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WARNEX

Third Quarter Report

WARNEX INC

MANAGEMENT'S DISCUSSION AND ANALYSIS

THIRD QUARTER ENDED SEPTEMBER 30, 2004

MANAGEMENT DISCUSSION AND ANALYSIS

Management's discussion and analysis provides a review of the performance of our company and should be read in conjunction with the unaudited financial statements for the quarter ended September 30, 2004 and the related notes appearing elsewhere in this document. This discussion and analysis compares the performance for fiscal 2004 with that of 2003 and also discloses additional information to help better understand our business. This includes a review of the opportunities, issues and risks that may impact future operations.

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

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

FORWARD-LOOKING STATEMENTS

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

OVERVIEW

Warnex is a publicly traded (TSX: WNX) biotechnology company devoted to protecting public health by providing advanced diagnostic and quality control products and services to the pharmaceutical, agri-food, and healthcare sectors. Warnex was founded on and remains committed to a business philosophy that reduces risk while building long-term shareholder value. Our Company combines the high growth opportunity of our Genevision[®] technology, which is based on a recurring revenue model, with a solid base of complementary revenues from our profitable and sustainable analytical, bioanalytical, and clinical service divisions.

The Genevision technology is a versatile DNA detection platform that produces results rapidly and accurately, using Real-Time PCR combined with genetic markers and unique software. Applications range from the rapid and thorough screening for bacteria to the detection and identification of GMOs. The technology also has a traceability function through the use of Molecular Bar Codes.

STRATEGIC BUSINESS UNITS

We have organized our operations into five strategic business units:

Business Unit	Activity
Analytical Services	Provides quality control services to the pharmaceutical, food and cosmetics industries. Services provided include traditional chemistry, microbiology, chromatography and method development and validation.
Bioanalytical Services	Provides advanced Mass Spectrometry technology to pharmaceutical and biotechnology companies in order to assist them in their development of new pharmaceutical products.
Clinical Services	Provides specialized laboratory testing services to the healthcare sector, including the Prenatest [®] , a prenatal screening test that enables pregnant women to find out if they are at a risk of carrying a fetus that may be affected by Trisomy 21 (Down syndrome), Trisomy 18, and other anomalies relating to the closure of the neural tube.
Research & Development	Focuses on the ongoing research and development of our technology platform. Our group of more than 25 highly qualified genomic researchers continues the development of our technology, as well as the transfer of the technology to the Diagnostics group for manufacture and commercialization.
Diagnostics	Responsible for the manufacturing, validation and sales of our products. The sales and marketing group has been very active since fall 2003 and we have signed several major Canadian and American customers. The manufacturing group commenced operations in Q4, 2003.

CORPORATE HIGHLIGHTS

OPERATING HIGHLIGHTS

- Signed up U.S.-based West Liberty Foods, L.L.C. as a customer for our food safety technology. West Liberty foods is a leading manufacturer of ready-to-eat meats and a major supplier to corporations such as Subway, Denny's, and Wal-Mart. They will use our Rapid Pathogen Detection System to test for the presence of *Salmonella* and *Listeria* in their products.
- Received U.S. validations for three more of our food safety tests. Our tests for *Listeria monocytogenes*, *Listeria* spp., and *Salmonella* spp. have been granted *Performance Tested*SM status by the AOAC Research Institute, a non-profit international scientific organization that validates laboratory testing methods. These tests, in conjunction with our previously validated *E. coli* O157 and *E. coli* O157:H7 tests, give us a significant U.S. portfolio of marketed tests for the three key pathogens that account for more than 70% of our target market.
- On August 2, 2004, we acquired the BioTestosterone test from Adaltis Inc. for \$250,000, payable in Warnex shares. The test measures bioavailable testosterone, i.e. the biologically active form of testosterone, in human serum. Annual revenues generated from this test are approximately \$400,000.

BALANCE SHEET

- Total assets of \$32.5 million and shareholders equity of \$20.1 million
- \$2.9 million invested in fixed assets
- \$9.3 million in cash and marketable securities (\$2 million of which is restricted cash)
- \$4.0 million bank financing facility not utilized to date

STATEMENT OF OPERATIONS

- Revenue growth of 94% from \$1.7 million in Q3 2003 to \$3.4 million in Q3 2004. For the nine-month period ended September 30, 2004, revenue is 75% above last year at \$8.2 million (2003 - \$4.7 million).
- Profit generated by the Analytical and Bioanalytical divisions totaled \$2.4 million for the nine-month period (2003-\$0.4 million).
- Net loss of \$1.4 million (2003 - \$1.0 million), including \$0.7 million in R&D and \$0.8 million in marketing and selling expenses for the Genevision technology. For the nine-month period ended September 30, 2004, the net loss was \$4.6 million (2003 - \$3.8 million), an increase of \$0.8 million over last year.
- Loss of \$0.03 per share (2003 - \$0.02). For the nine-month period ended September 30, 2004, the net loss per share was \$0.10 compared to \$0.09 last year.

MANAGEMENT OBJECTIVES

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

2004 Objectives

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

FINANCIAL PERFORMANCE

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDING SEPTEMBER 30, 2004 COMPARED TO THE THREE MONTHS ENDING SEPTEMBER 30, 2003

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

	Revenue			Net profit (net loss)		
	Q3 2004	Q3 2003	Variance	Q3 2004	Q3 2003	Variance
Analytical	1,001,907	1,011,086	(9,179)	164,888	160,724	4,164
Bioanalytical	1,526,857	665,192	861,665	475,389	256,511	218,878
R&D	6,529	937	5,592	(592,135)	(521,538)	(70,597)
Diagnostics	194,897	223	194,674	(832,375)	(337,448)	(494,927)
Management	50,412	70,516	(20,104)	(732,639)	(548,325)	(184,314)
Clinical	609,374		609,374	177,833	-	177,833
Other	-			(71,942)	(33)	(71,909)
Total Q3	3,389,976	1,747,954	1,642,022	(1,410,981)	(990,109)	(420,872)

For the three-month period ended September 30, 2004, revenue reached \$3,389,976 (2003 - \$1,747,954), an increase of 94% over last year. The Analytical division presented revenue similar to last year at \$1.0 million. The Bioanalytical division increased revenue by 130% from \$0.7 million to \$1.5 million. This increase is due to organic growth and demonstrates our commitment to provide our clients with a superior level of service and a dedication to quality. For the nine-month period ended September 30, 2004, revenue reached \$8,239,141 (2003 - \$4,698,896), an increase of 75% over last year.

Gross margins for the three-month period ended September 30, 2004 amounted to \$1,077,636 (2003 - \$518,899). The increase of \$558,737 in gross margin is mainly due to the contribution from additional sales in Bioanalytical services. For the nine-month period ended September 30, 2004, gross margin was \$2,826,536 (2003 - \$985,771), an increase of \$1,840,765 or 187% over last year.

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

	2004	2003	Variance
Selling and administrative expenses	1,588,336	853,421	734,915
Research & Development	664,862	521,832	143,030
Financial	235,419	133,722	101,697
Total	2,488,617	1,508,975	979,642

Selling and administrative expenses amount to \$1,588,336 for the three-month period ended September 30, 2004, (2003 - \$853,421). The \$734,915 increase is mainly due to expenses in marketing and promotional expenses as we intensify the commercial roll-out of the Genevision technology which allowed us, among other things, to sign up major U.S. food processors (Carolina Turkey, Gold Kist and West Liberty Foods) who will use our technology to test for the presence of *Salmonella* and *Listeria* in their products, professional fees, \$228,845 in share purchase options and \$116,126 in depreciation. For the nine-month period ended September 30, 2004, selling and administrative expenses amounted to \$4,852,656 (2003 - \$2,830,933), an increase of \$2,021,723.

Financial expenses increased by \$101,697 to reach \$235,419 (2003 - \$133,722) due to the US convertible debentures closed at the end of June 2004. For the nine-month period ended September 30, 2004, financial expenses were \$497,046 (2003 - \$368,537), \$128,509 more than last year.

Research & development expenses increased by \$143,030 or 27% compared to last year to reach \$664,862 (2003 -\$521,832). Year-to-date R&D expenses were \$2,065,629 (2003 - \$1,540,420) or \$525,209 more than last year. We have maintained the ongoing investment needed to gain regulatory approvals for the Genevision technology and continued to increase our portfolio of markers and improve our detection platform. We received US validations for three more Genevision tests. The Genevision tests for the detection of *Salmonella* spp., *Listeria monocytogenes* and *Listeria* spp. have been granted *Performance Tested*SM status by the AOAC Research Institute, a non-profit international scientific organization that validates laboratory testing method. We now have three Canadian regulatory approvals (*Salmonella* spp., *Listeria monocytogenes* and *E. coli* O157) and five U.S. approvals (*Salmonella* spp., *Listeria* spp., *Listeria monocytogenes*, *E. coli* O157 and *E. coli* O157:H7).

For the three-month period ended September 30, 2004, the net loss was \$420,905 more than last year at \$1,410,981 or \$0.03 per share (2003 - \$990,109 or \$0.02 a share). For the nine months ended September 2004, the net loss amounted to \$4,588,795 or \$0.10 per share (2003- \$3,752,424 or \$0.09 per share), and is mainly explained by our investments of \$2.4 million in selling and marketing and related activities for the Genevision technology and \$1.9 million in R&D as we aim to become a leader in the food diagnostics market. We have developed a unique technology, tailored it to the needs of sophisticated food suppliers with unique demands, and invested in key marketing and customer service initiatives to support commercial growth.

BALANCE SHEET

The balance sheet as at September 30, 2004 shows total assets of \$32.5 million (December 2003-\$23.8 million), working capital of \$10.6 million (December 2003 - \$7.8 million), shareholders' equity of \$20.1 million (December 2003 - \$18.2 million), cash of \$9.3 million and unused banking facilities of \$2.0 million (December 2003 - \$7.0 million and \$2.0 million respectively).

We also invested \$2.9 million in capital assets, of which \$2.3 million was invested in laboratory equipment to support continued growth in the Analytical and Bioanalytical divisions.

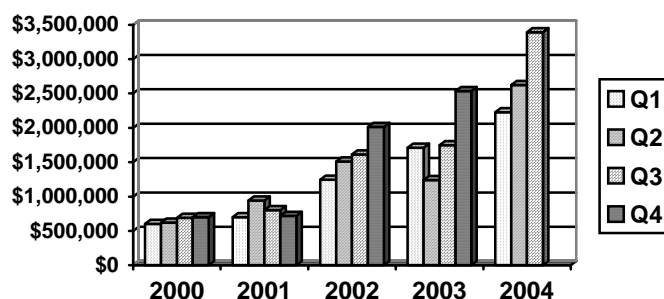
SUMMARY OF QUARTERLY RESULTS

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

	Revenue			Net loss			Net loss per share		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
Q1	2,226,094	1,711,566	1,246,743	1,565,802	1,105,369	322,466	0.04	0.03	0.01
Q2	2,623,071	1,239,376	1,512,278	1,612,012	1,656,947	262,987	0.04	0.04	0.01
Q3	3,389,976	1,747,954	1,611,727	1,410,981	990,109	540,500	0.03	0.02	0.02
Q4		2,534,306	2,024,822		1,251,144	879,177		0.03	0.02
Total	8,239,141	7,233,202	6,395,570	4,588,795	5,003,569	2,005,130	0.10	0.12	0.06

We have maintained a steady growth in revenue since 2000 with record revenue of \$3,389,976 in the third quarter of 2004. The revenue for the first nine months of 2004 is 75% higher than last year and the third quarter of 2004 is our all-time best quarter. We have leveraged these revenues into significant investments in research and development and in the selling and marketing of the Genevision technology.

Revenue per quarter



LIQUIDITY AND CAPITAL RESOURCES

To date, Warnex has financed its research and development, and capital expenditures associated with R&D and the manufacturing of the Genevision technology primarily through private placements of common shares, the issuance of convertible debentures and the receipt of investment tax credits earned on eligible expenditures. Since its inception, the Company has raised \$26.3 million from equity-based transactions and an additional \$9.8 million from the issuance of convertible debentures.

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

Warnex's Board of Directors has implemented an investment policy regulating the investment activities of

cash resources. The Company invests solely in liquid, high-grade securities with varying maturity dates. As at September 30, 2004, the Company has \$9,261,304 invested in cash and in such securities, \$2 million of which is restricted cash and \$503,510 of R&D tax credits. In addition, we have a \$4 million banking facility.

Management believes that Warnex's existing working capital, unused commercial banking facilities and ongoing cash flow from operations will generate sufficient amounts of cash in the short-term and the long-term to maintain the Company's capacity to meet its planned growth and fund development activities.

RELATED PARTY TRANSACTIONS

During the quarter, the Company paid rent in the amount of \$97,989 (2003-\$83,352) to a company owned by a director.

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

CRITICAL ACCOUNTING ESTIMATES

The \$8.4 million of goodwill results from the acquisition of the minority shareholder interest of 35% of Warnex Research Inc. in 2002 for \$7.3 million and \$1.1 million from the acquisition of the Clinical Laboratory division of Adaltis Inc. in June and August 2004. The Company assesses, on an ongoing basis, and at least annually, whether a provision for permanent impairment in the value of goodwill should be adjusted to earnings. In 2003, we assessed the value of goodwill of Warnex Research by projecting discounted cash flows and concluded that the value of goodwill as at December 31, 2003 was not impaired. We believe that this estimate is still adequate as at September 30, 2004.

INTANGIBLES

Intangible assets amounted to \$2.3 million and were mostly related to the acquisition of the assets of the Clinical Laboratory division of Adaltis Inc. in June 2004 (\$1.5 million of licenses and \$0.8 million of customer contracts).

CHANGES IN ACCOUNTING POLICIES

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

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

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

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

	2004	2003
Net loss		
- As reported	\$4,588,795	\$3,752,424
- Pro forma	\$4,588,795	\$3,858,100
Basic loss per share		
- As reported	\$0.10	\$0.09
- Pro forma	\$0.10	\$0.09

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

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

Nine months ended September 30	2004	2003
Balance, beginning of period	\$ -	\$ -
Compensation cost for stock options granted between January 1, 2002 and December 31, 2003	229,140	-
Compensation cost for stock options granted in 2004	228,845	-
Balance, end of period	\$ 457,985	\$ -

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

Company's results, financial situation or cash flows.

OUTSTANDING SHARE DATA

As at September 30, 2004, the fully diluted number of shares is as follows:

Instrument	Nominal	Fully diluted
Issued and outstanding common shares	48,649,400	48,649,400
Options Issued	1,553,334	1,553,334
Share warrants (note 1)	4,112,909	4,112,909
Convertible debentures issued in 2002 (note 1)	3,000,000	1,714,285
Convertible debentures issued in 2004 (note 2)	6,845,000	4,889,285
Fully diluted shares		55,739,196

Note 1: We used the 2004 \$1.75 conversion factor to estimate proportionate number of common shares.

Note 2: We used the agreed upon \$1.40 conversion factor to estimate proportionate number of common shares related to these convertible debentures.

In 2002, the Company issued non-secured debentures in the amount of \$3,000,000 bearing interest at a rate of 12% annually, maturing July 10, 2008, and convertible into common shares of the Company. The interest on the debentures was capitalized until July 9, 2003 and added to the cost of the debentures for the period of July 2002 to July 2003. The capitalized interest is paid in 60 monthly payments from August 2003.

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

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

The Company has the right to force the conversion of part of the debentures up to a total amount of \$2,000,000 from January 1, 2004 to December 31, 2004 in the event that the average market price of the common shares of the Company for a period of 21 business days prior to the conversion notice by the Company to the debenture holder is at least 30% higher than the conversion price at that date. Finally, the Company will have the right to force the conversion of the remaining portion of the debentures from January 1, 2005 to July 10, 2007 in the event that the average market price of the common shares of the Company for a period of 21 business days prior to the conversion notice by the Company to the debenture holder is at least 25% higher than the conversion price at that date.

On June 25, 2004, the Company issued non secured convertible debentures in the amount of US\$5,000,000 (equivalent to \$6,845,000) bearing interest at a rate of 7% annually, payable quarterly in arrears, maturing

June 25, 2008 and convertible into 4,889,285 common shares of the Company at the sole option of the lender. As part of this financing, share warrants were issued entitling the lender to purchase 1,963,729 common shares of the Company for a price of \$1.50 a share until June 25, 2009.

According to section 3860 of the CICA handbook, we are required to separately value the debt component and the equity portion of the debentures, i.e. the value of the option to convert debentures into common shares. The value of the debt component of the convertible debentures has been determined by discounting the future capital and interest payments until their maturity date, at a discount rate that represents the borrowing rate available to the Company for similar debentures having no conversion rights. The remaining portion of the net proceeds of the debentures is \$982,932 and is therefore presented in the balance sheet as part of shareholders' equity.

The interest expense related to the debt component has been charged to earnings and the allocation related to the equity component, \$45,072 (2003 - \$30,893), has been charged to the deficit and disclosed as interest on the equity component of the convertible debentures.

CORPORATE GOVERNANCE

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

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

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

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

RISK AND UNCERTAINTIES

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

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

OUTLOOK

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

Signed for management, this 8th day of November 2004.



Mark Busgang
President & CEO



Denis Pellerin, CA
Vice President and CFO

WARNEX INC.
INTERIM CONSOLIDATED BALANCE SHEET
(Unaudited)

	September 30 2004	December 31 2003
Assets		
Current		
Cash and cash equivalents	\$9,261,304	\$2,847,373
Marketable Securities	-	4,145,429
Accounts receivable	2,531,715	1,822,507
Inventory	351,109	101,295
Investment tax credits receivable	503,510	305,736
Prepaid expenses	407,837	202,543
	13,055,475	9,424,883
Capital assets	8,764,635	6,955,210
Intangibles (note 4)	2,270,400	-
Goodwill (note 4)	8,407,083	7,373,083
	\$32,497,593	\$23,753,176
Liabilities		
Current		
Accounts payable	\$1,843,556	\$1,305,510
Current portion of long-term debt	511,847	215,327
Current portion of convertible debentures	71,605	71,605
	2,427,008	1,592,442
Long-term debt (note 6)	929,740	1,075,343
Liability component of convertible debentures (note 7)	9,058,983	2,924,586
	12,415,731	5,592,371
Shareholders' equity		
Capital stock (note 8)	34,734,656	29,059,509
Equity component of convertible debentures	982,932	332,000
Contributed surplus	457,985	-
Deficit	(16,093,711)	(11,230,704)
	20,081,862	18,160,805
	\$32,497,593	\$23,753,176

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF EARNINGS
(Unaudited)

	Three months ended September 30 th		Nine months ended September 30 th	
	2004	2003	2004	2003
Revenue	\$3,389,976	\$1,747,954	\$8,239,141	\$4,698,896
Cost of goods sold (note 5)	2,312,340	1,229,055	5,412,605	3,713,125
Gross margin	1,077,636	518,899	2,826,536	985,771
Operating expenses (note 5)				
Selling, general and administrative	1,588,336	853,421	4,852,656	2,830,933
Finance charges	235,419	133,722	497,046	368,537
Research expenditures, net of tax credits	664,862	521,832	2,065,629	1,540,420
	2,488,617	1,508,975	7,415,331	4,739,890
Loss from continuing operations	(1,410,981)	(990,076)	(4,588,795)	(3,754,119)
Earnings (loss) from discontinued operations	-	(33)	-	1,695
Net loss	\$(1,410,981)	\$(990,109)	\$(4,588,795)	\$(3,752,424)
Basic and fully diluted net loss per share from continuing operations	\$0.03	\$0.02	\$0.10	\$0.09
Basic and fully diluted net loss per share	\$0.03	\$0.02	\$0.10	\$0.09
Weighted average number of shares outstanding	48,488,541	43,461,883	45,368,650	43,367,868

WARNEX INC.
INTERIM CONSOLIDATED STATEMENT OF DEFICIT
(Unaudited)

	Three months ended September 30 th		Nine months ended September 30 th	
	2004	2003	2004	2003
Balance, beginning of period				
As previously reported	\$14,659,590	\$8,967,131	\$11,230,704	\$6,185,059
Change in accounting policy regarding stock-based compensation (note 2)	-	-	229,140	-
As restated	14,659,590	\$8,967,131	11,459,844	8,967,131
Interest on equity component of convertible debentures	23,140	11,136	45,072	30,893
Net loss	1,410,981	990,109	4,588,795	3,752,424
Balance, end of period	\$16,093,711	\$9,968,376	\$16,093,711	\$9,968,376

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

	Three months ended September 30 th		Nine months ended September 30 th	
	2004	2003	2004	2003
Balance, beginning of period				
As previously reported	\$370,388	\$ -	\$ -	\$ -
Change in accounting policy regarding stock-based compensation (note 2)	-	-	229,140	-
As restated	370,388	-	229,140	-
Compensation cost for stock options granted in 2004	87,597	-	228,845	-
Balance, end of period	\$457,985	\$ -	\$457,985	\$ -

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

	Three months ended September 30 th		Nine months ended September 30 th	
	2004	2003	2004	2003
Operations (note 9)				
Net loss	\$(1,410,981)	\$(990,109)	\$(4,588,795)	\$(3,752,424)
Items not affecting cash:				
Amortization	544,550	298,308	1,217,464	875,364
Compensation cost for stock options	87,597	-	228,845	-
Interest on equity component of convertible debentures	(23,140)	(11,136)	(45,072)	(30,893)
	(801,974)	(702,937)	(3,187,558)	(2,907,953)
Net change in non-cash working capital items	(1,252,489)	(562,098)	(824,046)	(188,301)
	(2,054,463)	1,265,035	(4,011,604)	3,096,254
Financing activities				
Proceeds from long-term debt	-	-	700,000	2,515
Repayment of long-term debt	(148,732)	(78,900)	(1,455,669)	(228,203)
Liability component of convertible debentures	(17,901)	(10,011)	6,134,397	168,510
Equity component of convertible debentures	-	-	650,932	-
Issue of shares	850	-	5,013,601	98,125
Cost of issuance	-	-	(388,454)	(250)
	(165,783)	88,911	10,654,807	40,697
Investing activities				
Decrease in short-term investments	-	99,902	-	236,315
Decrease in marketable securities	-	1,349,992	4,145,429	4,356,892
Acquisition of capital assets	(436,389)	(363,240)	(2,003,751)	(1,700,088)
Acquisition of intangibles	(26,334)	-	(1,586,950)	-
Acquisition of goodwill	-	-	(784,000)	-
	(462,723)	1,086,654	(229,272)	2,893,119
Increase (decrease) in cash and cash equivalents	(2,682,969)	(267,292)	6,413,931	(162,438)
Cash and cash equivalents, beginning of period	11,944,273	494,144	2,847,373	389,290
Cash and cash equivalents, end of period	\$9,261,304	\$226,852	\$9,261,304	\$226,852

1. Significant accounting policies

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

2. Change in accounting policy

Stock-based compensation

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

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

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

3. Significant accounting policies

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions also affect revenues and expenses during the period reported. Actual results could differ from these estimates.

Revenue recognition

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

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

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

Cash and cash equivalents

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

Inventory

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

Research and development tax credits

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

Capital assets

Capital assets are recorded at cost and amortized as follows:

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

Intangible assets

Intangible assets represent the cost of acquired licenses and customer contracts and are amortized over their estimated useful lives, not exceeding 20 years. Intangible assets with finite lives are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the assets is greater than the undiscounted future cash flows expected to be provided by the asset. As at September 30, 2004, there were no events or circumstances indicating that the carrying value may not be recoverable.

Goodwill

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

Foreign exchange

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

Stock options

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

Loss per share

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

Long-lived assets

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

4. Business acquisition

On June 30, 2004, the Company acquired the assets of the Clinical Laboratory division of Adaltis Inc., offering among other things the Prenatest[®], a 1st and 2nd trimester prenatal screening test that enables pregnant women to find out if they are at a risk of carrying a fetus that may be affected by one of the most common birth anomalies such as Trisomy 21 (Down syndrome). The acquisition was accounted for using the purchase method. The purchase price was \$3,200,000, payable by \$2,400,000 in cash and 655,738 common shares of Warnex valued at \$800,000. No liabilities were assumed as part of this transaction. The purchase price was allocated \$85,000 to inventory, \$24,000 to capital assets, \$2,307,000 to intangibles (\$1,546,000 of licences and \$761,000 for customer contracts) and \$784,000 to goodwill. On August 2, 2004 and as part of this agreement, an additional amount of \$250,000 was paid by the issuance of 204,918 Warnex's shares when Adaltis was able to transfer the required permit to perform the biotestosterone test. This additional purchase price of \$250,000 was all allocated to goodwill.

5. Information relating to the interim consolidated statement of earnings

	2004
a) The following items are included in cost of goods sold:	
Amortization, capital assets	\$686,633
Loss on foreign exchange	168,114
b) The following items are included in operating expenses:	
Amortization, capital assets	\$414,281
Amortization, intangibles	116,550
Interest and bank charges	47,988
Interest on long-term debt	75,159
Interest on convertible debentures	373,899
Loss on foreign exchange	134
Recovery of loan receivable	(57,143)
Research and development expenses (includes amortization of \$176,294)	2,263,403
Research and development tax credits	(197,774)

6. Long-term debt

During the year, the Company repaid the \$500,000 bank term loan, due July 11, 2006, bearing interest at 1.5% over the bank's prime lending rate and with interest payable on a monthly basis without capital repayments.

In addition, in June 2004, the Company financed the acquisition of capital assets in the amount of \$906,586 with a 4.3% obligation under capital lease, due June 2007 repayable by monthly installments of \$26,862 principal and interest.

7. Convertible debentures

On June 25, 2004, the Company issued non secured convertible debentures in the amount of US\$5,000,000 (equivalent to \$6,845,000) bearing interest at a rate of 7% annually, payable quarterly in arrears, maturing June 25, 2008 and convertible into 4,889,285 common shares of the Company at the sole option of the lender. As part of this financing, share warrants were issued entitling the lender to purchase 1,963,729 common shares of the Company for a price of \$1.50 a share until June 25, 2009.

The value of the debt component of the convertible debentures has been determined by discounting the future capital and interest payments until June 25, 2008 at a discount rate which represents the borrowing rate available to the Company for similar debentures having no conversion rights. The remaining portion of the net proceeds of the debentures issued is presented as part of shareholders' equity.

The interest expense related to the long-term debt is charged to earnings and the allocation related to the equity component is charged to the deficit.

8. Capital stock

a) Authorized:

An unlimited number of the following classes of shares:

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

Common shares, voting, without nominal or par value.

b) Issued and fully paid

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

	Three months ended September 30, 2004		Nine months ended September 30, 2004	
	Number	Amount	Number	Amount
Balance, beginning of period	48,443,482	\$34,483,806	43,674,383	\$29,059,509
Options exercised	1,000	850	16,000	13,600
Issued shares on acquisition	204,918	250,000	860,656	1,050,000
Private placement	-	-	4,098,361	5,000,000
Net costs of issuance	-	-	-	(388,453)
Balance, end of period	48,649,400	\$34,734,656	48,649,400	\$34,734,656

8. Capital stock...cont'd

c) Common stock option plan

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

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

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

As at September 30, 2004, the Company has granted options to purchase 1,553,334 (2003 – 1,202,834) common shares at various exercise prices, each pursuant to the Incentive Stock Option Plan of the Company, expiring no later than the year 2014.

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

Nine months ended September 30 th , 2004	Number of options	Weighted-average exercise price (\$)
Balance, beginning of period	1,198,334	0.98
Granted	452,000	1.27
Exercised	(16,000)	0.87
Cancelled	(81,000)	1.12
Balance, end of period	1,553,334	1.06

Stock options outstanding are as follows:

Range of Exercise price of outstanding options (\$)	Number	Weighted- average remaining life (years)	Weighted-average exercise price (\$)
0.40 - 0.80	240,000	1.48	0.53
0.84 - 0.92	253,500	8.84	0.86
1.00 - 1.20	406,834	4.43	1.08
1.21 - 1.35	608,000	8.37	1.31
1.50 - 1.70	45,000	1.50	1.50
	1,553,334	6.15	1.06

8. Capital stock...cont'd

During the period, the Company granted 452,000 options to purchase common shares. The weighted average grant date fair value of options granted during the period amounted to \$1.10 per option. The weighted average value of each option granted in 2003 was \$1.18 and \$1.02 in 2002. The fair value of each option granted was determined using the Black-Scholes option pricing model and the following weighted average assumptions:

	2004 options
Risk-free interest rate	4.65%
Expected life	10 years
Expected volatility in the market price of the shares	88%
Expected dividend yield	0%

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

	2004	2003
Net loss		
- As reported	\$4,588,795	\$3,752,424
- Pro forma	\$4,588,795	\$3,858,100
Basic loss per share		
- As reported	\$0.10	\$0.09
- Pro forma	\$0.10	\$0.09

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

d) Share warrants

During the period, the Company received a private placement in the amount of \$5,000,000 and issued convertible debentures in the amount of \$6,845,000. As a result of these transactions, the Company issued 4,112,909 share warrants which could be used to purchase 4,112,909 common shares. The 4,607,143 share warrants due July 10, 2004 were not exercised and were therefore cancelled.

As at September 30, 2004, the Company has 4,112,909 share warrants outstanding, as follows:

Exercise price	Expiry date	Number
\$1.50	June 25, 2009	1,963,729
\$1.50	June 28, 2009	2,149,180
		4,112,909

9. Information relating to the interim consolidated statement of cash flows

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

Accounts receivables	\$(582,916)
Inventory	(249,814)
Investment tax credits receivable	(197,774)
Prepaid expenses	(205,295)
Accounts payables	411,753
	<u>\$(824,046)</u>

b) During the year, capital assets with an aggregate cost of \$906,586 were acquired by means of a capital lease.

10. Segmented information

For the nine-month period ended September 30, 2004, the Companies operated in Canada in the following industries:

	Revenue	Net earnings (loss)	Amortization	Capital assets, intangibles and goodwill	Total assets
Analytical services	\$3,247,253	\$707,881	\$287,103	\$1,978,708	\$3,002,232
Bioanalytical services	3,827,681	1,693,585	306,750	2,906,147	4,598,385
Clinical services	609,374	177,833	116,650	3,249,099	3,406,288
Research & development	36,528	(1,947,629)	176,295	8,537,148	9,019,951
Manufacturing diagnostic products	401,655	(2,393,815)	186,999	1,440,285	1,936,199
Management services	116,650	(2,742,241)	143,667	1,330,731	10,507,944
Sales agency	-	(84,409)	-	-	26,594
	<u>\$8,239,141</u>	<u>\$(4,588,795)</u>	<u>\$1,217,464</u>	<u>\$19,442,118</u>	<u>\$32,497,593</u>

11. Financial instruments

Fair value

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

The fair value of long-term debt approximates market value and corresponds to those the Company would currently obtain for loans with similar maturity dates and terms. Considering the due dates of the long-term debt as at September 30, 2004, the fair value has been established at its carrying amount.

11. 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.

Interest rate risk

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

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

Currency risk

The Company realizes some of its sales and purchases in foreign currencies. Consequently, it is exposed to fluctuations of these currencies. As at September 30, 2004, assets and liabilities in other currencies are the following:

	US Dollars	Euro
Cash	178,396	-
Accounts receivable	957,810	3,408
Accounts payable	52,707	1,907