements

Certain statements contained in this Management's Discussion and Analysis are forward-looking and are subject to numerous risks and uncertainties, known and unknown. For information identifying known risks and uncertainties, relating to financial resources, liquidity risk, key customers and business partners, credit risk, foreign currency risk, government regulations, laboratory facilities, volatility of share price, employees, suppliers, and other important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements, please refer to the Risk and Uncertainties Section of this Management's Discussion and Analysis. Consequently, actual results may differ materially from the anticipated results expressed in these forward-looking statements.

Overview

Warnex is a life sciences company devoted to protecting public health by providing laboratory services to the pharmaceutical and healthcare sectors. Warnex Analytical Services provides pharmaceutical and biotechnology companies with a variety of quality control services, including chemistry, chromatography, microbiology, method development and validation, and stability studies. Warnex Bioanalytical Services specializes in bioequivalence and bioavailability studies for clinical trials. Warnex Medical Laboratories provides specialized testing for the healthcare industry as well as pharmaceutical and central laboratory services. Warnex PRO-DNA Services offers DNA identification tests for paternity, maternity and other family relationships, as well as for immigration and forensic testing purposes. Warnex has three facilities located in Laval and Blainville, Quebec, and Thunder Bay, Ontario. The Company's common stock is traded on the Toronto Stock Exchange, under the symbol WNX.

In June 2009, the Company acquired the shares of Molecular World Inc. and subsequently changed its name to Warnex PRO-DNA Services Inc. The operations of this subsidiary are included in the Medical Laboratories division.

Strategic Business Units

Our operations are organized into these strategic business units:

Business Unit	Activity
Analytical Services	Provides quality control services to the pharmaceutical and biotechnology industries, including chemistry, chromatography, microbiology, method development and validation, and stability studies. This includes assessing the physical, chemical and microbiological properties of individual ingredients in addition to verifying the active ingredient content of finished products.
Bioanalytical Services	Assists both innovator and generic pharmaceutical companies as well as biotechnology companies in their development of new pharmaceutical products by conducting bioavailability and bioequivalence studies as part of clinical trials.
Medical Laboratories	Provides specialized laboratory testing services to the healthcare and pharmaceutical sectors, including the Prenatest® prenatal screening test. This division also offers genetic testing, pharmacogenetic services and human DNA identification including forensic DNA testing.

Corporate Highlights

<u>Operating Highlights</u>

- Second quarter revenues of $6.4 million compared to $5.4 million for the same quarter last year, representing an increase of 18%.
- Warnex Medical Laboratories and Epigenomics AG, a molecular diagnostics company focussed on cancer, entered into a non-exclusive licensing agreement for Epigenomics' colorectal cancer biomarker Septin9. Under the terms of the agreement, Warnex has obtained the rights to establish a laboratory-developed test for Septin9 and offer colorectal cancer blood testing services in Canada. This blood test, using Epigenomics' Septin9 biomarker, offers an easy and accurate method to help diagnose patients with colorectal cancer.
- Warnex's Bioanalytical Services division successfully passed a Good Clinical Practices (GCP) inspection by a European health authority, the Austrian Agency for Health and Food Safety (AGES). The inspection was a routine, study-specific inspection of a bioequivalence study, whose objective was to evaluate the organization's adherence to the applicable regulatory requirements. Warnex intends to leverage this successful inspection in its business development efforts in the European market.
- Warnex appointed a new director at its annual meeting: Dr. Richard Lacombe. Dr. Lacombe is a consultant with over 30 years of experience with pharmaceutical, biotech, and contract research organization (CRO) companies.

<u>Balance Sheet</u>

- Total assets of $14.9 million and shareholders' equity of $2.8 million
- $76.7 thousand invested in property, plant and equipment
- $102.9 thousand invested in computer software
- Cash and cash equivalents of $0.3 million
- $0.3 million used from the $2.0 million short-term bank financing facility

Statement of Earnings and Comprehensive Income

- Revenue of $6.4 million (2009 - $5.4 million). For the six-month period ended June 30, 2010, revenue was $11.5 million (2009 - $13.0 million).
- Net earnings of $11,295 (2009 - net loss $0.3 million). For the six-month period ended June 30, 2010, net loss totalled $0.8 million (2009 - net earnings of $0.8 million).
- Net earnings of $0.00 per share (2009 - net loss of $0.01 per share). For the six-month period ended June 30, 2010, net loss totalled $0.01 per share (2009 - net earnings of $0.01 per share).
- Adjusted earnings before interest, taxes, depreciation and amortization (adjusted EBITDA), as defined in the financial performance section of this report, of $0.9 million (2009 - $0.1 million). For the six-month period ended June 30, 2010, adjusted EBITDA amounted to $0.5 million (2009 - $2.0 million).

Management Objectives

Our goal is to create value for our shareholders by building a strong suite of profit-generating pharmaceutical and medical laboratory services. Below are our objectives for 2010.

2010 Objectives

- Attain profitability by increasing revenues, managing costs and improving productivity
- Restructure our balance sheet
- Increase business development effort in all divisions to increase revenue and expand our geographic markets
- Evaluate new business opportunities, including strategic acquisitions, to expand our service offering and increase critical mass

Financial Performance

Results of Operations for the Three Months Ending June 30, 2010, Compared to the Three Months Ending June 30, 2009

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

	Revenue			**Net earnings (net loss)**		
	Q2 2010 $	Q2 2009 $	Variance $	Q2 2010 $	Q2 2009 $	Variance $
Analytical	2,893,222	2,943,970	(50,748)	196,543	309,395	(112,852)
Bioanalytical	2,146,877	1,332,306	814,571	766,061	(83,859)	849,920
Medical	1,246,859	1,065,836	181,023	218,573	144,058	74,515
Management services	85,468	79,362	6,106	(1,169,882)	(716,254)	(453,628)
Total	6,372,426	5,421,474	950,952	11,295	(346,660)	357,955

For the three-month period ended June 30, 2010, revenue reached $6,372,426 (2009 - $5,421,474), an increase of 18% compared to last year.

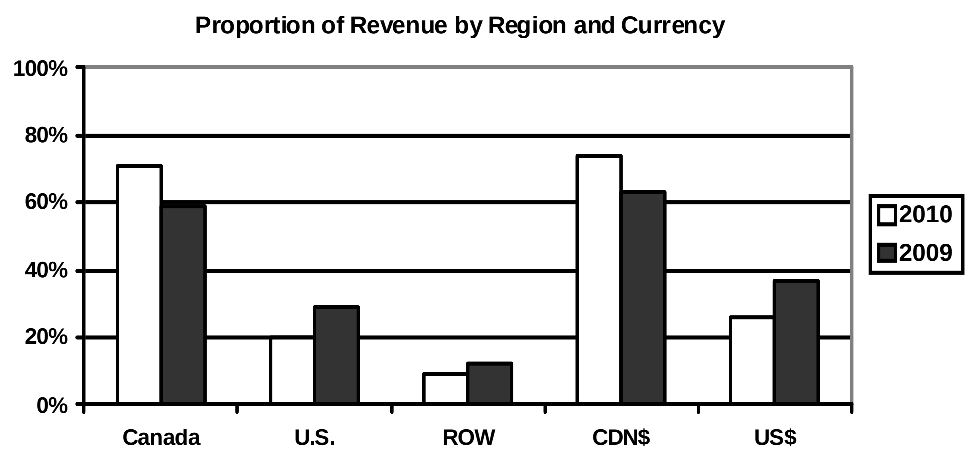
The Analytical division’s revenues were similar to last year at $2.9 million. The analytical laboratory in Laval generated $1.1 million during the quarter (2009 - $1.1 million) while the Neopharm division in Blainville generated $1.8 million (2009 - $1.8 million).

The Bioanalytical division's revenues increased by 61% from $1.3 million in 2009 to $2.1 million in 2010. This increase is due to a substantial increase in volume while the average price decreased compared to the same period last year. Our business development efforts in this division are ongoing to increase our business from new and existing customers.

The Medical division's revenue increased by 17% from $1.0 million in 2009 to $1.2 million in 2010. Prenatal testing revenues increased by 4%, molecular diagnostics increased by 33% and pharmacogenetic contracts increased by 5% compared to last year. The acquisition of Molecular World Inc., concluded on June 12, 2009, provided revenues of $0.1 million for the quarter ended June 30, 2010.

For the six-month period ended June 30, 2010, revenue reached $11,463,096 (2009 - $12,979,129).

For the six-month period, the proportion of revenues generated by Canadian customers increased to 71% in 2010 from 59% in 2009. The proportion of revenues from U.S. customers decreased to 20% in 2010 from 29% in 2009 and from foreign customers decreased to 9% in 2010 from 12% in 2009. The proportion of total revenue generated in U.S. dollars was lower than last year, with 26% in 2010 versus 37% in 2009.



Gross margin for the three-month period ended June 30, 2010, amounted to $1,813,275 or 28% of revenue (2009 - $1,042,478 or 19% of revenue). The increase of $770,797 in gross margin is mainly explained by the increase in revenue in the Bioanalytical division compared to last year. Gross margin for the six-month period ended June 30, 2010, amounted to $2,596,194 or 23% of sales (2009 - $4,110,010 or 32% of sales), a decrease of $1,513,816. This decrease is mainly explained by a slow first quarter in the Bioanalytical division this year compared to last year as well as the execution of high margin projects in this division during the first quarter of 2009.

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

	Q2 2010 $	Q2 2009 $	Variance $
Selling and administrative	1,561,595	1,481,407	80,188
Financial	277,837	313,086	(35,249)
Research and development tax credits	(238,000)	-	(238,000)
Total	1,601,432	1,794,493	(193,061)

Selling and administrative expenses amounted to $1,561,595 for the three-month period ended June 30, 2010 (2009 - $1,481,407). The increase of $80,188 is mainly explained by an increased investment in our sales group, professional fees related to the transition to International Financial Reporting Standards ("IFRS"), the review of our ISO certification in the Medical division and an increase in the salary expense, despite a reduction in other expenses compared to last year. In proportion of revenue, administrative and selling expenses were lower than last year at 24% (2009 - 27%). For the six-month period ended June 30, 2010, selling and administrative expenses amounted to $3,097,427 (2009 - $2,962,911).

Financial expenses decreased by $35,249, from $313,086 in the second quarter of 2009 to $277,837 in the second quarter of 2010, mainly due to less interest following repayments made on the long term debt. For the six-month period ended June 30, 2010, financial expenses amounted to $554,393 (2009 - $624,025), a decrease of $69,632.

For the three-month period ended June 30, 2010, net earnings amounted to $11,295 or $0.00 per share (2009 - net loss of $346,660 or $0.01 per share). For the six-month period ended June 30, 2010, net loss totalled $785,869 or $0.01 per share (2009 - net earnings of $756,097 or $0.01 per share).

For the three-month period ended June 30, 2010, adjusted earnings before interest, taxes, depreciation and amortization (adjusted EBITDA) amounted to $854,173 (2009 - $129,414), an increase of $724,759. For the six-month period ended June 30, 2010, adjusted EBITDA amounted to $534,334 (2009 - $2,042,388), a decrease of $1,508,054. This decrease is mainly due to lower revenue and margins in the first quarter of 2010 compared to 2009.

Adjusted EBITDA is a non-GAAP financial measure and does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. The calculation for the period under review is as follows:

	Q2 2010 $	Q2 2009 $	Variance $
Net earnings (loss)	11,295	(346,660)	357,955
Financial expenses	277,837	313,086	(35,249)
Interest revenue	(404)	(3,575)	3,171
Amortization	371,827	407,020	(35,193)
Unrealized foreign exchange loss (gain) on debentures	200,548	(405,355)	605,903
Unrealized foreign exchange loss (gain) on working capital components	(38,142)	144,341	(182,483)
Compensation for stock options	31,212	20,557	10,655
Adjusted EBITDA	854,173	129,414	724,759

The calculation for the six-month period ended June 30, 2010, is as follows:

	2010 $	2009 $	Variance $
Net earnings (loss)	(785,869)	756,097	(1,541,966)
Financial expenses	554,393	624,025	(69,632)
Interest revenue	(2,971)	(9,397)	6,426
Amortization	738,406	804,371	(65,965)
Unrealized foreign exchange loss (gain) on debentures	56,243	(233,023)	289,266
Unrealized foreign exchange loss (gain) on working capital components	(16,076)	79,723	(95,799)
Compensation for stock options	(9,792)	20,592	(30,384)
Adjusted EBITDA	534,334	2,042,388	(1,508,054)

For the adjusted EBITDA calculation, the Company now includes the unrealized gains and/or losses on foreign exchange.

Balance Sheet

The balance sheet as at June 30, 2010, shows total assets of $14.9 million (December 2009 - $15.5 million), working capital of $(0.1) million (December 2009 - $0.4 million), shareholders' equity of $2.8 million (December 2009 - $3.6 million), cash of $0.3 million (December 2009 - $0.9 million) and a bank indebtedness of $0.3 million (December 2009 - $nil). In 2010, the Company also invested $76.7 thousand in property, plant and equipment and $102.9 thousand in computer software.

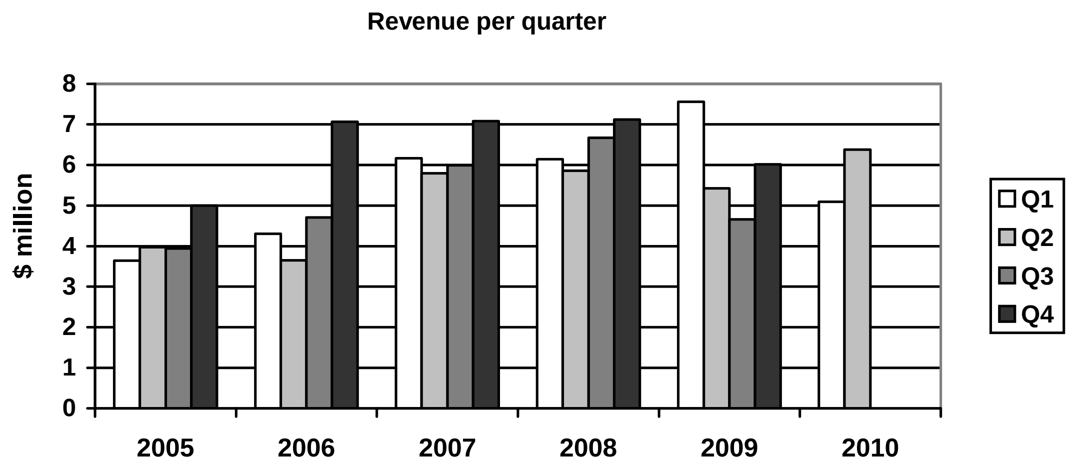
Summary of Quarterly Results

The following tables provide selected quarterly information regarding the Statement of Earnings:

	Revenue			Net earnings (loss)		
	2010 $	2009 $	2008 $	2010 $	2009 $	2008 $
Q1	5,090,670	7,557,655	6,141,566	(797,164)	1,102,757	(286,322)
Q2	6,372,426	5,421,474	5,858,423	11,295	(346,660)	1,520,417*
Q3		4,656,405	6,669,833		(782,797)	511,610
Q4		6,011,453	7,116,899		(137,548)	627,352
Total		23,646,987	25,786,721		(164,248)	2,373,057*

*Includes a gain on extinguishment of debt of $1,814,192.

	Net earnings (loss) per share			Diluted net earnings (loss) per share		
	2010 $	2009 $	2008 $	2010 $	2009 $	2008 $
Q1	(0.01)	0.02	(0.01)	(0.01)	0.01	(0.01)
Q2	0.00	(0.01)	0.03	0.00	(0.01)	0.02
Q3		(0.01)	0.01		0.00	0.01
Q4		0.00	0.01		0.00	0.01
Total		0.00	0.04		0.00	0.03



Liquidity and Capital Resources

The commercial operations of Warnex's service divisions have been financed through their own internally generated cash flows, the use of commercial banking facilities, debentures and capital leases with equipment vendors.

In May 2008, the Company extinguished its debt in the principal amount of $11,345,000 with the existing debenture holders. The Company then entered into new agreements with the same lenders which included the following terms and conditions:

- Elimination of the fixed conversion rate of 1.369 contained in the US dollar denominated debentures, therefore reducing the principal debt from CDN$6,845,000 to US$5,000,000;
- Conversion of an aggregate of $1,830,200 in principal into common shares of Warnex;
- Repayment of an aggregate of $1,333,333 in principal upon closing;
- An aggregate of $6,333,333 in principal to be paid in three years;
- Increase in the interest rate on the US dollar denominated debentures to 12% per annum;
- Reduction in the exercise price of 3,963,729 warrants to $0.25 and the extension of the term of 1,570,983 warrants by two years.

In 2008, the Company issued 12,343,316 common shares at $0.15 each in connection with the conversion of debentures.

In June 2008, a non-secured convertible debenture holder converted $15,000 into 100,000 common shares at a price of $0.15 each.

In August and September 2009, a non-secured convertible debenture holder converted $120,000 into 800,000 common shares at a price of $0.15 each.

The Company entered into an agreement with Desjardins Group for financing and banking services as announced on May 6, 2008. As part of the agreement, Warnex received financing facilities totalling $4 million, which include a revolving line of credit of $2 million and term debt of $2 million. The proceeds of this financing were used to repay certain debentures and the existing term debt with the National Bank of Canada, as well as for general working capital purposes. In June 2009, the Company received a new term loan of $350,000, which was used in the Molecular World Inc. acquisition.

In June 2009, The Company renewed its financing facility which remained unchanged except for the financial covenants.

As of December 31, 2009, the Company was not in compliance with the working capital ratio and the annual debt service coverage covenants contained in the credit facility. As of June 30, 2010, the Company is not in compliance with the working capital ratio covenant contained in the credit facility. The lender has continued to waive compliance with these covenants as at these dates.

In June 2010, the Company entered into agreements with certain debenture holders to modify the maturity dates. The Company is in the process of analyzing its cash flow needs and in reviewing the alternatives between its current debenture structure, seeking new investors or other financing strategies.

The Board of Directors of Warnex has implemented an investment policy regulating the investment activities of cash resources. The Company invests, if necessary, solely in liquid, high-grade securities with varying maturity dates. As at June 30, 2010, the Company had $0.3 million invested in cash (December 2009 - $0.9 million) and had used $0.3 million of the line of credit (December 2009 - $nil). The Company does not invest in asset backed commercial paper.

The following table provides the contractual obligations for the next five years:

Payments due by period	Less than 1 year $	1 - 3 years $	4 - 5 years $	More than 5 years $
Long-term debt[1]	799,028	135,790	-	-
Capital lease obligations	538,921	141,834	-	-
Operating leases[2]	716,416	1,492,970	1,440,843	1,890,887
Purchase obligations	42,309	50,770	-	-
Non-convertible debenture	854,866	-	-	-
Convertible debentures[3]	-	5,623,204	-	-
Total	2,951,540	7,444,568	1,440,843	1,890,887

Note 1: As of June 30, 2010, the Company did not meet a covenant contained in the agreement with its banker. As a result, all of the bank term loans are being included in the current liabilities.

Note 2: Operating leases of more than 5 years consist mainly of lease contracts for the buildings until 2018.

Note 3: The convertible debentures may be converted into Warnex shares at or before their maturity.

Note 4: The Company does not engage in off-balance sheet arrangements.

Related Party Transactions

During the period, the Company paid $1,000 per month for a total of $6,000 (2009 - $6,000), to the Company's Chairman of the Board for his work on specific mandates for the various operating divisions of the Company.

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 the non-related members of the Board of Directors must approve any related party transaction.

Critical Accounting Estimates

The $1.0 million of goodwill results from the acquisition of PRO-DNA Diagnostics Inc. in May 2006. 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. No adjustment was required as at June 30, 2010.

Future Accounting Changes

<u>International Financial Reporting Standards</u>

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises will be required to transition from Canadian GAAP to International Financial Reporting Standards ("IFRS") for interim and annual financial reporting purposes for fiscal years beginning on or after January 1, 2011, with comparative information.

The Company has established a changeover plan that consists primarily of three phases: assessment, planning, and implementation. An external advisor has been engaged to work closely with the Company's staff to complete the changeover to IFRS. The Company's management has been receiving training from this advisor and this training is expected to continue throughout the transition on an as-needed basis. The Board of Directors and Audit Committee have also received IFRS information.

The assessment phase includes the identification of significant differences between the Company's existing Canadian GAAP and IFRS that are relevant to the Company and a high-level review of the alternatives available upon adoption. This phase was completed during 2009.

The planning phase includes identification, evaluation and selection of accounting policies necessary for the Company to transition from Canadian GAAP to IFRS as well as potential first-time adoption exemptions. This phase was initiated in the second half of 2009. The Company is currently in the process of finalizing this phase. This phase involves assessing the impact of the transition on the data system and internal control over financial reporting, and disclosure controls and procedures. It also involves assessing the further training required for the financial team and the impact on business activities such as capital requirements, banking agreements or compensation arrangements.

The implementation phase will integrate all the solutions into the Company's financial system and processes that are necessary for the Company to convert to IFRS.

To date, the transition process has identified the following significant accounting issues:

Key Accounting Areas	**Identified Differences with Potential Impact to the Company**
Presentation of financial statements	▪ Additional disclosures in the notes to the financial statements. ▪ Presentation of financial statements will change, however the Company has not yet decided on the most appropriate presentation.
Property, plant and equipment	▪ Evaluating impact of componentization on accounting policy: all significant components of property and equipment will be amortized accordingly to their useful lives determined in accordance with IFRS. ▪ Evaluating impact of different recognition and measurement principles, including but not limited to amortization policies and residual values. ▪ The Company is still compiling the data required to identify required adjustments, if any.
Impairment of assets	▪ Grouping of assets in cash-generating units (CGUs) on the basis of independent cash inflows for impairment testing purposes, using a Fair Value or Value-in-Use (i.e. discounted cash-flow method (DCF)) approach. ▪ Goodwill will then be allocated to and tested in conjunction with its related CGU or group of CGUs. ▪ The Company has identified its CGUs and is in the process of identifying whether any impairment has occurred.
Revenue	▪ Analysing whether the Company measures revenue at fair value, whether identifiable components are required to be recognized, whether revenue from services is recorded using the percentage of completion method. ▪ The Company has preliminarily determined that no change is required to measure revenue at fair value, that no identifiable components are required to be identified, and that no material change will be realized as a result of recognizing all revenue using the percentage of completion method. However, as a result of the evaluation, the Company has modified its information systems in order to satisfy revenue measurement in accordance with IFRS. The impact of this modification was not significant.
Leases	▪ The Company has reviewed all existing lease agreements and preliminarily determined that no adjustments are required.
Share-based payments	▪ Compensation expense for a share-based payment award issued to non-employees should be measured at the fair value of services received. Forfeitures shall not subsequently be reversed if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised. ▪ The Company is currently evaluating the impact of these differences.
Provisions	▪ Different threshold used for recognition of a contingent liability, which could have an impact on timing of when a provision may be recorded. ▪ The Company has preliminarily determined that the application of this standard will not have a significant impact on the Company.

Furthermore, the Company has identified the following significant IFRS 1 optional exemptions that will likely be selected:

Business combinations exemption	IFRS 1 provides the option to apply IFRS 3, Business Combinations, retrospectively or prospectively from the Transition Date. The retrospective basis would require restatement of all business combinations that occurred prior to the Transition Date. The Company has initially decided to elect not to retrospectively apply IFRS 3 to business combinations that occurred prior to its Transition Date and such business combinations will not be restated. Any goodwill arising on such business combinations before the Transition Date will not be adjusted from the carrying value previously determined as a result of applying this exemption.
Share-based payments exemption	IFRS 2, Share-based Payments, encourages application of its provisions to equity instruments granted on or before November 7, 2002, but permits the application only to equity instruments granted after November 7, 2002 that had not vested by the Transition Date. The Company has initially decided to elect to avail itself of the exemption provided under IFRS 1 and applied IFRS 2 for all equity instruments granted after November 7, 2002, that had not vested by its Transition Date.

As the Company continues to analyze the impact of applying IFRS, it has selected its IFRS accounting policies and IFRS 1 exemptions as detailed above, on a preliminary basis, subject to approval by the Audit Committee and Board of Directors which is expected to be achieved once the draft IFRS financial statements are prepared. The Company has initiated this process.

The Company will continue to make progress on its changeover plan as well as monitor the development of standards as issued by both the IASB and the AcSB and expects to finalize the planning phase throughout the remainder of 2010 taking into account these anticipated modifications.

The Company does not expect to realize any significant business impacts, or significant changes to its internal controls over financial reporting as a result of the IFRS transition. The Company does expect to modify its IT systems to accommodate the changeover however, this modification is expected to be minimal. This assessment may change as the Company continues to evolve during its transition to IFRS.

As the Company's transition activities progress, disclosures of IFRS, as issued by the IASB implementation accounting policy differences are expected to increase. The Company will also ensure that its key stakeholders are informed about the anticipated effects of the IFRS transition. In the current year, the Company is providing IFRS information through its public disclosure documents to highlight such anticipated effects on the Company.

The Company will present its results for fiscal 2010 using Canadian GAAP. In 2011, the Company will present its comparative results for fiscal 2010 using IFRS as issued by the IASB effective at that time. To accomplish this, in 2010 the Company will track any adjustments required to its accounting records in order to effect its reconciliations from Canadian GAAP to IFRS.

Capital disclosures

The Company's objective when managing capital is to maintain adequate cash resources to support planned activities which include providing analytical, bioanalytical and medical laboratory services. The Company includes shareholders equity, cash, short-term investments and long term debt in the definition of capital. The Company currently has debt owing to the trade accounts payable, the bank, and the holders of the long-term debt and debentures.

The Company's objective when managing capital is also to maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments. The Company has entered into agreements with certain debenture holders to modify the maturity dates. Accordingly, the Company had entered into agreements with various lending institutions as described in notes 8, 9 and 10.

The Company is also in the process of analyzing its cash flow needs and in reviewing the alternatives between its current debenture structure, seeking new investors or other financing strategies.

In managing capital, the Company estimates its future cash requirements by preparing a budget and a multiyear plan annually for review and approval by the Company's Board of Directors. The budget establishes the approved activities for the upcoming year and estimates the costs associated with these activities. The multiyear plan estimates future activity along with the potential cash requirements and is based on the Company's assessment of its current services along with the expected results from the coming year's activity. Budget to actual variances are prepared monthly and reviewed by the Company's management and are presented quarterly to the Board.

Historically, funding for the Company's plan has been primarily managed through the issuance of additional common shares, common share purchase warrants that upon exercise are converted to common shares, and the issuance of various debt instruments. Management regularly monitors the capital markets attempting to balance the timing of issuing additional equity with the Company's progress through its programs, general market conditions, and the availability of capital. There are no assurances that funds will be made available to the Company when required.

Outstanding Share Data

As at the date of this report, the nominal and fully diluted numbers of shares are as follows:

	Nominal	Fully diluted
Issued and outstanding common shares	67,117,191	67,117,191
Options issued	1,949,877	1,949,877
Share warrants(1)	3,570,983	3,570,983
Convertible debentures(2)	$1,500,000	2,500,000
U.S. convertible debentures(3)	US$4,000,000	14,300,000
Total		89,438,051

Note 1: 1,570,983 share warrants expire in June 2011 and the balance in October 2011.
Note 2: The conversion rates are $0.50 and $0.75 for each tranche of $750,000 of the principal amount.
Note 3: The conversion rates of the debentures are $0.15, $0.20, $0.25, $0.50 and $0.75 for each tranche of US$800,000 of the principal amount. In June 2008, 100,000 common shares at $0.15 each were issued in connection with a debenture conversion. In August and September 2009, 800,000 common shares at $0.15 each were issued in connection with debenture conversions.

In May 2008, the Company extinguished its debt in the principal amount of $11,345,000 with the existing debenture holders. The Company then entered into new agreements with the same lenders which included the following terms and conditions:

- Elimination of the fixed conversion rate of 1.369 contained in the US dollar denominated debentures, therefore reducing the principal debt from CDN$6,845,000 to US$5,000,000;
- Conversion of an aggregate of $1,830,200 in principal into common shares of Warnex;
- Repayment of an aggregate of $1,333,333 in principal upon closing;
- An aggregate of $6,333,333 in principal to be paid in three years;
- Increase in the interest rate on the US dollar denominated debentures to 12% per annum;
- Reduction in the exercise price of 3,963,729 warrants to $0.25 and the extension of the term of 1,570,983 warrants by two years.

As part of these new agreements, the Company issued warrants as follows:

- For the debentures totalling $905,100, warrants were issued to the lenders entitling the purchase of 392,746 shares until June 25, 2009, and 2,000,000 shares until October 24, 2011, for a total of 2,392,746 common shares at a price of $0.25 per share.
- For the debentures totalling $4,842,734, warrants were issued to the lenders entitling the purchase of 1,570,983 common shares until June 25, 2011, at a price of $0.25 per share.

On June 12, 2009, the Company issued 2,000,000 common shares of Warnex for the acquisition of Molecular World Inc.

On June 25, 2009, warrants for 392,746 shares expired.

Financial Disclosure

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed by us is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the President and Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of June 30, 2010, an evaluation was carried out, under the supervision of and with the participation of management, including the President and Chief Executive Officer and the Chief Financial Officer, of the design of our disclosure controls and procedures as defined under National Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures were properly designed as at June 30, 2010.

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

As of June 30, 2010, management evaluated the design of internal control over financial reporting as defined under National Instrument 52-109, and based on that evaluation determined that certain aspects of internal control over financial reporting were not designed effectively. The control deficiencies identified by the Company did not result in adjustments to our interim consolidated financial statements for 2010. Management's assessment identified the following material weaknesses:

- Entity level controls

  The Company did not maintain a completely effective control environment as defined in accordance with COSO control framework. Specifically, we do not have comprehensive procedure manuals to clearly communicate management's and employees' roles and responsibilities in the Company's internal control over financial reporting.

  To mitigate the risk, management relies on automated controls mainly relating to the implementation of a new accounting system, as well as manual procedures and detection controls, weekly management meetings, monthly reviews of financial statements by the operating divisions and quarterly reviews of financial statements by the Audit Committee. These procedures were performed during the first semester of 2010.

- Information technology general controls

  The Company did not adequately maintain effective control over ensuring that the backup tapes are periodically tested to verify their accuracy. In addition, there is no information technology strategic plan and business continuity plan and no periodic review performed on the security logs for failed logins. Also, the Company did not adequately maintain effective controls over program development and program changes.

- Period-end financial reporting process

  The Company did not maintain effective controls over ensuring that certain account balances requiring the use of accounting estimates are reviewed by a person other than the preparer. The Company consults with its external auditor when necessary.

- Income Taxes

  The Company did not maintain effective controls over the recording of income taxes payable and the income tax provision. The Company is currently relying on its external auditor to ensure correctness of the above mentioned items.

- Segregation of duties

  The Company had deficient controls within its accounting and finance department over segregation of duties inherent to its size. Specifically, as a result of the limited number of personnel in the accounting and finance department, certain financial personnel had incompatible duties that allowed for the creation, review and processing of certain financial data without independent review and authorization.

  To mitigate the risk, management relies on automated controls mainly relating to the implementation of a new accounting system, as well as, manual procedures and detection controls, weekly management meetings, monthly reviews of financial statements by the operating divisions and quarterly reviews of financial statements by the Audit Committee. These procedures were performed during the first quarter of 2010.

Remediation of material weaknesses in internal control over financial reporting

Subsequent to June 30, 2010, we have begun or plan to take the following actions to address the material weaknesses in internal controls over financial reporting identified as of June 30, 2010. Management and the Audit Committee have taken an active role in responding to the deficiencies identified, including overseeing management's implementation of the remedial measures described below.

- Entity level controls

  We will finalize and distribute procedure manuals which communicate management's and employees' roles and responsibilities.

- Information technology general controls

  We will implement enhanced information technology policies and procedures specifically with regards to system's change management, program development, program changes, IT operations and related monitoring. We will develop and implement a global information technology strategic plan and a business continuity plan.

  In the beginning of 2009, management administered the implementation of a new accounting system. This new system introduced automated controls into the accounting system process and replaced certain manual controls that management had to rely upon. This major step ensured more rigorous monitoring of controls over access to the accounting system.

- Period-end financial reporting process

  We will continue to develop controls over the period-end financial reporting process where feasible. As the Company grows, we plan to expand the number of individuals involved in the financial close process and enhance the level of accounting knowledge. We intend to add one additional person in the accounting department.

  Since 2009, the new accounting system improved the period-end financial reporting process by replacing certain manual procedures with automated procedures. We introduced new controls such as, ensuring access to certain accounting spreadsheets was restricted to the appropriate personnel, implemented a disclosure checklist to ensure compliance with GAAP, and implemented a review process for the consolidation and complex journal entries by a person other than the preparer.

- Income taxes

  We will continue to consult with our third party expert advisors on a regular basis for tax advice. As the Company grows, we will plan to expand the number of individuals involved in the accounting function and enhance the level of tax knowledge.

- Inadequate segregation of duties

  We will continue to employ appropriate measures to restrict or independently monitor systems access and/or properly assign job roles and responsibilities to employees to ensure the proper segregation of duties where feasible. As the Company grows, we will expand the number of individuals involved in the accounting function. For the coming year, we will add one additional person in the accounting department.

Management realizes that some of the above weaknesses are inherent to a company of our size. Nevertheless, we believe in and are committed to establishing rigorous disclosure controls and procedures and internal control over financial reporting. It will take time to put in place the rigorous controls and procedures desired by our management and our Board of Directors. We cannot at this time estimate how long it will take to complete the steps identified above. Our management will continue to evaluate the design of our overall control environment and will continue to refine existing controls as they, in conjunction with the Audit Committee of our Board of Directors, Chief Executive Officer and Chief Financial Officer, think necessary. Again, the control deficiencies identified by the Company did not result in adjustments to our interim consolidated financial statements for 2010.

Other than the remediation efforts discussed above and the implementation of Warnex' internal controls over financial reporting, there have been no changes in our internal control over financial reporting that occurred since the beginning of fiscal year 2010 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting. Our management, including our Chief Executive Officer and our Chief Financial Officer, have discussed these issues and remediation efforts in detail with the Audit Committee of our Board of Directors.

The Company will provide updates on the remediation plan in its quarterly reports and its annual MD&A.

Risk and Uncertainties

<u>Financial Resources</u>

Warnex believes that it should be able to obtain long-term capital, if necessary, to support its corporate objectives. Please refer to the liquidity and capital resources section for additional comments. However, it is impossible to guarantee the availability of additional financial resources or that these will be available under acceptable conditions. Our cash requirements may vary materially depending on various factors, including changes in the number of customers and the volume of work ordered in our service divisions.

Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company manages liquidity risk by forecasting cash flows to identify financing requirements by maintaining committed and demand credit facilities and by maintaining access to additional financing at competitive rates through capital markets and highly rated financial institutions.

Key Customers and Business Partners

Warnex Analytical's two most important customers accounted for 37% of sales for the year 2009 (2008 - 38%). These customers have remained Warnex Analytical's largest customers in each of its sites for many years and we consider that our relationships with them are good. Warnex Bioanalytical's three main customers accounted for 53% of this division's revenues for the year 2009 (2008 - 57%) and we consider that our relationships with these important customers are good. The loss of any of these customers could adversely affect our financial results.

Credit Risk

Financial instruments, which potentially subject Warnex to concentrations of credit risk, consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents are maintained with high-credit quality financial institutions. Consequently, management considers the risk of non-performance related to cash and cash equivalents to be minimal. 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. Individual overdue accounts are reviewed and allowance adjustments are recorded when determined necessary to state receivables at the realizable value. If the financial conditions of customers deteriorate, resulting in their diminished ability or willingness to make payment, additional provisions for doubtful accounts are recorded. The Company's maximum credit risk exposure corresponds to the carrying amounts of the accounts receivable.

Foreign Currency Risk

The Company realizes some of its revenues in U.S. dollars and Euros and some of its purchases and interest payments on the convertible debentures in U.S. dollars. Consequently, we are exposed to fluctuations of these currencies.

Government Regulations

The provision by Warnex of its analytical, bioanalytical and medical laboratories services is governed by numerous statutes and regulations. The subject-matter of this legislation includes Good Laboratory Practices (GLP), Good Manufacturing Practices (GMP), the Therapeutic Products Directorate (TPD) and other standards and permits required to operate our laboratories. Findings of important non-compliance to such regulations, or important modifications to statutes and regulations governing Warnex's activities, could affect the ability or the conditions upon which the Company carries out services, and could have an adverse effect on results.

Laboratory Facilities

The Company relies on having properly validated, fully functioning laboratory facilities in which to render its services. Should systems fail, or a disaster strike, the ability to render services would be negatively affected which, in turn, would affect revenue generation. The Company does not currently have backup solutions for all the equipment used for rendering services. As a result, should an unexpected event as described above occur, our results could be adversely affected.

Volatility of Share Price

The market price of Warnex shares is subject to volatility because of different factors, including reports on new information and deviations in actual financial or scientific results as compared to expectations of shareholders and securities analysts who follow our activities. In addition, the shares of Warnex, of other life sciences companies and of the stock market in general have been subject to fluctuations, which were unrelated to the operations or results of the Company. There is no guarantee that the market price of Warnex's shares will be protected from all such fluctuations in the future.

Employees

Warnex's continued success will be dependent on the performance and continued service of certain key employees. The loss of any of these individuals could have a material adverse impact on the Company's business. We believe that our success relies in part on our ability to continue attracting and retaining such competent employees.

Suppliers

Warnex is dependant on third parties for the supply of certain specialized reagents. Although Warnex looks to secure alternative suppliers, Warnex may not be able to obtain the reagents or products from such third parties, the reagents or products may not comply with specifications, the prices at which Warnex purchases them may increase or Warnex may not be able to locate alternative sources of supply in a reasonable time period. Should any of these events occur, Warnex may not be able to continue to market certain of its services which could adversely affect our results.

Outlook

We expect to generate profits and a positive EBITDA, as defined in the financial performance section, and improve our financial results compared to 2009.

Signed for management, this 11th day of August 2010.

Mark Busgang
President & CEO

François Jetté, CA
Chief Financial Officer

Interim Consolidated Balance Sheets (Unaudited)

	June 30 2010	December 31 2009
Assets		
Current		
Cash and cash equivalents	**$249,274**	$894,031
Accounts receivable (note 5)	**3,806,093**	2,880,919
Work-in-progress	**129,595**	531,142
Inventory	**106,729**	177,027
Investment tax credits receivable	**801,000**	712,471
Prepaid expenses	**413,411**	388,502
	5,506,102	5,584,092
Future income taxes	**1,221,000**	1,221,000
Property, plant and equipment (note 6)	**6,761,040**	7,375,516
Intangible assets (note 7)	**437,790**	382,145
Goodwill	**937,695**	937,695
	$14,863,627	$15,500,448
Liabilities		
Current		
Bank indebtedness (note 8)	**$320,000**	$-
Accounts payable	**3,333,501**	3,008,594
Deferred revenue	**485,987**	411,599
Current portion of long-term debt (note 9)	**1,421,253**	1,800,372
Current portion of debentures (note 10)	**324,177**	-
	5,884,918	5,220,565
Long-term debt (note 9)	**157,675**	447,661
Liability component of debentures (note 10)	**6,029,747**	6,245,274
	12,072,340	11,913,500
Shareholders' equity		
Capital stock (note 11)	**40,981,049**	40,981,049
Equity component of debentures (note 10)	**312,288**	312,288
Contributed surplus	**2,456,224**	2,466,016
Deficit	**(40,958,274)**	(40,172,405)
	2,791,287	3,586,948
	$14,863,627	$15,500,448

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

Interim Consolidated Statements of Contributed Surplus (Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	**2009**	**2010**	**2009**
Balance, beginning of period	**$2,425,012**	$2,445,078	**$2,466,016**	$2,445,043
Stock-based compensation	**31,212**	20,557	**(9,792)**	20,592
Balance, end of period	**$2,456,224**	$2,465,635	**$2,456,224**	$2,465,635

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

Interim Consolidated Statements of Deficit (Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	**2009**	**2010**	**2009**
Balance, beginning of period	**$(40,969,569)**	$(38,905,400)	**$(40,172,405)**	$(40,008,157)
Net earnings (loss)	**11,295**	(346,660)	**(785,869)**	756,097
Balance, end of period	**$(40,958,274)**	$(39,252,060)	**$(40,958,274)**	$(39,252,060)

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

Consolidated Statements of Accumulated Other Comprehensive Income (Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	**2009**	**2010**	**2009**
Accumulated Other Comprehensive Income	**$-**	$-	**$-**	$-

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

Interim Consolidated Statements of Earnings and Comprehensive Income (Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	**2009**	**2010**	**2009**
Revenue	**$6,372,426**	$5,421,474	**$11,463,096**	$12,979,129
Cost of goods sold (note 12)	**4,559,151**	4,378,996	**8,866,902**	8,869,119
Gross margin	**1,813,275**	1,042,478	**2,596,194**	4,110,010
Operating expenses (note 12)				
Selling, general and administrative	**1,561,595**	1,481,407	**3,097,427**	2,962,911
Finance charges	**277,837**	313,086	**554,393**	624,025
Research and development tax credits	**(238,000)**	-	**(326,000)**	-
	1,601,432	1,794,493	**3,325,820**	3,586,936
Earnings (loss) before under noted item and income taxes	**211,843**	(752,015)	**(729,626)**	523,074
Unrealized foreign exchange gain (loss) on debentures	**(200,548)**	405,355	**(56,243)**	233,023
Earnings (loss) before income taxes	**11,295**	(346,660)	**(785,869)**	756,097
Income taxes	**-**	(75,000)	**-**	225,000
Recovery of income taxes due to utilization of prior years' losses	**-**	75,000	**-**	(225,000)
	-	-	**-**	-
Net earnings (loss) and comprehensive income	**$11,295**	$(346,660)	**$(785,869)**	$756,097
Basic net earnings (loss) per share	**$0.00**	$(0.01)	**$(0.01)**	$0.01
Fully diluted net earnings (loss) per share	**$0.00**	$(0.01)	**$(0.01)**	$0.01
Weighted average number of shares outstanding	**67,117,191**	64,983,858	**67,117,191**	64,602,905
Weighted average number of fully diluted shares outstanding	**67,117,191**	76,113,853	**67,117,191**	76,113,853

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

Interim Consolidated Statements of Cash Flows (Unaudited)

	Three months ended June 30		Six months ended June 30	
	2010	**2009**	**2010**	**2009**
Operations				
Net earnings (loss)	**$11,295**	$(346,660)	**$(785,869)**	$756,097
Items not affecting cash:				
Amortization of property, plant and equipment	**346,117**	389,166	**691,117**	771,409
Amortization of intangible assets	**25,710**	17,854	**47,289**	32,962
Accretion of interest	**26,804**	23,298	**52,407**	45,551
Unrealized foreign exchange gain (loss) on debentures	**200,548**	(405,355)	**56,243**	(233,023)
Foreign currency fluctuation	**(46,132)**	172,174	**(22,106)**	141,033
Compensation cost for stock options	**31,212**	20,557	**(9,792)**	20,592
	595,554	(128,966)	**29,289**	1,534,621
Net change in non-cash working capital items (note 13)	**(131,731)**	(399,618)	**(155,376)**	(803,300)
Net cash provided by (used in) operations	**463,823**	(528,584)	**(126,087)**	731,321
Investing activities				
Acquisition of property, plant and equipment	**(23,896)**	(42,481)	**(76,641)**	(178,328)
Acquisition of intangible assets	**(38,047)**	(29,221)	**(102,934)**	(124,707)
Net cash used in investing activities	**(61,943)**	(71,702)	**(179,575)**	(303,035)
Financing activities				
Increase (decrease) in operating line of credit	**(140,000)**	-	**320,000**	-
Proceeds from long-term debt	**-**	350,000	**-**	350,000
Repayment of long-term debt	**(326,141)**	(310,772)	**(669,105)**	(694,155)
Net cash provided by (used in) financing activities	**(466,141)**	39,228	**(349,105)**	(344,155)
Foreign exchange gain (loss) on cash held in foreign currencies	**11,918**	(133,934)	**10,010**	(90,764)
Decrease in cash and cash equivalents	**(52,343)**	(694,992)	**(644,757)**	(6,633)
Cash and cash equivalents, beginning of period	**301,617**	3,121,847	**894,031**	2,433,488
Cash and cash equivalents, end of period	**$249,274**	$2,426,855	**$249,274**	$2,426,855

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

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

1. Description of business and basis of financial statement presentation

Warnex Inc. is incorporated under the laws of Canada. Warnex is a life sciences company devoted to protecting public health by providing diverse laboratory services. The Company offers analytical, bioanalytical and medical laboratory services to the pharmaceutical and healthcare sectors. The Company's common stock is traded on the Toronto Stock Exchange, under the symbol WNX.

The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and all of its subsidiaries: Warnex Analytical Services Inc., Warnex PRO-DNA Services Inc., and Warnex America Inc. All amounts are presented in Canadian dollars, unless otherwise indicated.

On June 12, 2009, the Company purchased the shares of Molecular World Inc. On June 30, 2009, the Company changed the name of Molecular World Inc. to Warnex PRO-DNA Services Inc.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) on a going concern basis, which presumes the Company will continue in operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the ordinary course of business for the foreseeable future. These consolidated financial statements do not include any adjustments to amounts and classifications of assets and liabilities should the Company not be able to continue as a going concern.

2. Changes in accounting policies and significant accounting policies

<u>**Changes in accounting policies**</u>

Goodwill and intangible assets

In February 2008, the CICA issued Handbook section 3064, *Goodwill and Intangible Assets*, replacing Handbook Sections 3062, *Goodwill and Other Intangible Assets* and 3450, *Research and Development Costs and Emerging Issues Committee (EIC) Abstract 27, Revenues and Expenditures during the Pre-Operating Period.* Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and intangible assets by profit-oriented enterprises. This new standard became effective January 1, 2009. There is no material impact on the Company's financial statements in adopting this new standard.

Credit Risk and Fair Value of Financial Assets and Financial Liabilities

In January 2009, the CICA issued EIC Abstract 173, *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*. The EIC requires the Company to take into account the Company's own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. There is no material impact on the Company's financial statements in adopting this new standard.

Financial Instruments Disclosures

In May 2009, the CICA amended Section 3862, *Financial Instruments – Disclosures*, to include additional disclosure requirements about fair market value measurements for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The application of this amendment did not materially impact the Company.

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

2. Changes in accounting policies and significant accounting policies… cont'd

Revenue recognition
The Company changed their accounting policy for revenue recognition for the analytical services division in order to reflect the progression of analytical tests at each stage. The analytical services division will now record revenue using the percentage of completion method instead of only recording revenue when the tests are completed. As a result of the change in this accounting policy, revenue for the period ended June 30, 2010, increased by $37,656. The impact of the change in this accounting policy was undeterminable for the prior periods and was therefore not adjusted.

Significant accounting policies

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The most significant accounting policies are summarized below.

Interim financial statements
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, 2009. 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, 2009. 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.

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 reported period. Actual results could differ from these estimates.

Revenue recognition
Analysis revenue from analytical and 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. Analysis revenue from medical laboratory services is recorded at the time the test is completed.

Project revenue from analytical and medical laboratory services is recorded using the percentage of completion method whereby revenue and profit are based on ratio of costs incurred to total estimated costs of the projects.

Costs and estimated profit on contracts in progress in excess of amounts billed are reflected as work-in-progress. Cash received in advance of revenues being recognized on contracts is classified as deferred revenue.

The Company monitors its contracts with customers on a regular basis to determine if a loss is likely to occur. If a loss is anticipated on a contract, the entire estimated loss is recorded as a reduction of revenue and work-in-progress in the period in which the loss becomes evident and reasonably estimable.

Cash and cash equivalents
Cash and cash equivalents consist of bank accounts and short-term investments with maturity dates of three months or less.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

2. Changes in accounting policies and significant accounting policies…cont'd

Inventory

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

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.

Investment tax credits

The Company claims investment tax credits as a result of incurring scientific research and experimental development expenditures. Investment tax credits are recognized when the related expenditures are incurred and there is reasonable assurance of their realization. Management has made a number of estimates and assumptions in determining the expenditures eligible for the investment tax credit claim. It is possible that the allowed amount of the investment tax credit claim could be materially different from the recorded amount upon assessment by the tax authorities.

Future income taxes

The Company follows the liability method with respect to accounting for income taxes. Future tax assets and liabilities are determined based on differences between the carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using the enacted income tax rates that will be in effect when these differences are expected to reverse. Future income tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not the assets will be realized.

Property, plant and equipment

Property, plant and equipment are recorded at cost and amortized over their estimated useful life or over the term of the lease as follows:

Declining-balance method	
Lab equipment	20%
Machinery and equipment	20%
Computer equipment	30%
Furniture, fixtures and telephone equipment	20%
Non-refundable government financial assistance	20%
Straight-line method	
Leasehold improvements	over the terms of the leases

Non-refundable government financial assistance regarding property, plant and equipment are netted against these assets when earned.

Intangible assets and goodwill

Computer software is recorded at cost and amortized on the declining balance method at a rate of 20%. Licences and customer lists are recorded at cost and amortized over their estimated useful lives, not exceeding 5 years. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill and intangible assets with indefinite life are subject to at least an annual assessment for impairment by applying a fair value test. The Company then assesses 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.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

2. Changes in accounting policies and significant accounting policies… cont'd

Impairment of long-lived assets

Long-lived assets, which comprise property, plant and equipment, and intangible assets with definite life, are reviewed for impairment when certain events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable i.e. when their net book value exceeds the sum of the undiscounted cash flows expected to result from their use and eventual disposition. An impairment loss should be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The impairment amount is measured as the amount by which the carrying amount of the asset exceeds its fair value, calculated using discounted cash flows when quoted market prices are not available.

Debentures

The value of the debt component of the debentures has been determined, at the time of their issuance, by discounting the future capital and interest payments until their maturity dates at a discount rate which represented the borrowing rate available to the Company for similar debentures having no warrants or conversion rights. The remaining portion of the net proceeds of the debentures issued is presented as part of shareholders' equity. The difference between the principal amount of the debentures and the liability component carrying amount at inception is accreted to the face value of each debenture through the recording of additional interest expense over the term of the debenture through periodic charges to income using the effective interest rate method of amortization.

Deferred revenue

In the bioanalytical services and medical laboratory services divisions, deferred revenue represents the difference between the amount invoiced to customers as per each customer agreement and the revenue recognized. Furthermore, the medical laboratory services may have deferred revenue consisting of the amount received from customers as prepayments for services to be rendered in the future.

Earnings (loss) per share

Earnings (loss) per share are calculated using the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share are computed using the treasury stock method, giving effect to the exercise of all stock options, share warrants and convertible debentures. The diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of these elements.

Foreign exchange

The Company follows the temporal method to translate its foreign currency balances and transactions into Canadian dollars. Monetary items on the balance sheet are translated at the exchange rates in effect at the end of the period, while non-monetary items are translated at the historical rates of exchange. Revenues and expenses are translated at the rates of exchange in effect on the transaction date or at the average exchange rates for the period. Gains or losses resulting from the translation are included in earnings for the period.

Stock option plan

The fair value of stock options is evaluated on the grant date using the Black-Scholes model. The cost is recognized on a straight-line basis over the vesting period of the options as an increase to the compensation expense and to contributed surplus. Upon exercise of these stock options, the cash proceeds received and the amount previously credited to contributed surplus related to the exercised options are credited to common share paid-up capital.

Financial instruments

The Company establishes the classification of financial instruments at their initial recognition. Financial assets are classified as held for trading, available for sale, held to maturity or loans and receivables. Financial liabilities are classified as held for trading or other liabilities.

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

2. Changes in accounting policies and significant accounting policies… cont'd

Subsequent measurement and recognition of changes in fair value of financial instruments depend on their initial classification. Held for trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet.

The standards also require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

3. Future accounting changes

International Financial Reporting Standards
In February 2008, the Canadian Accounting Standards Board (AcSB) has confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards ("IFRS") will replace Canada's current Generally Accepted Accounting Principles for all publicly accountable profit-oriented enterprises. The Company is currently evaluating the impact of this changeover on its consolidated financial statements.

Business combinations
In January 2009, the CICA issued Handbook Section 1582, *Business Combinations*, which requires that all assets and liabilities of an acquired business will be recorded at fair value at acquisition. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expenses as incurred and that restructuring charges will be expensed in periods after the acquisition date. The new standard applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or following January 1, 2011. The Company will assess the impact of this new standard at the time of any applicable acquisitions.

Consolidations and Non-Controlling Interests
In January 2009, the CICA issued Handbook Section 1601, *Consolidations*, and Section 1602, *Non-Controlling Interests*. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company is currently assessing the impact of this new standard on its financial statements.

4. Business acquisition

On June 12, 2009, the Company acquired all of the issued and outstanding shares of Molecular World Inc., a laboratory located in Thunder Bay, Ontario, specializing in human DNA identification including forensic DNA testing. The acquisition was accounted for using the purchase method. The purchase price was paid by the issuance of 2,000,000 common shares of Warnex with a fair value of $310,000. The net assets acquired at the attributed values were: $82,996 of short-term assets; $471,000 of future income taxes; $345,372 of property, plant and equipment; $2,530 of computer software; $38,936 of customer lists; assumption of short-term liabilities of $343,989, and long-term debt of $286,845.

The operations of this subsidiary are included in the Medical Laboratories division.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

5. Accounts receivable

	June 30, 2010 $	December 31, 2009 $
Trade	3,814,980	2,925,847
Allowance for doubtful accounts	(45,588)	(45,588)
	3,769,392	2,880,259
Sundry	36,701	660
	3,806,093	2,880,919

6. Property, plant and equipment

June 30, 2010	Cost $	Accumulated Amortization $	Net $
Lab equipment	13,550,166	8,738,333	4,811,833
Machinery and equipment	113,004	32,752	80,252
Computer equipment	833,525	641,041	192,484
Furniture, fixtures and telephone equipment	505,804	384,064	121,740
Leasehold improvements	5,732,221	4,014,643	1,717,578
Non-refundable government financial assistance	(465,000)	(302,153)	(162,847)
	20,269,720	13,508,680	6,761,040

December 31, 2009	Cost $	Accumulated Amortization $	Net $
Lab equipment	13,514,056	8,206,749	5,307,307
Machinery and equipment	113,004	23,835	89,169
Computer equipment	808,647	607,717	200,930
Furniture, fixtures and telephone equipment	503,159	369,166	133,993
Leasehold improvements	5,719,213	3,894,155	1,825,058
Non-refundable government financial assistance	(465,000)	(284,059)	(180,941)
	20,193,079	12,817,563	7,375,516

The above includes lab equipment under capital lease having a cost of $1,599,039 (December 2009 - $1,599,039) and a net carrying value of $1,084,707 (December 2009 - $1,205,230), and computer equipment under capital lease having a cost of $37,439 (December 2009 - $37,439) and a net carrying value of $27,397 (December 2009 - $32,232).

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

7. Intangible assets

June 30, 2009	Cost $	Accumulated Amortization $	Net $
Licences	33,380	18,915	14,465
Customer lists	38,936	12,978	25,958
Computer software	892,495	495,128	397,367
	964,811	527,021	437,790

December 31, 2009	Cost $	Accumulated Amortization $	Net $
Licences	33,380	15,577	17,803
Customer lists	38,936	6,489	32,447
Computer software	789,561	457,666	331,895
	861,877	479,732	382,145

8. Financing facility

The Company has the following credit facilities which are renewed annually with the bank:

i) $2,000,000 operating line of credit which is due on demand and bears interest at 2% over the bank's prime lending rate;

ii) $2,000,000 bank loan, due May 2011, bearing interest at 2.25% over the bank's prime lending rate and repayable by monthly instalments of $55,556 plus interest; and

iii) $350,000 bank loan, due June 2012, bearing interest at 2.25% over the bank's prime lending rate and repayable by monthly instalments of $9,722 plus interest.

The Company and its subsidiaries have provided as security for the facilities a first ranking moveable hypothec in the amount of $6,000,000 covering the universality of tangible and intangible moveable properties, present and future.

The credit facility requires the following financial covenants to be met:

i) Quarterly working capital ratio of 1.25:1;

ii) Quarterly debt to tangible net worth ratio of 2:1; and

iii) Annual debt service coverage ratio of a minimum of 1.25:1.

In June 2009, the Company renewed its financing facility which remained unchanged except for the financial covenants, as indicated above.

As at June 30, 2010, the Company is not in compliance with the working capital ratio covenant contained in the credit facility. The lender has waived compliance with this covenant.

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

9. Long-term debt

	June 30 2010 $	December 31 2009 $
Business Development Bank of Canada (BDC) term loan, due April 2011, bearing interest at 2% over the BDC's floating rate, repayable by monthly instalments of $3,300, plus interest and secured by a general security agreement providing for a first charge on all equipment, furniture and fixtures of Warnex PRO-DNA Services Inc.	33,000	52,800
Bank term loan, due May 2011, bearing interest at 2.25% over the bank’s prime lending rate, repayable by monthly instalments of $55,556 plus interest and secured as described in note 8.	611,111	944,444
Bank term loan, due June 2012, bearing interest at 2.25% over the bank’s prime lending rate, repayable by monthly instalments of $9,722 plus interest and secured as described in note 8. The Company did not meet its covenants contained in the agreement with its banker. As a result, the bank term loan is being included in the current portion.	233,333	291,667
6.6% obligation under capital lease, due June 2011, repayable by monthly instalments of $17,955 principal and interest. This obligation is secured by specific equipment having a carrying value of $381,030	207,927	306,856
8.5% obligation under capital lease, due November 2011, repayable by monthly instalments of $25,750 principal and interest. This obligation is secured by specific equipment having a carrying value of $703,677	411,059	544,758
9.4% obligation under capital lease, due April 2012, repayable by monthly instalments of $686 principal and interest. This obligation is secured by specific equipment having a carrying value of $15,230	13,805	17,177
9.4% obligation under capital lease, due June 2012, repayable by monthly instalments of $519 principal and interest. This obligation is secured by specific equipment having a carrying value of $12,167	11,319	13,832
Canada Economic Development interest-free loan up to a maximum amount of $153,000 or 40% of approved expenses to assist in export market development, repayable in eight equal consecutive semi-annual payments commencing March 2008	57,374	76,499
	1,578,928	2,248,033
Current portion	1,421,253	1,800,372
	157,675	447,661

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

10. Debentures

	June 30 2010 $	December 31 2009 $
$500,000 non-secured non-convertible debenture, bearing interest at a rate of 12% annually. Also, as part of this financing, share warrants were issued entitling the lender to purchase 2,000,000 common shares of the Company for a price of $0.25 a share until October 24, 2011. The Company has entered into an agreement with the lender to modify the maturity date from June 2, 2011, to July 2, 2011, keeping all other terms and conditions the same.	500,000	500,000
US$4,000,000 non-secured convertible debentures, bearing interest at a rate of 12% annually and convertible into 15,200,000 common shares of the Company at the sole option of the lender. The conversion rates of the debentures are $0.15, $0.20, $0.25, $0.50 and $0.75 for each tranche of US$800,000 of the principal amount. Also, as part of this financing, share warrants were issued entitling the lender to purchase 1,570,983 common shares of the Company for a price of $0.25 a share until June 25, 2011. The Company has entered into agreements with the lenders to modify the maturity dates from June 25, 2011, to July 5, 2011, keeping all other terms and conditions the same.	4,123,204	4,070,531
US$333,333 non-secured non-convertible debenture, bearing interest at a rate of 12% annually maturing June 25, 2011. Also, as part of this financing, share warrants were issued entitling the lender to purchase 392,746 common shares of the Company for a price of $0.25 a share until June 25, 2009.	354,866	350,333
$1,500,000 non-secured convertible debenture bearing interest at a rate of 12% annually maturing July 9, 2011, and convertible into 2,500,000 common shares of the Company at the sole option of the lender. The conversion rates are $0.50 and $0.75 for each tranche of $750,000 of the principal amount.	1,500,000	1,500,000
	6,478,070	6,420,864
Discount on debentures	(124,146)	(175,590)
Current portion of debentures	(324,177)	-
	6,029,747	6,245,274

The nominal and effective interest rates are as follows:

	Nominal	Effective
$500,000 maturing June 2, 2011	12.0%	14.0%
US$4,000,000 maturing June 25, 2011	12.0%	14.0%
US$333,333 maturing June 25, 2011	12.0%	14.0%
$1,500,000 maturing July 9, 2011	12.0%	14.0%

In August and September 2009, a non-secured convertible debenture holder converted $120,000 into 800,000 common shares at a price of $0.15 each.

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

11. 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 common shares

	June 30, 2010		December 31, 2009	
	Number	Amount $	Number	Amount $
Balance, beginning of period	67,117,191	40,981,049	64,317,191	40,551,049
Issuance of shares	-	-	2,800,000	430,000
Balance, end of period	67,117,191	40,981,049	67,117,191	40,981,049

In June 2009, the Company issued 2,000,000 common shares at $0.155 each for the acquisition of Molecular World Inc., as described in note 4.

In August and September 2009, the Company issued 800,000 common shares at $0.15 each in connection with a debenture conversion as described in note 10.

c) Stock option plan

The Company has in place an Incentive Stock Option Plan. The Plan provides that the terms of the options and the option price shall be fixed by the Board of 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 Board of Directors of the Company.

The maximum number of common shares that are issuable under the Plan cannot exceed 4,319,273, 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, in order to comply with the Exchange requirements, the Company amended its stock option plan changing the period from 5 years to 10 years.

On September 17, 2008, the Board of Directors revised the Company’s stock option plan for employees and decided not to grant any more stock options to employees, excluding directors and officers, which is at the discretion of management. As a result, the Company cancelled 123,000 options.

As at June 30, 2010, the Company has granted options to purchase 1,949,877 (December 2009 - 869,229) common shares at various exercise prices, each pursuant to the Incentive Stock Option Plan of the Company, expiring no later than the year 2020.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

11. Capital stock… cont'd

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

	June 30, 2010		December 31, 2009	
	Number	Weighted average exercise price $	Number	Weighted average exercise price $
Balance, beginning of period	869,229	0.61	884,898	0.87
Granted	1,080,648	0.15	233,331	0.15
Exercised	-	-	-	-
Cancelled	-	-	(249,000)	1.08
Balance, end of period	1,949,877	0.36	869,229	0.61
Exercisable at the end of period	1,949,877	0.36	869,229	0.61

Stock options outstanding are as follows:

	June 30, 2010			December 31, 2009		
Range of exercise prices $	Number	Weighted average remaining life (years)	Weighted average exercise price $	Number	Weighted average remaining life (years)	Weighted average exercise price $
0.00 – 0.19	1,543,977	9.38	0.15	463,329	8.84	0.15
0.84 – 0.96	106,000	3.85	0.87	106,000	4.35	0.87
1.00 – 1.12	95,000	5.56	1.10	95,000	6.06	1.10
1.15 – 1.22	28,000	4.17	1.15	28,000	4.67	1.15
1.25 – 1.50	176,900	4.16	1.33	176,900	4.66	1.33
	1,949,877			869,229		

During 2010, the Company granted 1,080,648 (December 2009 - 233,331) options to purchase common shares. The weighted average fair value of options granted during the period amounted to $0.13 (December 2009 - $0.12) per option. The fair value of each option granted was determined using the Black-Scholes option pricing model and the following weighted average assumptions:

	June 30 2010	December 31 2009
Risk-free interest rate	2.84%	2.66%
Expected life	10 years	10 years
Expected volatility in the market price of the shares	86.2%	76.9%
Expected dividend yield	-	-

d) Share warrants

The share warrants outstanding are as follows:

Expiry date	Exercise price $	June 30 2010	December 31 2009
June 25, 2011	0.25	1,570,983	1,570,983
October 24, 2011	0.25	2,000,000	2,000,000
Balance, end of period		3,570,983	3,570,983

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

12. Information relating to the consolidated statements of earnings

For the six months ended June 30	2010 $	2009 $
a) The following items are included in cost of goods sold:		
Amortization of property, plant and equipment	583,626	669,419
Loss on foreign exchange	3,325	323
b) The following items are included in operating expenses:		
Amortization of property, plant and equipment	107.491	101,990
Amortization of intangible assets	47,289	32,962
Accretion of interest	52,407	45,551
Interest and bank charges	63,170	62,406
Interest on long-term debt	55,365	83,896
Interest on convertible debentures	383,451	432,172
Loss on foreign exchange	5,079	113,308

13. Information relating to the consolidated statements of cash flows

a) Cash flows from operations include interest paid of $462,841 (2009 - $441,930).

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

For the six months ended June 30	2010 $	2009 $
Accounts receivable	(905,527)	653,541
Work-in-progress	401,547	1,166,401
Inventory	70,298	4,621
Investment tax credits receivables	(88,529)	-
Prepaid expenses	(24,909)	(78,879)
Accounts payable	317,356	(1,519,542)
Deferred revenue	74,388	(1,029,442)
	(155,376)	(803,300)

14. Capital disclosures

The Company's objective when managing capital is to maintain adequate cash resources to support planned activities, which include providing analytical, bioanalytical and medical laboratory services. The Company includes shareholders' equity, cash, short-term investments and long term debt in the definition of capital. The Company currently has debt owing to the trade accounts payable, the bank, and the holders of the long-term debt and debentures.

The Company's objective when managing capital is also to maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments. The Company has entered into agreements with certain debenture holders to modify the maturity dates. Accordingly, the Company had entered into agreements with various lending institutions as described in notes 8, 9 and 10. The Company is also in the process of analyzing its cash flow needs and in reviewing the alternatives between its current debenture structure, seeking new investors or other financing strategies.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2010 and 2009

14. Capital disclosures… cont'd

In managing capital, the Company estimates its future cash requirements by preparing a budget and a multiyear plan annually for review and approval by the Company's Board of Directors. The budget establishes the approved activities for the upcoming year and estimates the costs associated with these activities. The multiyear plan estimates future activity along with the potential cash requirements and is based on the Company's assessment of its current services along with the expected results from the coming year's activity. Budget to actual variances are prepared monthly and reviewed by the Company's management and are presented quarterly to the Board.

Historically, funding for the Company's plan is primarily managed through the issuance of additional common shares, common share purchase warrants that upon exercise are converted to common shares, private placements from various institutions and the issuance of various debt instruments. Management regularly monitors the capital markets attempting to balance the timing of issuing additional equity with the Company's progress through its programs, general market conditions, and the availability of capital. There are no assurances that funds will be made available to the Company when required.

15. Segmented information

a) For the six months ended June 30, 2010, the Companies operated in the following industries:

	Revenue $	Net earnings (loss) $	Amortization $	Long-term assets $	Total assets $
Analytical services	5,761,124	525,568	198,275	2,010,167	4,452,193
Bioanalytical services	3,042,644	246,366	368,776	3,357,694	5,259,687
Medical laboratories	2,515,825	491,751	71,881	2,058,959	2,736,585
Management services	143,503	(2,049,554)	99,474	1,930,705	2,415,162
	11,463,096	(785,869)	738,406	9,357,525	14,863,627

b) For the six months ended June 30, 2009, the Companies operated in the following industries:

	Revenue $	Net earnings (loss) $	Amortization $	Long-term assets $	Total assets $
Analytical services	5,708,733	423,570	232,305	2,377,157	4,623,749
Bioanalytical services	4,923,172	1,798,136	453,606	4,134,187	5,144,595
Medical laboratories	2,191,956	375,771	25,474	2,026,584	2,586,412
Management services	155,268	(1,841,380)	92,986	2,058,877	4,885,914
	12,979,129	756,097	804,371	10,596,805	17,240,670

c) Revenues were derived from customers located in the following geographic areas:

For the six months ended June 30	2010 $	2009 $
Canada	8,086,408	7,705,183
United States of America	2,276,626	3,754,117
Rest of the world	1,100,062	1,519,829
	11,463,096	12,979,129

Notes to Consolidated Financial Statements (unaudited)
June 30, 2010 and 2009

15. Segmented information… cont'd

d) Revenues were generated in the following currencies:

For the six months ended June 30	2010 $	2009 $
Canadian dollars	8,485,511	8,186,526
U.S. dollars	2,973,570	4,792,603
Euros	4,015	-
	11,463,096	12,979,129

16. Related party transactions

During the period, the Company paid $1,000 per month for a total of $6,000 (2009 - $6,000), to the Company's Chairman of the Board for his work on specific mandates for the various operating divisions of the Company.

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 Board of Directors.

17. Financial instruments

Financial risks
The Company is exposed to a number of financial risks in the normal course of business operations, including interest rates and foreign currency exchange rates as well as credit risks and liquidity risks. The nature of these risks and the Company's strategy for managing these risks has not changed significantly from the prior period.

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 and cash equivalents, accounts receivable, bank indebtedness and accounts payable.

The fair value of long-term debt approximates market value and corresponds to what the Company would currently obtain for loans with similar maturity dates and terms. Considering the due dates of the long-term debt as at June 30, 2010, 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. Individual overdue accounts are reviewed and allowance adjustments are recorded when determined necessary to state receivables at the realizable value. If the financial conditions of customers deteriorate, resulting in their diminished ability or willingness to make payment, additional provisions for doubtful accounts are recorded. The Company's maximum credit risk exposure corresponds to the carrying amounts of the accounts receivable.

The Company's allowance for doubtful accounts is $45,588 (December 2009 - $45,588). Of the Company's accounts receivable, $305,288 (December 2009 - $506,600) is greater than 90 days. Of this amount, $58,574 (December 2009 - $211,942) is included in deferred revenue. Any amounts not provided for are considered to be fully collectable.

Notes to Consolidated Financial Statements (unaudited)
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17. Financial instruments… cont'd

The Company has one customer which account for approximately 11% of the accounts receivable as at June 30, 2010 (December 2009 - two customers for approximately 22%).

Interest rate risk
The Company has a line of credit and a portion of the long-term debt 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. Assets and liabilities in other currencies are the following:

June 30, 2010	U.S. Dollars	Euros
Cash	167,133	-
Accounts receivable	1,324,485	-
Work-in-progress	-	-
Accounts payable	371,537	8,205
Deferred revenue	244,409	-

Liquidity risk
Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company manages liquidity risk by forecasting cash flows to identify financing requirements by maintaining committed and demand credit facilities and by maintaining access to additional financing at competitive rates through capital markets and highly rated financial institutions.