

Laboratory Services
Our roots... our future.



Sample



Test

Report

A lab is a lab is a lab. The process, whether we're testing patients, drugs or consumer products, remains the same: **sample, test, report.** It's how we've grown our business in the past, by providing reliable and consistent results. It's how we'll continue to grow it in the future.

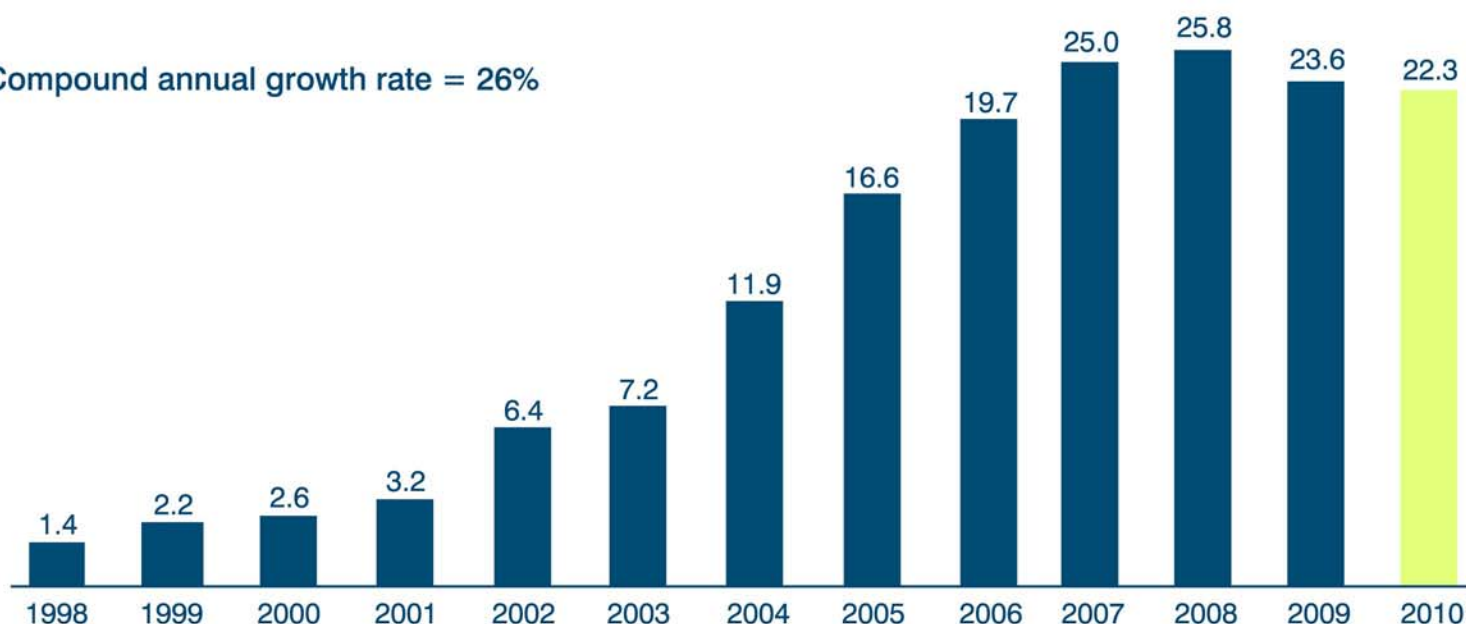


WARNEX
Annual Report 2010

Solid Revenue Growth

(\$ millions)

Compound annual growth rate = 26%



5 lab sector acquisitions

1 organically created division

3 facilities

85,000 square feet

250 employees

20 LC/MS/MS systems

60 HPLC systems

250,000 + tests per year

Letter to Shareholders

2010 has certainly been one of the most challenging years since we started Warnex in 1998. On a macroeconomic level, the global economy continued to be challenging to most industrialized countries. Even with low interest rates and low inflation, many countries and industries were affected by global economic challenges and the pharmaceutical industry was not spared. Cutbacks in R&D budgets, substantially reduced spending as well as huge cutbacks in venture capital were among the factors that contributed to a slowdown in the CRO industry overall. In spite of these issues, Warnex remained focused on its objectives and maintained its commitment to quality science and customer service. While our top and bottom lines were impacted compared to last year, we still generated a positive EBITDA and an overall reduction of our long term debt.

All of our divisions passed various inspections from both Canadian and American regulators. Our Bioanalytical division successfully passed a Good Clinical Practices (GCP) inspection by the Austrian Agency for Health and Food Safety (AGES). Our Medical division renewed its accreditation by COLA, a U.S. healthcare accreditation organization, and our PRO-DNA Services division received U.S. accreditation from ASCLD for forensic science testing.

In 2010, we also pursued various business opportunities as well as internal development efforts to expand our service offering. During the year, our Medical Laboratories division signed a distribution agreement with Epigenomics AG to offer its test for colorectal cancer in Canada. We also announced a collaboration with the Montreal Heart Institute and CEPMED to develop a new diagnostic test for early detection of cardiovascular and metabolic diseases. These services, as well as those announced in previous years, add to our growing portfolio of genetic-based diagnostic tests and positions Warnex as a leader in Canada in the area of personalized medicine. The ongoing use of information obtained from a patient's genetic profile will allow physicians to tailor medical treatments to the individual patient's needs, which we believe will offer significant additional business opportunities as the healthcare industry evolves.

While we continued to execute our plan to control costs and improve efficiencies in our operations during the year, we also increased our business development efforts across our three divisions. We added additional members to our sales team, we increased our presence at targeted strategic conferences and tradeshows and we amplified our pursuit of opportunities outside of our current geographical markets. As part of this effort, we expanded our presence in India by participating in the Quebec economic mission to India with Premier Jean Charest and followed up by adding a permanent sales representative based in Delhi.

Outlook for 2011

While the economic conditions of the pharmaceutical industry will continue to present challenges in 2011, Warnex will remain focused on its strategic objectives and committed to its values and vision of becoming a significant player in laboratory-based services, through both organic growth and acquisitions. Since 1998, our laboratory services divisions have exhibited a compound annual growth rate of 26% and have been consistently EBITDA positive. In 2011, we plan to return to delivering growth in revenues and increasing our cash flow. We will continue to look at new business opportunities, including strategic acquisitions, to expand our service offering and increase critical mass. Since its foundation, Warnex has completed five acquisitions in the laboratory sector and we have proven our ability to successfully integrate them into our existing operations, contributing to the growth of the Company.

In 2011, one of goals is to return to profitability by managing costs, improving productivity, and increasing our revenues through enhanced business development efforts, while maintaining our commitment to quality and scientific excellence in all aspects of our business. We have made several changes to our organizational structure, uniting all of our pharmaceutical sales representatives into a unified structure, thus broadening our scope of potential clients.

As well, one of the main elements of our 2011 strategic plan is to finalize the restructuring of our balance sheet to reduce our long term debt and give us the flexibility to pursue our plans for growth.

Our Board continues to focus on operational performance and challenge management to strive for excellence and increase shareholder value. We appreciate their contribution and diverse experiences and we thank our Board of Directors for their continued support and strategic leadership.

We would also like to thank our employees for their hard work and dedication. They are Warnex's biggest asset and they make all of Warnex's achievements possible.

Finally, we would like to thank our shareholders for their support during this more challenging economic period. We believe that Warnex's business model is sound and has the potential for significant growth in the coming years.



Richard Laferrière
Chairman of the Board of Directors



Mark Busgang
President & CEO

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 audited financial statements for the year ended December 31, 2010, and the related notes appearing elsewhere in this document. This discussion and analysis compares the performance for fiscal 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 March 15, 2011, 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

Operating Highlights

- Warnex Medical Laboratories and Epigenomics AG, a molecular diagnostics company focused on cancer, entered into a non-exclusive licensing agreement for Epigenomics' colorectal cancer biomarker Septin9. Under the terms of the agreement, Warnex 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 launched its Septin9 blood testing service for colorectal cancer in Canada in December 2010.
- Warnex's PRO-DNA Services division, located in Thunder Bay, Ontario, received accreditation from the American Society of Crime Lab Directors/Laboratory Accreditation Board - International[®] (ASCLD/LAB-International[®]) for forensic science testing. Warnex was specifically accredited in the categories of nuclear and mitochondrial DNA testing, relationship testing and body fluid identification.
- Warnex's PRO-DNA Services division, located in Thunder Bay, Ontario, signed a Contribution Agreement with the National Research Council of Canada's Industrial Research Assistance Program (NRC-IRAP), for forensic DNA analysis of "Touch DNA" samples from expended firearm cartridges. In addition to technical and business advisory services, NRC-IRAP will contribute up to \$47,300 for the research and development work performed by Warnex.
- Warnex, the Montreal Heart Institute (MHI) and CEPMED (The Centre of Excellence in Personalized Medicine) are collaborating to develop a new diagnostic test for early detection of cardiovascular and metabolic diseases. It is hoped that this test will enable more personalized treatment of diseases such as atherosclerosis and diabetes. Financed in part by CEPMED, the test will be developed by Warnex in collaboration with Dr. Éric Thorin, a researcher at the MHI.
- Warnex confirmed that Persistence Capital Partners LP, a leading Canadian private equity firm focused exclusively on investments in high-growth opportunities in the healthcare field, acquired by way of a private agreement with SGF Soquia Inc. 10,738,750 common shares of Warnex, representing approximately 16% of the issued and outstanding shares of Warnex, and \$1.5 million principal amount of convertible debentures. As part of this transaction, the shareholder agreement between Busgang Investments Inc., a company controlled by Mark Busgang, President and Chief Executive Officer of Warnex, and SGF Soquia Inc., entered into on July 10, 2002, was terminated.

- 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's Medical Laboratories division was recognized for quality laboratory services. Warnex Medical Laboratories has met all criteria for the renewal of its Laboratory Accreditation by COLA, a U.S. healthcare accreditation organization. Accreditation is given only to laboratories that apply rigid standards of quality in day-to-day operations, demonstrate continued accuracy in the performance of proficiency testing, and pass a rigorous on-site laboratory survey. COLA standards meet or exceed requirements under CLIA (Clinical Laboratory Improvement Amendments).
- Warnex's CEO, Mark Busgang, participated in Quebec Premier Jean Charest's economic mission to India from January 31 to February 6, 2010. During the Mission Québec-India 2010, Mr. Charest was accompanied by the Minister of Economic Development, Innovation and Export Trade, Mr. Clément Gignac, the Minister of International Relations, Mr. Pierre Arcand, as well as a delegation of 130 participants from industry, academia, research and innovation sectors. The Mission Québec-India 2010 made stops in Mumbai, Bangalore and New Delhi. Warnex already has several very important customers in India and Mr. Busgang was exploring additional business opportunities in this market, which has a significant pharmaceutical and clinical research industry.
- 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.

Balance Sheet

- Total assets of \$13.4 million (2009 - \$15.5 million) and shareholders' equity of \$2.0 million (2009 - \$3.6 million)
- \$0.2 million invested in property, plant and equipment (2009 - \$0.3 million)
- Cash and cash equivalents of \$0.2 million (2009 - \$0.9 million)
- \$0.6 million used from the \$1.25 million short-term bank financing facility

Statement of Earnings and Comprehensive Income

- Revenue of \$22.3 million in 2010 compared to \$23.6 million in 2009, a decrease of 6%
- Net loss of \$1.6 million (2009 - \$0.2 million)
- Net loss of \$0.02 per share (2009 - \$0.00 per share)
- Earnings before interest, taxes, depreciation and amortization (EBITDA), as defined in the financial performance section of this report, of \$1.0 million (2009 - \$2.2 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 2010 objectives and results as well as our objectives for 2011.

2010 Objectives	2010 Results
Attain profitability by increasing revenues, managing costs and improving productivity	Due to the global economic recession and particularly the conditions of the pharmaceutical industry, we did not achieve budgeted expectations.
Restructure our balance sheet	The restructuring of our balance sheet is still ongoing. In September 2010, we brought in Persistence Capital Partners as a significant investor.
Increase business development effort in all divisions to increase revenue and expand our geographic markets	We hired a sales representative in Ontario and we increased our sales effort in India.
Evaluate new business opportunities, including strategic acquisitions, to expand our service offering and increase critical mass	We signed a licensing agreement with Epigenomics for the Septin9 colorectal cancer biomarker. We continue to review various strategic opportunities to expand our laboratory services business on an ongoing basis.

2011 Objectives
<ul style="list-style-type: none"> ▪ Finalize the restructuring of our long-term debentures ▪ Attain profitability by increasing revenues, managing costs and improving productivity ▪ 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 Twelve Months Ending December 31, 2010, Compared to the Twelve Months Ending December 31, 2009

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

	Revenue			Net earnings (net loss)		
	2010 \$	2009 \$	Variance \$	2010 \$	2009 \$	Variance \$
Analytical	10,468,434	11,551,123	(1,082,689)	188,666	1,200,689	(1,012,023)
Bioanalytical	6,355,347	7,404,942	(1,049,595)	977,263	1,362,992	(385,729)
Medical	5,160,983	4,414,684	746,299	1,048,841	937,388	111,453
Management services	266,026	276,238	(10,212)	(3,774,253)	(3,665,317)	(108,936)
Total	22,250,790	23,646,987	(1,396,197)	(1,559,483)	(164,248)	(1,395,235)

For the twelve-month period ended December 31, 2010, revenue reached \$22,250,790 (2009 - \$23,646,987), a decrease of 6% compared to last year. The Medical division generated revenue growth of 17% while the Analytical and Bioanalytical divisions had a 9% and 14% revenue decrease, respectively, compared to last year.

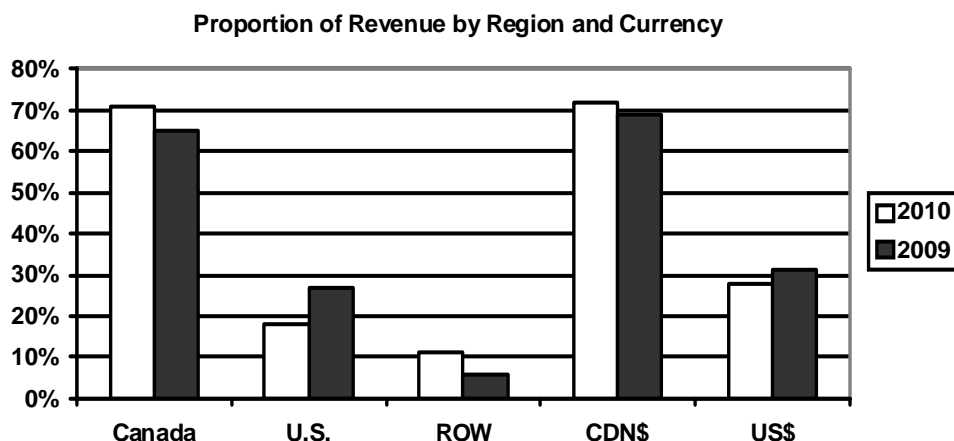
The Analytical division's revenues decreased by 9% from \$11.6 million in 2009 to \$10.5 million in 2010. The analytical laboratory in Laval generated \$4.2 million during the year (2009 - \$4.9 million) while the Neopharm division in Blainville generated \$6.3 million (2009 - \$6.7 million). This decrease is mainly due to a decrease in volume from major customers during the year.

The Bioanalytical division's revenues decreased by 14% from \$7.4 million in 2009 to \$6.4 million in 2010. This decrease is due to a substantial decrease of average price per sample while the volume of samples increased compared to last year.

The Medical division's revenue increased by 17% from \$4.4 million in 2009 to \$5.2 million in 2010. Prenatal testing revenues increased by 6%, molecular diagnostics increased by 37% and pharmacogenetic contracts increased by 23% compared to last year. The acquisition of Molecular World Inc., concluded on June 12, 2009, provided revenues of \$0.9 million for the year ended December 31, 2010 compared to \$0.2 million for the 6-month period last year.

In 2010 and going forward in 2011, the Company has increased its business development effort in order to reverse the negative revenue trend and increase business from new and existing customers.

The proportion of revenues generated by Canadian customers increased to 71% in 2010 from 65% in 2009. The proportion of revenues from U.S. customers decreased to 18% in 2010 from 27% in 2009, and from foreign customers increased to 11% in 2010 from 8% in 2009. The proportion of total revenue generated in U.S. dollars was lower than last year, with 28% in 2010 versus 31% in 2009.



Gross margin for the twelve-month period ended December 31, 2010, amounted to \$4,941,749 or 22% of revenue (2009 - \$5,768,409 or 24% of revenue). The decrease of \$826,660 in gross margin is mainly explained by lower revenues compared to last year.

The Analytical division's gross margin decreased by \$978,087 or 48%, from \$2.0 million in 2009 to \$1.1 million in 2010. The Laval facility's gross margin decreased by \$478,615, from \$789,997 in 2009 to \$311,382 in 2010. The Neopharm (Blainville) facility's gross margin decreased by \$499,470, from \$1,241,771 in 2009 to \$742,301 in 2010. These decreases are explained by a lower volume of tests as some of our customers decreased their activity levels.

The Bioanalytical division's gross margin decreased by \$563,989 or 30%, from \$1.9 million in 2009 to \$1.3 million in 2010. This decrease is explained by a 39% decrease of the average price per sample in 2010 compared to last year.

The Medical division's gross margin increased by \$762,749 or 40%, from \$1.9 million in 2009 to \$2.6 million in 2010. This increase is mainly due to the growth in revenues as well as a higher efficiency of operations.

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

	2010	2009	Variance
	\$	\$	\$
Selling and administrative	6,397,120	5,956,234	440,886
Financial	1,101,329	1,185,473	(84,144)
Research and development tax credits	(923,735)	(526,222)	(397,513)
Total	6,574,714	6,615,485	(40,771)

Selling and administrative expenses amounted to \$6,397,120 for the twelve-month period ended December 31, 2010 (2009 - \$5,956,234). The increase of \$440,886 is mainly explained by an increased investment in our sales group, professional fees related to the transition to International Financial Reporting Standards ("IFRS") and to the refinancing process, consulting fees related to the income tax credit claims 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 higher than last year at 29% (2009 - 25%).

Financial expenses decreased by \$84,144 to \$1,101,329 in 2010 from \$1,185,473 in 2009, mainly due to less interest following repayments made on the long term debt.

Research and development tax credits increased by \$397,513 to \$923,735 in 2010 from \$526,222 in 2009. The increase is mainly explained by adjustments for prior years based on notices of assessments received and for an accrual for the current year for an amount of \$498,000.

For the twelve-month period ended December 31, 2010, net loss amounted to \$1,559,483 or \$0.02 per share (2009 - \$164,248 or \$0.00).

For the twelve-month period ended December 31, 2010, earnings before interest, taxes, depreciation and amortization (EBITDA) amounted to \$989,675 (2009 - \$2,238,025), a decrease of \$1,248,350. This decrease is mainly due to lower revenue and margins in 2010 compared to 2009.

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:

	2010	2009	Variance
	\$	\$	\$
Net loss	(1,559,483)	(164,248)	(1,395,235)
Unrealized foreign exchange gain on debentures	(233,482)	(682,828)	449,346
Unrealized foreign exchange loss on working capital components	46,729	220,965	(174,236)
Interest revenue	(7,348)	(14,276)	6,928
Financial expenses	1,101,329	1,185,473	(84,144)
Restructuring costs	160,000	-	160,000
Amortization	1,491,681	1,671,966	(180,285)
Compensation for stock options	(9,751)	20,973	(30,724)
EBITDA	989,675	2,238,025	(1,248,350)

Balance Sheet

The balance sheet as at December 31, 2010, shows total assets of \$13.4 million (2009 - \$15.5 million), working capital of \$(6.7) million (2009 - \$0.4 million), shareholders' equity of \$2.0 million (2009 - \$3.6 million), cash of \$0.2 million (2009 - \$0.9 million) and a bank indebtedness of \$0.6 million (2009 - \$nil). In 2010, the Company also invested \$0.2 million in property, plant and equipment (2009 - \$0.7 million) and \$0.1 million in computer software (2009 - \$0.2 million).

Selected Annual Information

The following table provides selected financial data from the audited financial statements for each of the three most recently completed financial years:

	2010	2009	2008
	\$	\$	\$
Revenue	22,250,790	23,646,987	25,786,721
Net earnings (loss)	(1,559,483)	(164,248)	2,373,057
Net earnings (loss) per share	(0.02)	0.00	0.04
Diluted net earnings (loss) per share	(0.02)	0.00	0.04
Total assets	13,440,143	15,500,448	18,612,046
Total long-term financial liabilities, including the current portion of long-term debt	7,021,782	8,493,307	10,092,622

Note: The Company has never declared dividends.

The 8% decrease in revenue from 2008 to 2009 was mainly due to a decrease in volume in the Bioanalytical division caused by the economic conditions in the pharmaceutical industry. The 6% decrease in revenue from 2009 to 2010 was mainly due to a decrease in volume in the Analytical division as well as a decrease of average price per sample in the Bioanalytical division caused by the economic conditions in the pharmaceutical industry. Revenue in the Analytical division decreased by 12%, from \$11.8 million in 2008 to \$10.5 million in 2010. In the Bioanalytical division, revenue decreased by 36% from \$9.9 million in 2008 to \$6.4 million in 2010. The Medical Laboratories division increased revenue by 34%, from \$3.9 million in 2008 to \$5.2 million in 2010.

In 2010, net loss per share was \$(0.02) compared to \$0.00 in 2009 and net earnings per share of \$0.04 in 2008.

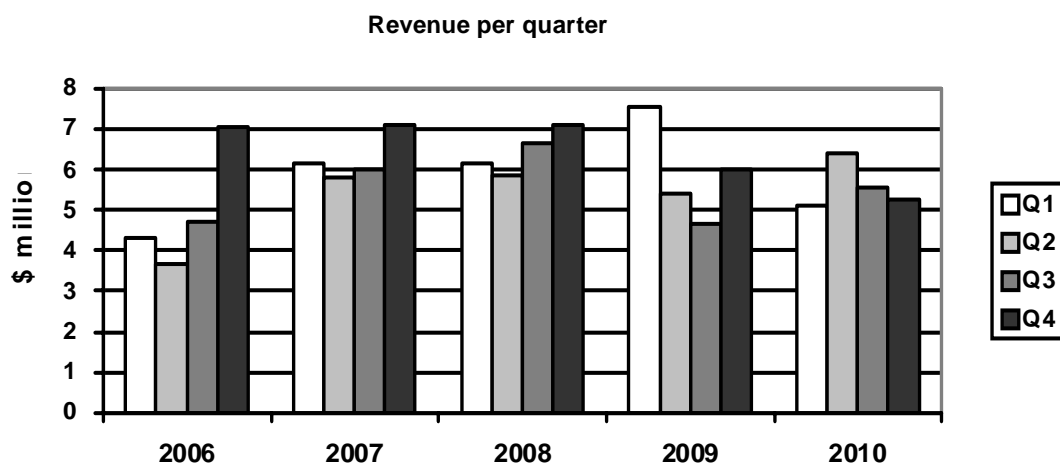
Summary of Quarterly Results

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	5,538,122	4,656,405	6,669,833	5,569	(782,797)	511,610
Q4	5,249,572	6,011,453	7,116,899	(779,183)	(137,548)	627,352
Total	22,250,790	23,646,987	25,786,721	(1,559,483)	(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	0.00	(0.01)	0.01	0.00	0.00	0.01
Q4	(0.01)	0.00	0.01	(0.01)	0.00	0.01
Total	(0.02)	0.00	0.04	(0.02)	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. 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.

In December 2010, the Company renewed its financing facility which remained unchanged except for the authorized operating line of credit amount. As of December 1st, 2010, the authorized amount was reduced from \$2,000,000 to \$1,250,000 and on January 31, 2011, the authorized amount was changed to \$1,000,000.

As at December 31, 2010, the Company is not in compliance with the working capital ratio and the annual debt service coverage covenants contained in the credit facility. The lender has not waived compliance with these covenants. Accordingly, the entire amount due to the bank is presented as a current liability as at December 31, 2010.

With the reorganization of our balance sheet, the Company intends to pursue its business plan and finance its planned growth through internally generated funds. If the growth is faster than anticipated or if the Company makes acquisitions, the Company may then require additional capital.

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 December 31, 2010, the Company had \$0.2 million invested in cash (2009 - \$0.9 million) and had used \$0.6 million of the line of credit (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⁾	504,228	-	-	-
Capital lease obligations	405,440	5,859	-	-
Operating leases ⁽²⁾	732,777	1,532,736	1,448,121	1,480,552
Purchase obligations	66,944	30,000	30,000	-
Non-convertible debenture	831,533	-	-	-
Convertible debentures ⁽³⁾	5,352,093	-	-	-
Total	7,893,015	1,568,595	1,478,121	1,480,552

Note 1: As of December 31, 2010, the Company did not meet certain covenants contained in the agreement with its banker. As a result, all of the bank term loans are being included in the current liabilities and \$58,335 was reclassified with the less than 1 year amount.

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 year, the following transactions occurred:

- i) The Company paid \$1,000 per month for a total of \$12,000 (2009 - \$12,000), to the Company's Chairman of the Board for his work on specific mandates for the various operating divisions of the Company.
- ii) The Company paid sales commissions to a company owned by a board member, in the amount of \$21,223 (2009 - \$nil).

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.

Fourth Quarter Results

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

	Revenue			Net earnings (net loss)		
	Q4 2010 \$	Q4 2009 \$	Variance \$	Q4 2010 \$	Q4 2009 \$	Variance \$
Analytical	2,096,451	2,895,357	(798,906)	(574,973)	313,023	(887,996)
Bioanalytical	1,750,546	1,950,649	(200,103)	380,980	440,022	(59,042)
Medical	1,342,064	1,108,310	233,754	277,082	183,170	93,912
Management services	60,511	57,137	3,374	(862,272)	(1,073,763)	211,491
Total	5,249,572	6,011,453	(761,881)	(779,183)	(137,548)	(641,635)

We generated \$5,249,572 in revenues in the fourth quarter of this year (2009 - \$6,011,453). In the Analytical division, revenue for the quarter decreased by \$0.8 million compared to last year due to a decrease in volume from major customers during the period. In the Bioanalytical division, revenue was \$0.2 million less than last year due to the postponement of some studies to 2011. In the Medical division, the revenue increase is mainly due to an increase in volume by the new subsidiary in Thunder Bay as well as our business development efforts.

The variance in net earnings in the Analytical division is mainly due to a decrease in volume from major customers during the period. The variances in the Bioanalytical and Medical divisions are mainly explained by the revenue levels compared to last year.

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 December 31, 2010.

Future Accounting Changes

International Financial Reporting Standards

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 included 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 included 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 has completed its assessments. 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 Company is in the process of reviewing its various agreements and modifying them for IFRS. In the Company's current bank agreements and negotiations, it will ensure that any new agreement take into account IFRS as the financial framework.

The implementation phase integrates all the solutions into the Company's financial system and processes that are necessary for the Company to convert to IFRS. This phase is ongoing as the Company prepares for IFRS compliance.

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	<ul style="list-style-type: none"> ▪ Additional disclosures in the notes to the financial statements. ▪ Presentation of financial statements will change. The Company has made some decisions regarding this presentation. The Company will present an analysis of expenses recognized in profit or loss using a classification based on function. This is believed to provide the most reliable and relevant information. The Company will also present all items of income and expense, recognized in a period, in a single statement of comprehensive income. The decisions made by the Company regarding presentation are still pending approval from the Board of Directors. ▪ The Company has evaluated the one-time transition choices that are available (listed below). ▪ Evaluation and selection of accounting policies is complete. ▪ Quantification of significant effects is ongoing. ▪ The external advisor has commenced preparation of the interim and annual skeleton financial statements. Financial statement note disclosure has been drafted and is expected to be finalized in the first quarter of 2011.
Property, plant and equipment	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ 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 completed its preliminary impairment testing upon transition to IFRS. Based upon these preliminary figures, the Company did not identify any impairment under IFRS.
Revenue	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ The Company has reviewed all existing lease agreements and preliminarily determined that no adjustments are required.
Share-based payments	<ul style="list-style-type: none"> ▪ 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 completed its evaluation and has preliminarily determined that upon transition no adjustment is required.

Provisions	<ul style="list-style-type: none"> ▪ 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.
Financial Instruments	<ul style="list-style-type: none"> ▪ The Company's accounting policy is to expense transaction costs as incurred. This policy is acceptable in accordance with Canadian GAAP but is not acceptable in accordance with IFRS. IFRS requires that transaction costs be netted against the debt or equity to which they relate and amortized using the effective interest method. Upon preliminary calculations, the Company has determined that an adjustment will be required as a result of the transaction costs incurred on the Company's long-term debt and debentures. Upon transition the long-term debt will be decreased by approximately \$58,000; equity decreased by approximately \$6,000; and deficit decreased by \$64,000.

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

Business combinations exemption	<p>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.</p>
Share-based payments exemption	<p>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.</p>
Fair value as deemed cost election	<p>IFRS 1 provides an option to elect to measure, upon transition, an item of property, plant and equipment at fair value. The Company has decided to elect the fair value as deemed cost for its lab equipment. The Company hired an external valuator to perform valuations on its equipment. The opening balance sheet will reflect this one-time revaluation of the property, plant and equipment to fair value as at January 1, 2010. The election is subject to the approval of the Board of Directors and final management review of the fair value analysis.</p>

There are other additional optional exemptions under IFRS 1, however, the Company does not expect any other exemptions to be significant to the Company's adoption of IFRS.

The mandatory IFRS 1 exception that is relevant to the Company relates to the use of estimates. More specifically, hindsight cannot be used to create or revise estimates previously made under Canadian GAAP except where necessary to reflect any difference in accounting policies or where there is objective evidence that those estimates were in error.

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 implementation phase throughout the beginning of 2011 taking into account these anticipated modifications.

The IFRS transition process is almost complete. As the Company progresses in its plan and as IFRS continues to change, the Company cannot determine, at this time, the full impact of adoption of IFRS on the financial position and future results.

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 has presented 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 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.

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	1,852,711	1,852,711
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		89,340,885

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 December 31, 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, on the design and effectiveness 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 design and operation of our disclosure controls and procedures were effective as at December 31, 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 December 31, 2010, management evaluated the design and effectiveness 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 nor operated effectively. The control deficiencies identified by the Company did not result in adjustments to our annual and any 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 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, payroll, and finance department over segregation of duties inherent to its size. Specifically, as a result of the limited number of personnel in the accounting, payroll, 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 2010.

Remediation of material weaknesses in internal control over financial reporting

Subsequent to December 31, 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 December 31, 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 continue to 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 added one additional temporary person in the accounting department in 2010.

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. We added one additional temporary person in the accounting department in 2010.

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

Financial Resources

The Company's balance sheet presently shows a negative current ratio since the debentures mature in June and July 2011. Therefore, the Company does not maintain the current ratio required by its banking agreement. The Company's ability to continue as a going concern is dependent upon its ability to negotiate new terms with the debenture holders, considering that the conversion prices of these convertible debentures are higher than the current market price of the Company's shares at the date of this report, and to agree on amenable covenants with the bank or to find alternative financing to repay debts maturing in 2011.

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. The Company is currently seeking investors to refinance the debentures.

Key Customers and Business Partners

Warnex Analytical's two most important customers accounted for 29% of sales for 2010 (2009 - 37%). 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 four main customers accounted for 54% of this division's revenues for 2010 (2009 - 3 customers for 53%) 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 2010.

Signed for management, this 15th day of March 2011.



Mark Busgang
President & CEO



François Jetté, CA
Chief Financial Officer

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Warnex Inc. and other financial information included in this annual report are the responsibility of the management and have been approved by Warnex's Board of Directors.

These financial statements were prepared by management in accordance with Canadian generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments where appropriate. Financial information included elsewhere in this annual report is consistent with that in the consolidated financial statements.

To ensure the accuracy and objectivity of the information contained in the financial statements, Warnex Inc.'s management maintains a system of internal accounting and administrative controls. Management believes this system gives reasonable assurance that the financial information is reliable and provides an adequate basis for the financial statements, and that the Company's assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this annual report primarily through its Audit Committee. The Audit Committee is formed of outside directors who review the Company's consolidated annual financial statements as well as management's analysis and the operating results and recommend their approval to the Board.

These consolidated financial statements have been audited by NEXIA FRIEDMAN LLP, Chartered Accountants, the external auditors designated by the shareholders. They periodically meet with the Audit Committee to discuss auditing, the reporting of financial information and other related subjects.



Mark Busgang
President & CEO



François Jetté, CA
Chief Financial Officer

March 15, 2011

Independent Auditors' Report

To the Shareholders of Warnex Inc.

We have audited the accompanying consolidated financial statements of Warnex Inc., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of earnings and comprehensive income, contributed surplus, deficit, accumulated other comprehensive income, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Warnex Inc. as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company has incurred significant operating losses and negative cash flows from operations and has an accumulated deficit of \$41,731,888 as at December 31, 2010. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

1



Chartered Accountants

Montreal, Quebec
March 15, 2011

¹CA auditor permit No. 21749

Consolidated Balance Sheets

As at December 31	2010	2009
Assets		
Current		
Cash and cash equivalents	\$244,456	\$894,031
Accounts receivable (note 5)	2,980,299	2,880,919
Work-in-progress	328,289	531,142
Inventory	355,132	177,027
Investment tax credits receivable	498,000	712,471
Prepaid expenses	293,636	388,502
	4,699,812	5,584,092
Future income taxes (note 13)	1,221,000	1,221,000
Property, plant and equipment (note 6)	6,174,451	7,375,516
Intangible assets (note 7)	407,185	382,145
Goodwill	937,695	937,695
	\$13,440,143	\$15,500,448
Liabilities		
Current		
Bank loan (note 8)	\$580,000	\$-
Accounts payable and accrued liabilities	2,899,115	3,008,594
Deferred revenue	921,532	411,599
Current portion of long-term debt (note 9)	894,716	1,800,372
Current portion of debentures (note 11)	6,121,344	-
	11,416,707	5,220,565
Long-term debt (note 9)	5,722	447,661
Liability component of debentures (note 11)	-	6,245,274
	11,422,429	11,913,500
Shareholders' equity		
Capital stock (note 12)	40,981,049	40,981,049
Equity component of debentures (note 11)	312,288	312,288
Contributed surplus	2,456,265	2,466,016
Deficit	(41,731,888)	(40,172,405)
	2,017,714	3,586,948
	\$13,440,143	\$15,500,448

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

On behalf of the Board:



Richard Laferrière
Director

Mark Busgang
Director

Consolidated Statements of Contributed Surplus

For the years ended December 31	2010	2009
Balance, beginning of year	\$2,466,016	\$2,445,043
Stock-based compensation	(9,751)	20,973
Balance, end of year	\$2,456,265	\$2,466,016

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

Consolidated Statements of Deficit

For the years ended December 31	2010	2009
Balance, beginning of year	\$40,172,405	\$40,008,157
Net loss	1,559,483	164,248
Balance, end of year	\$41,731,888	\$40,172,405

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

Consolidated Statements of Accumulated Other Comprehensive Income

For the years ended December 31	2010	2009
Accumulated Other Comprehensive Income	\$-	\$-

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

Consolidated Statements of Earnings and Comprehensive Income

For the years ended December 31	2010	2009
Revenue	\$22,250,790	\$23,646,987
Cost of goods sold (note 14)	17,309,041	17,878,578
Gross margin	4,941,749	5,768,409
Operating expenses (note 14)		
Selling, general and administrative	6,397,120	5,956,234
Finance charges	1,101,329	1,185,473
Research and development tax credits	(923,735)	(526,222)
	6,574,714	6,615,485
Loss before under noted items and income taxes	(1,632,965)	(847,076)
Restructuring costs	(160,000)	-
Unrealized foreign exchange gain on debentures	233,482	682,828
	73,482	682,828
Loss before income taxes	(1,559,483)	(164,248)
Income taxes - current	-	162,000
Recovery of income taxes due to utilization of prior years' losses	-	(162,000)
	-	-
Net loss and comprehensive income	\$(1,559,483)	\$(164,248)
Basic and fully diluted net loss per share	\$(0.02)	\$0.00
Weighted average number of shares outstanding	67,117,191	65,663,345

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

Consolidated Statements of Cash Flows

For the years ended December 31	2010	2009
Operations		
Net loss	\$(1,559,483)	\$(164,248)
Items not affecting cash:		
Amortization of property, plant and equipment	1,390,081	1,592,034
Amortization of intangible assets	101,600	79,932
Accretion of interest	109,552	95,221
Unrealized foreign exchange gain on debentures	(233,482)	(682,828)
Foreign currency fluctuation	70,862	267,647
Compensation cost for stock options	(9,751)	20,973
	(130,621)	1,208,731
Net change in non-cash working capital items (note 15)	622,115	(1,066,248)
Net cash provided by operations	491,494	142,483
Investing activities		
Acquisition of property, plant and equipment	(189,016)	(312,861)
Acquisition of intangible assets	(126,640)	(177,320)
Net cash used in investing activities	(315,656)	(490,181)
Financing activities		
Increase in bank loan	580,000	-
Proceeds from long-term debt	-	350,000
Repayment of long-term debt	(1,347,595)	(1,317,608)
Net cash used in financing activities	(767,595)	(967,608)
Foreign exchange loss on cash held in foreign currencies	(57,818)	(224,151)
Decrease in cash and cash equivalents	(649,575)	(1,539,457)
Cash and cash equivalents, beginning of year	894,031	2,433,488
Cash and cash equivalents, end of year	\$244,456	\$894,031

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

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

1. Description of business, basis of financial statement presentation and going concern uncertainty

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 ("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.

As at December 31, 2010, the Company has an accumulated deficit of \$41,731,888 and a negative current ratio, since the debentures mature in June and July 2011. In addition, the Company did not meet its covenants with its banker, as a result, the long term debt is being presented as a current liability. Without refinancing its operations, the Company's committed cash obligation exceeds the cash on hand and the expected level of cash flow from operations for the next twelve months. As a result, there is significant uncertainty as to whether the Company will have the ability to continue as a going concern. The Company's ability to continue as a going concern is therefore dependent upon its ability to obtain financing arrangements.

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

Changes in accounting policies

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 year ended December 31, 2010, increased by \$39,592 and work-in-progress increased by the same amount. The impact of the change in this accounting policy was undeterminable for the prior periods and was therefore not adjusted.

Accounting policies implemented in 2009

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 was no material impact on the Company's financial statements as a result of adopting this new standard.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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

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 was no material impact on the Company's financial statements as a result of 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.

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.

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 the 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 the ratio of costs incurred to total estimated costs of the projects.

Costs and estimated profits 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 whether a loss is likely to occur. When 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

December 31, 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. Net realizable value is the estimated revenue of the tests less the estimated costs necessary to complete the tests.

Research and development

Current research and development expenses are charged to earnings in the year they are incurred, net of related tax credits. The cost of property, plant and equipment is reduced by the amount related to the investment tax credits.

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 relating to property, plant and equipment is 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 carrying value of the assets.

Notes to Consolidated Financial Statements

December 31, 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

December 31, 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.

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.

5. Accounts receivable

	2010 \$	2009 \$
Trade	2,941,814	2,925,847
Allowance for doubtful accounts	(6,354)	(45,588)
	2,935,460	2,880,259
Sundry	44,839	660
	2,980,299	2,880,919

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

6. Property, plant and equipment

December 31, 2010	Cost \$	Accumulated Amortization \$	Net \$
Lab equipment	13,572,678	9,234,595	4,338,083
Machinery and equipment	113,004	41,669	71,335
Computer equipment	854,169	676,129	178,040
Furniture, fixtures and telephone equipment	560,990	439,431	121,559
Leasehold improvements	5,746,254	4,136,068	1,610,186
Non-refundable government financial assistance	(465,000)	(320,248)	(144,752)
	20,382,095	14,207,644	6,174,451

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 (2009 - \$1,599,039) and a net carrying value of \$964,184 (2009 - \$1,205,230), and computer equipment under capital lease having a cost of \$37,439 (2009 - \$37,439) and a net carrying value of \$22,563 (2009 - \$32,232).

7. Intangible assets

December 31, 2010	Cost \$	Accumulated Amortization \$	Net \$
Licences	33,380	22,253	11,127
Customer lists	38,936	19,467	19,469
Computer software	916,201	539,612	376,589
	988,517	581,332	407,185

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

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

8. Financing facility

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

- i) \$1,250,000 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 term 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 term 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.

As security for the facilities, the Company and its subsidiaries have provided 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 December 2010, the Company renewed its financing facility which remained unchanged except for the authorized amount of the operating line of credit. As of December 1, 2010, the authorized amount was reduced from \$2,000,000 to \$1,250,000 and on January 31, 2011, the authorized amount was decreased to \$1,000,000.

As at December 31, 2010, the Company is not in compliance with the working capital ratio and the annual debt service coverage covenants contained in the credit facility. The lender has not waived compliance with these covenants. Accordingly, the entire amount due to the bank is presented as a current liability as at December 31, 2010.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

9. Long-term debt

	2010 \$	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. having a carrying value of \$145,862.	13,200	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.	277,778	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 the covenants contained in the agreement with its banker. As a result, the bank term loan is being included in the current portion of the long-term debt.	175,000	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 \$338,694.	105,677	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 \$625,490.	271,577	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 \$12,543.	10,272	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 \$10,020.	8,684	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.	38,250	76,499
	900,438	2,248,033
Current portion	894,716	1,800,372
	5,722	447,661

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

9. Long-term debt... cont'd

Minimum lease payments required under capital leases are as follows:

	Payments \$
2011	405,440
2012	5,859
	411,299
Interest portion	15,089
	396,210
Current portion	390,488
	5,722

Principal payments required on long-term debt for the next two years are as follows:

	Payments \$
2011	445,893
2012	58,335
	504,228

The Company did not meet its covenants contained in the agreement with its banker as described in note 8. As a result, all of the bank term loans are being included in the current liabilities. Accordingly, the revised principal payments required for the next year amounts to \$504,228.

10. Commitments

a) The minimum rentals payable under long-term operating leases, exclusive of certain operating costs for which the Company is responsible are approximately as follows:

	Payments \$
2011	732,777
2012	743,073
2013	789,663
2014	724,771
2015	723,350
Thereafter	1,480,552
	5,194,186

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

10. Commitments... cont'd

b) The Company's commitments to purchase products from specific suppliers are approximately as follows:

	Payments \$
2011	66,944
2012	15,000
2013	15,000
2014	15,000
2015	15,000
	<u>126,944</u>

11. Debentures

	2010 \$	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.	3,852,093	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.	331,533	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
	<u>6,183,626</u>	<u>6,420,864</u>
Discount on debentures	(62,282)	(175,590)
Current portion of debentures	6,121,344	-
	<u>-</u>	<u>6,245,274</u>

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

11. Debentures... cont'd

The nominal and effective interest rates are as follows:

	Nominal	Effective
\$500,000 maturing July 2, 2011	12.0%	14.0%
US\$4,000,000 maturing July 5, 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.

12. 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

	2010		2009	
	Number	Amount \$	Number	Amount \$
Balance, beginning of year	67,117,191	40,981,049	64,317,191	40,551,049
Issuance of shares	-	-	2,800,000	430,000
Balance, end of year	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 11.

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, 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.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

12. Capital stock... cont'd

As at December 31, 2010, the Company has granted options to purchase 1,852,711 (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.

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

	2010		2009	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance, beginning of year	869,229	0.61	884,898	0.87
Granted	1,080,648	0.15	233,331	0.15
Exercised	-	-	-	-
Cancelled	(97,166)	0.43	(249,000)	1.08
Balance, end of year	1,852,711	0.35	869,229	0.61
Exercisable at the end of year	1,852,711	0.35	869,229	0.61

Stock options outstanding are as follows:

Range of exercise prices \$	2010			2009		
	Number	Weighted average remaining life (years)	Weighted average exercise price \$	Number	Weighted average remaining life (years)	Weighted average exercise price \$
0.15 – 0.19	1,477,311	8.92	0.15	463,329	8.84	0.15
0.84 – 0.95	89,500	3.23	0.87	106,000	4.35	0.87
1.08 – 1.10	95,000	5.00	1.10	95,000	6.06	1.10
1.15	21,000	3.61	1.15	28,000	4.67	1.15
1.27 – 1.35	169,900	3.60	1.33	176,900	4.66	1.33
	<u>1,852,711</u>			<u>869,229</u>		

During 2010, the Company granted 1,080,648 (2009 - 233,331) options to purchase common shares. The weighted average fair value of options granted during the period amounted to \$0.13 (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:

	2010	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	-	-

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

12. Capital stock... cont'd

d) Share warrants

The share warrants outstanding are as follows:

Expiry date	Exercise price \$	2010	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 year		3,570,983	3,570,983

13. Income taxes

a) The reconciliation of income tax computed at the statutory tax rates to the provision for income taxes is as follows:

	2010 \$	2009 \$
Net loss	(1,559,483)	(164,248)
Basic income tax rate	29.9%	30.9%
Computed income tax recovery	(466,285)	(50,753)
Effect on income tax rate resulting from:		
- Unrecorded potential tax benefits of current period losses, timing differences and loss carry forwards	412,443	(1,404)
- Accounting charges not deductible for tax purposes	53,842	52,157
	-	-

b) The Company and its subsidiaries have accumulated non-capital losses for federal and provincial income tax purposes of approximately \$18,696,000 and \$18,754,000 respectively. These losses may be applied against taxable income of future years, not later than as follows:

	Federal \$	Provincial \$
2014	5,788,000	5,680,000
2015	4,199,000	4,150,000
2023	163,000	163,000
2024	274,000	274,000
2025	73,000	73,000
2026	5,872,000	6,087,000
2027	411,000	411,000
2028	65,000	65,000
2029	207,000	207,000
2030	1,644,000	1,644,000
	18,696,000	18,754,000

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

13. Income taxes... cont'd

- c) The Company and its subsidiaries have accumulated unused investment tax credits for federal income tax purposes of approximately \$2,752,000. These investment tax credits may be applied against taxable income of future years not later than as follows:

	\$
2020	78,000
2021	172,000
2022	307,000
2023	292,000
2024	419,000
2025	347,000
2026	395,000
2027	135,000
2028	273,000
2029	334,000
	<u>2,752,000</u>

- d) The Company and its subsidiaries have research and development expenses for federal and provincial income tax purposes of approximately \$7,735,500 and \$12,097,500 respectively, which have not been deducted. These expenses may be applied against taxable income of future years.

- e) The Company and its subsidiaries have additional tax capital cost allowance in excess of depreciation amounting to approximately \$8,753,000 to be utilized in future years.

- f) The tax effects of these amounts that give rise to future income tax assets are as follows:

	2010 \$	2009 \$
Total tax effects	12,499,000	6,757,000
Valuation allowance	(11,278,000)	(5,536,000)
	<u>1,221,000</u>	<u>1,221,000</u>

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

14. Information relating to the consolidated statements of earnings

	2010 \$	2009 \$
a) The following items are included in cost of goods sold:		
Amortization of property, plant and equipment	1,172,542	1,376,844
Loss on foreign exchange	5,795	11,383
b) The following items are included in operating expenses:		
Amortization of property, plant and equipment	217,539	215,190
Amortization of intangible assets	101,600	79,932
Accretion of interest	109,552	95,221
Interest and bank charges	132,962	101,087
Interest on long-term debt	94,297	158,672
Interest on debentures	764,518	830,493
Loss on foreign exchange	65,363	311,989
c) Research and development tax credits		

The statement of earnings includes an amount of \$923,735 related to research and development tax credits. This includes an amount of \$425,735, which represents the research and development claims for 2008 and 2009 that were assessed in the current year in excess of the amounts previously accrued. Included in the 2009 statement of earnings is a net amount of \$87,500 related to amended research and development investment tax credits for the 2008 fiscal year.

15. Information relating to the consolidated statements of cash flows

a) Cash flows from operations include interest paid of \$883,556 (2009 - \$887,838).

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

	2010 \$	2009 \$
Accounts receivable	(167,424)	1,106,758
Work-in-progress	202,853	825,007
Inventory	(178,105)	(55,326)
Investment tax credits receivables	214,471	(526,222)
Prepaid expenses	94,866	(82,264)
Accounts payable and accrued liabilities	(54,479)	(1,387,214)
Deferred revenue	509,933	(946,987)
	622,115	(1,066,248)

c) During the year, property, plant and equipment with a cost of \$nil (2009 - \$37,439) were acquired by means of capital leases.

d) In 2009, 2,000,000 common shares of the Company, valued at \$310,000, were issued as described in the transaction in note 4.

e) In 2009, 800,000 common shares of the Company, valued at \$120,000, were issued as described in the transaction in note 11.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

16. 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 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.

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.

17. Segmented information

a) In 2010, the Companies operated in the following industries:

	Revenue \$	Net earnings (loss) \$	Amortization \$	Long-term assets \$	Total assets \$
Analytical services	10,468,434	188,666	399,634	1,883,204	3,902,241
Bioanalytical services	6,355,347	977,263	739,205	3,007,672	4,569,960
Medical laboratories	5,160,983	1,048,841	152,945	2,012,156	2,668,162
Management services	266,026	(3,774,253)	199,897	1,837,299	2,299,780
	22,250,790	(1,559,483)	1,491,681	8,740,331	13,440,143

b) In 2009, the Companies operated in the following industries:

	Revenue \$	Net earnings (loss) \$	Amortization \$	Long-term assets \$	Total assets \$
Analytical services	11,551,123	1,200,689	468,461	2,175,767	4,421,716
Bioanalytical services	7,404,942	1,362,992	908,306	3,704,827	5,096,684
Medical laboratories	4,414,684	937,388	95,247	2,019,477	2,739,266
Management services	276,238	(3,665,317)	199,952	2,016,285	3,242,782
	23,646,987	(164,248)	1,671,966	9,916,356	15,500,448

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

17. Segmented information... cont'd

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

	2010 \$	2009 \$
Canada	15,719,334	15,342,904
United States of America	3,988,350	6,305,938
Rest of the world	2,543,106	1,998,145
	<u>22,250,790</u>	<u>23,646,987</u>

d) Revenues were generated in the following currencies:

	2010 \$	2009 \$
Canadian dollars	16,074,486	16,267,141
U.S. dollars	6,172,289	7,379,846
Euros	4,015	-
	<u>22,250,790</u>	<u>23,646,987</u>

18. Related party transactions

During the year, the following transactions occurred:

- i) The Company paid \$1,000 per month for a total of \$12,000 (2009 - \$12,000), to the Company's Chairman of the Board for his work on specific mandates for the various operating divisions of the Company.
- ii) The Company paid sales commissions to a company owned by a board member, in the amount of \$21,223 (2009 - \$nil).

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.

19. 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 loan and accounts payable and accrued liabilities.

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 December 31, 2010, the fair value has been established at its carrying amount.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

19. Financial instruments... cont'd

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 \$6,354 (2009 - \$45,588). Of the Company's accounts receivable, \$71,352 (2009 - \$506,600) is greater than 90 days. Of this amount, \$nil (2009 - \$211,942) is included in deferred revenue. Any amounts not provided for are considered to be fully collectable.

The Company has one customer which account for approximately 16% of the accounts receivable as at December 31, 2010 (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:

December 31, 2010	U.S. Dollars	Euros
Cash	91,863	-
Accounts receivable	860,868	-
Work-in-progress	241,711	-
Accounts payable and accrued liabilities	260,948	3,566
Deferred revenue	654,680	-

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. The Company is currently seeking investors to refinance the debentures.

Corporate Information

Corporate Headquarters

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Stock Symbol and Exchange Listing

Stock Symbol: WNX
Toronto Stock Exchange (TSX)

Auditors

Nexia Friedman, LLP
Chartered Accountants
Montreal, Quebec

Transfer Agent

Computershare Trust Company of Canada
Montreal, Quebec

Directors



Richard Laferrière⁽³⁾
Chairman of the Board of Directors, Warnex Inc.;
Executive Chairman,
Extenway Solutions Inc.



Mark J. Busgang
President and CEO,
Warnex Inc.



Louis Lacasse⁽¹⁾
President, GeneChem
Management Inc.



Dr. Jacques Gagné^(2,3)
Consultant



Gilles Gagnon⁽¹⁾
Consultant



Mattie Chinks⁽²⁾
President,
Avmor Ltd.



Michel Lassonde^(1,3)
Consultant



The Honourable Baljit S. Chadha⁽²⁾
President,
Balcorp Ltd.



Dr. Richard Lacombe⁽¹⁾
Consultant

(1) Audit Committee

(2) Human Resources & Remuneration Committee

(3) Corporate Governance Committee

Management



Mark J. Busgang
President and CEO,
Warnex Inc.



François Jetté
Chief Financial Officer,
Warnex Inc.



Dr. Michael Mancini
President,
Warnex Bioanalytical
Services



Dr. Yvan Côté
Vice President &
General Manager, Warnex
Medical Laboratories
and Warnex PRO-DNA
Services

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report 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 heading Risks and Uncertainties in the Management's Discussion and Analysis. Consequently, actual results may differ materially from the anticipated results expressed in these forward-looking statements.

