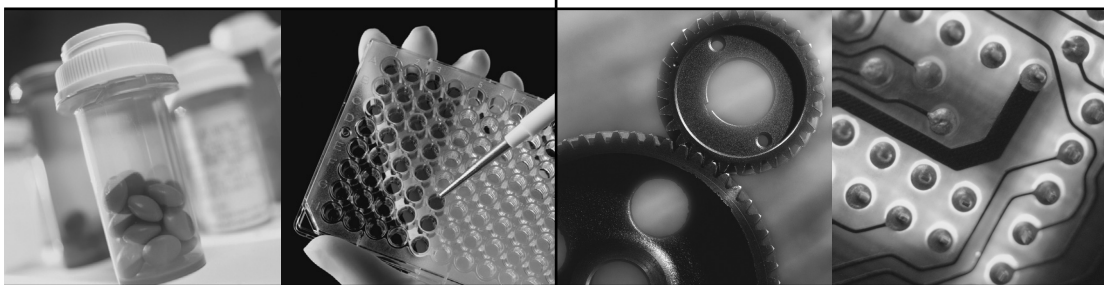


# CLEMEX

## Annual Report 2003-2004

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the images **analysis** people



biotechnology and pharmaceutical

metallurgy and materials

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## **Our Mission**

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*To be the worldwide leaders in providing automated solutions in quantitative microscopy.*

## **What we do at a glance...**

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Clemex is in the business of providing quality control and research and development laboratories with tools that automate the quantitative microscopy process. Applicable in a broad scope of industries, including pharmaceuticals, life sciences, automobile manufacturing, or metals and materials research, Clemex automated imaging systems enable laboratories to increase throughput, reduce costs, and improve the statistical accuracy of their data.

Typically an imaging system will be comprised of a microscope, motorized microscope stage, digital camera, computer, and specialized Clemex image analysis software. As an example of a popular application, steel mills will use the system to scan samples in order to quantify impurity levels according to specific industry standards. Production engineers or quality control managers can then modify their production methods accordingly.

For over 13 years, Clemex has cultivated a reputation for providing technologically superior solutions backed by excellent service primarily amongst Fortune 1000 clients. With over 700 installations, customers such as General Motors, General Electric, Pfizer, Novartis, and Dofasco, have come to rely on Clemex in providing them with the necessary tools required to gain a competitive edge in their respective industries.

## **A Message to Our Shareholders**

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2004 was a challenging year that brought on significant changes in the way the Company operates. Key decisions were made in order to restructure the organization which involved cost cutting measures and a reorientation back to the Company's core focus of providing automated digital imaging systems.

In the fourth quarter, management took the step of divesting its low-margin metallographic equipment and supply business. In so doing, our team would be able to concentrate one-hundred percent of their efforts in accomplishing the Company's main mission of becoming worldwide leaders in providing technologically advanced automated quantitative microscopy solutions.

Although we are not satisfied with top and bottom line results, we made major strides in getting the organization back on track. Net loss for the year was more than halved when compared to fiscal 2003. With respect to sales from the pharmaceutical market, we saw our revenues double in this sector and reach more than 20% of our total sales which helped us increase total US sales when compared with the previous year.

Nevertheless, overall Company gross sales slightly declined which was affected by a number of factors including a cautious economy that saw large firms delay capital expenditure spending, fluctuations in currency exchange rates, and other socio-economic factors such as the SARS epidemic.

On the R&D front, version 4 of the Company's flagship software application - Clemex Vision was delayed which also affected revenue growth. We anticipate the release of the new version during the first or second half of the new fiscal year. An important version launch, Clemex Vision 4 will not only enable us to generate upgrade revenues from our over 700 clients worldwide but open up lucrative market possibilities based on anticipated new software features.

As we bring to a close a period in which our organization made a key decision to concentrate on its core competencies, we are confident the Company is on the right path to long-term growth. The ongoing support of our employees, shareholders, directors, and most importantly our customers, will enable us to accomplish our mission of becoming worldwide leaders in the field of quantitative microscopy.



**Clément Forget**  
CEO and President  
Clemex Technologies, Inc.

## **Management Discussion and Analysis of Financial Results**

The purpose of the following Management Discussion and Analysis of the Financial Results ("MD&A") is to provide an overview of the operations of Clemex Technologies Inc. ("Clemex" or the "Company"). Matters considered by management to be important to understanding the results of the operation including financial position and liquidity, capital resources and borrowings, for the year ended April 30, 2004 will be discussed. Thereafter, the MD&A will touch upon our cash flows, risks and uncertainties, concluded by a look at future growth opportunities.

### **Clemex Technologies Overview**

Clemex is a leading provider of a broad range of image analysis systems that enable quality control and research laboratories to reduce costs and improve their research methods. The Company supplies imaging equipment and software that facilitate the process of quantifying microscopic images. Imaging systems are used in numerous industries including automotive, aerospace, biotechnology, pharmaceutical, industrial manufacturing and raw materials processing. As an example, an aluminum plant may use a Clemex system to analyze the morphological characteristics of aluminum grains. In so doing, quality control managers can then instruct their production managers to adjust production processes accordingly. On the biotechnology side, imaging systems may be used to analyze the effectiveness of bone integration of artificial joints.

Although a large percentage of the Company's clients are in the metals and materials analysis field, the organization is expanding into other vertical markets such as life sciences and pharmaceuticals. Its solutions are sold through the combination of a network of qualified international distributors and a direct sales force.

Clemex's headquarters are located in an industrial park on the south shore of Montreal in Longueuil, Quebec. Administrative, sales and marketing, R&D, and distribution activities are conducted at this 10,000 square foot facility.

### **Results of Operation**

The Company has divested part of its business near end of Fiscal Year 2004 and has restated some accounts in its Statements of Results in order to comply with new CICA regulations with regards to discontinued operations (section 3475). Consequently, the following Management Discussion and Analysis is in view of these restatements.

#### **Revenues and Earnings**

Fiscal Year revenues for the continued activities 2004 slightly decreased to \$ 4,358,469. from \$ 4,664,924. in 2003. Loss before taxes for the continued activities was reduced to \$ 149,838. in 2004 from \$ 580,439. in 2003 for the same activities. Loss before taxes for discontinued activities (distribution of metallographic equipment and consumables) was \$467,450. in 2004 while Loss for the same discontinued activities in 2003 was \$265,977. Net loss for all activities was halved to \$617,288. or \$0.03 in 2004 from \$1,202,017. or \$0.06 in 2003.

## **Management Discussion and Analysis of Financial Results**

### **Results of Operation (con't)**

#### **Sales**

Sales revenues for the continued activities decreased by 6.5% to \$ 4,358,469 in 2004 from \$ 4,664,924 in 2003 (after restatement). A drop in revenues was the results of a cautious economy, which saw large firms delay capital expenditure spending, changes in currency rates, and other socio-economic factors such as the SARS epidemic.

The delayed release of Clemex's latest version of its flagship image analysis software application - Clemex Vision 4.0 also affected the organization's ability to increase revenues as far as upgrading its existing customers.

Although overall sales declined, the Company was successful in expanding its presence in the pharmaceutical marketplace, with sales of more than \$850,000. or 20% of its total revenues and more than doubling its sales over last year in this sector. This progression contributed to growing sales in the US.

#### **Cost of Sales**

Margins on sales revenues slightly improved from 55.2 % in 2003 to 56.7% (after restatement) in 2004.

#### **Selling, Administrative and General Expenses**

Cost restructuring led to a decrease in selling, administrative and general expenses of \$ 534,533 over the previous fiscal year. Calculated as a percentage of gross revenues, selling, administrative and general expenses were 41.6% as opposed to 50.3% for fiscal 2003.

#### **Research and Development**

R&D spending remained relatively unchanged totaling \$ 448,039 after R & D tax credits versus \$ 425,389 when compared with the previous fiscal year. The R&D team concentrated their efforts in the development of Clemex Vision version 4 which is slated for release in the first quarter of the coming fiscal year. Other areas of research included the development of next generation robotic imaging systems which will be targeted principally at the pharmaceutical and life science sector.

#### **Interest Expense, Net**

Net interest expense remained steady with the Company posting a figure of \$ 210,798 for this year as opposed to \$ 198,168 for the previous fiscal year.

#### **Currency**

A drop in the US dollar valuation in combination with a strong Euro contributed to the Company's loss in currency exchange of \$ 46,782. Price changes to take place in the following year are expected to allow the Company to reach its sales profitability objectives.

## **Accounting Changes**

### **Discontinued Operations**

In order to comply with new CICA regulations with regards to discontinued operations (section 3475), fiscal 2003 financial statements were restated to reflect the Company's divestiture of its metallographic distribution business.

In December 2002, the Canadian Institute of Chartered Accountants "CICA" issued Section 3475, Disposal of Long-Lived Assets and Discontinued Operations, of the CICA Handbook. This section supersedes the write-down and disposal provisions of Section 3061, Property, Plant and Equipment, as well as Section 3475, Discontinued Operations, of the CICA Handbook. Section 3475 provides specified criteria for classifying an asset as held-for-sale and requires assets classified as held-for-sale to be accounted for at the lower of their carrying amounts or fair value, less selling costs.

Section 3475 also broadens the scope of businesses that qualify for reporting by including as discontinued operations any disposals of a component of an entity for which operating results and cash flows can be clearly distinguished from the rest of the Company, and changes the timing of loss recognition on such operations.

The revised standards in Section 3475 on disposal of long-lived assets and discontinued operations are applicable to disposal activities initiated under an exit plan committed to on or after May 1, 2003.

Thus, since the Company has abandoned its Distribution activities of Metallography instruments and consumables in the last quarter of Fiscal Year 2004, some accounts in the Balance Sheet have been restated accordingly.

## **Balance Sheet**

### **Liquidity, Capital Resources and Borrowings:**

Short term assets decreased by \$ 262,703 to \$ 2,026,758 (\$ 2,289,461 in 2003) on a year-over-year basis. The drop can be attributed to two main factors::

- The depreciation of some inventory tied to the discontinued metallography equipment distribution activities.
- A tight control of inventory levels and refundable tax credits.

Short-term liabilities decreased by \$ 351,504 when compared with fiscal 2003, reaching a total of \$ 1,459,475. Short-term debt was replaced by long-term debt secured in part by Investissement Québec and a \$ 500,000 private placement involving a 5 year convertible debenture bearing interest annually at 9% and convertible on the basis of one Class A share per \$0.20.

As at April 30th, 2004, the Company had a working capital position of \$ 567,283 versus \$ 478,482 from a year earlier. The current and quick ratio stood at 1.39 and 1.06 respectively.

## Management Discussion and Analysis of Financial Results

### Cash Flows

The following summarizes the Company's cash flows for the years ended April 30th, 2004 and 2003 as reported in the Consolidated Statements of Cash Flows.

<u>Years Ended April 30</u>	<u>2004</u>	<u>2003</u>
Cash flow from operating activities	\$ 232 395	\$ ( 221 336 )
Cash flow from financing activities	66 703	1 196 050
Cash flows from investing activities	73 144	(498 266)
Increase in cash and cash equivalents	372 242	476 448
Decrease in net cash and cash equivalents resulting from discontinued operations	( 278 321 )	( 460 025 )
Cash at beginning of year	29 718	13 295
Cash at end of year	123 639	29 718

An increase in the Company's cash position of \$ 93,921 at the end of the fiscal year was principally the result of a cash infusion in the form of a \$ 500,000 convertible debenture.

### Dividends

The Company did not pay any dividends on its common shares during the 2004 fiscal year and does not plan to do so in the near future, preferring to retain its cash to finance growth.

### Risks and Uncertainties

The risk of obsolescence is high due to rapidly changing technology and changing customers' needs. The Company's success depends on its ability to enhance existing products and to introduce new products and features to meet changing customer requirements; the Company's research and development staff often uses beta hardware and software to ensure that it will remain ahead of its competitors.

Protection in the form of patents is generally not available for software products such as those produced by the Company. There can be no assurance that the Company's means of protecting its proprietary rights will be adequate or that the Company's competitors will not independently develop similar technology, however the Company does take whatever steps it can to protect itself.

The Company is highly dependent on principal members of its management staff as well as its advisors and collaborators, the loss of whose services might impede the achievement of development objectives; however, this risk is considered to be minimal as the majority of shares are held by employees.

The risk of bad debt, although present, is not high, as the majority of the Company's clients are Fortune 1000 corporations.

## **Outlook**

2004 was a year of restructuring where major changes took place in order to put the organization back on track to profitability. Key strategic decisions were taken to exit a low-margin business and concentrate on the Company's core mission of providing automated solutions for quantitative microscopy.

As we enter the new year with a strong focus, we are confident that Clemex will return to profitability in the short to mid-term. We anticipate a positive response of our over 700 clients worldwide as we introduce the new version of Clemex Vision in the first quarter of the New Year. It is our belief that the introduction of this new version will certainly generate an interesting revenue stream.

With respect to the pharmaceutical marketplace, we continue to expand our presence in this sector. New R&D projects are in the works that will enable us to gain a competitive foothold in this field and open new possibilities for future expansion.

Staying innovative while at the time remaining lean will be important factors in helping us grow the Company in the short to long-term. The combination of a talented and dedicated workforce coupled with innovative solutions, will play important roles in placing us at the forefront of our field and set the stage for future growth opportunities in 2005 and beyond.

## **Forward-looking statements**

Except for historical information contained herein, the statements in this document are Forward-looking and made pursuant to the safe harbour provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties, which may cause the Company's actual results in future periods to differ materially from forecasted results. Those risks include, among others, changes in customer demand for the Company's products and services, changes in labour and equipment costs and availability, seasonal changes in customer orders, pricing actions by competitors and general changes in economic conditions.



## **Management's Report**

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The accompanying consolidated financial statements of Clemex Technologies Inc. are the responsibility of the management and have been approved by the Board of Directors of Clemex Technologies Inc.

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. They include some amounts that are based on estimates and judgements. The financial information contained elsewhere in the annual report is consistent with that in the financial statements.

To ensure the accuracy and objectivity of the information contained in the financial statements, Clemex management maintains systems of internal accounting controls. Management believes these systems give a reasonable degree of assurance that the financial documents are reliable and provide adequate basis for the financial statements, and that the Company's assets are properly accounted for and safeguarded.

Since the Company's initial public offering, the Board of Directors acted as the Company's audit committee. The Board of Directors carries out its responsibility for the financial statements in this annual report. The Board reviews the Company's annual financial statements as well as the management's analysis and the operating results and recommend their approval by the Board.

These financial statements have been examined by the auditors appointed by the shareholders, Massie Pharand Marcil Turcotte et associés, CA inc., chartered accountants, and their report is presented hereafter.



**Clément Forget**  
Chairman, President & CEO



**Sylvain Laroche**  
Director, Vice-President R&D

Longueuil, Canada, September 10, 2003







## AUDITOR'S REPORT

To the Shareholders of  
**CLEMEX TECHNOLOGIES INC.**

I have audited the consolidated balance sheet of **CLEMEX TECHNOLOGIES INC.** as at April 30, 2004 and the consolidated statements of income, deficit and cash flows for the year then ended. These financial statements are the responsibility of the company's management. My responsibility is to express an opinion on these consolidated financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at April 30, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The comparative figures have been audited by another auditor.

Pierre Pharand, CA  
Massie Pharand Marcil Turcotte et associés, CA inc.

Brossard, Quebec, Canada  
June 17, 2004, except as to note 23 which is as of August 24, 2004

**CLEMEX TECHNOLOGIES INC.**  
**CONSOLIDATED INCOME STATEMENT**  
**YEAR ENDED APRIL 30, 2004**

	2004	2003
	\$	\$
<b>SALES (note 12)</b>	4,358,469	4,664,924
<b>COST OF SALES</b>	<u>1,888,973</u>	<u>2,086,059</u>
<b>GROSS PROFIT</b>	<u>2,469,496</u>	<u>2,578,865</u>
<b>OPERATING EXPENSES</b>		
Commercial expenses	1,083,439	1,681,868
Administrative expenses	730,625	666,729
Financial expenses (note 13)	210,798	198,168
Depreciation (note 14)	146,433	187,150
Research and development (note 15)	<u>448,039</u>	<u>425,389</u>
	<u>2,619,334</u>	<u>3,159,304</u>
<b>LOSS BEFORE INCOME TAXES AND DISCONTINUED OPERATIONS</b>	( 149,838 )	( 580,439 )
<b>INCOME TAXES</b>		
Future	<u>-</u>	<u>355,601</u>
<b>LOSS FROM CONTINUING OPERATIONS</b>	( 149,838 )	( 936,040 )
<b>LOSS FROM DISCONTINUED OPERATIONS (note 12)</b>	<u>( 467,450 )</u>	<u>( 265,977 )</u>
<b>NET LOSS</b>	<u>( 617,288 )</u>	<u>( 1,202,017 )</u>
<b>NET LOSS PER SHARE</b>		
Basic and diluted loss from continuing operations	( 0.01 )	( 0.05 )
Basic and diluted loss from discontinued operations	( 0.02 )	( 0.01 )
Basic and diluted loss	<u>( 0.03 )</u>	<u>( 0.06 )</u>
Weighted average number of shares outstanding	18,543,560	18,543,560
Dilutive effect of stock options (1)	<u>-</u>	<u>-</u>
Diluted weighted average number of shares	<u>18,543,560</u>	<u>18,543,560</u>

(1) Stock options were outstanding but are not included in the computation of diluted loss per share because their effect would be anti-dilutive.

**CLEMEX TECHNOLOGIES INC.**  
**CONSOLIDATED DEFICIT**  
**YEAR ENDED APRIL 30, 2004**

	<u>2004</u>	<u>2003</u>
	\$	\$
<b>DEFICIT, BEGINNING OF YEAR</b>	<b>( 3,572,659 )</b>	<b>( 2,370,642 )</b>
<b>NET LOSS</b>	<b>( 617,288 )</b>	<b>( 1,202,017 )</b>
<b>DEFICIT, END OF YEAR</b>	<b>( 4,189,947 )</b>	<b>( 3,572,659 )</b>

See accompanying notes to consolidated financial statements

**CLEMEX TECHNOLOGIES INC.**  
**CONSOLIDATED BALANCE SHEET**  
**APRIL 30, 2004**

	2004	2003
	\$	\$
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	123,639	29,718
Accounts receivable (note 3)	989,248	1,038,910
Income taxes receivable	175,000	230,000
Inventories	390,328	497,309
Assets of discontinued operations held for disposal (note 12)	310,315	448,798
Prepaid expenses	38,228	44,726
	<u>2,026,758</u>	<u>2,289,461</u>
<b>CAPITAL ASSETS (note 4)</b>	<b>524,178</b>	<b>734,439</b>
<b>LONG-TERM ASSETS HELD FOR DISPOSAL (note 12)</b>	<b>69,249</b>	<b>84,305</b>
<b>DEFERRED FINANCING COSTS, net of accumulated amortization of \$11,152 (2003 : \$3,717)</b>	<b>26,021</b>	<b>33,455</b>
	<u><u>2,646,206</u></u>	<u><u>3,141,660</u></u>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Bank indebtedness (note 5)	325,000	755,650
Accounts payable (note 6)	653,566	662,352
Liabilities of discontinued operations held for disposal (note 12)	122,920	109,170
Customer deposits and deferred revenue	70,798	37,502
Current portion of long-term debt (note 7)	287,191	246,305
	<u>1,459,475</u>	<u>1,810,979</u>
<b>LONG-TERM DEBT (note 7)</b>	<b>673,449</b>	<b>716,982</b>
<b>CONVERTIBLE DEBENTURES (note 8)</b>	<b>341,862</b>	<b>-</b>
<b>SHAREHOLDERS' EQUITY</b>		
Other component of shareholders' equity (note 8)	168,624	-
Share capital (note 9)	4,186,358	4,186,358
Contributed surplus (note 11)	6,385	-
Deficit	( 4,189,947 )	( 3,572,659 )
	<u>171,420</u>	<u>613,699</u>
	<u><u>2,646,206</u></u>	<u><u>3,141,660</u></u>

On behalf of the Board

....., Director

....., Director

**CLEMEX TECHNOLOGIES INC.**  
**CONSOLIDATED CASH FLOWS STATEMENT**  
**YEAR ENDED APRIL 30, 2004**

	<b>2004</b>	<b>2003</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Loss from continuing operations	( 149,838 )	( 936,040 )
Adjustment for:		
Depreciation	146,433	187,150
Amortization of deferred financing costs	7,434	3,717
Increase in the value of the convertible debenture	10,486	-
Gain on disposal of capital assets	( 31,156 )	( 6,812 )
Increase in the contributed surplus	6,385	-
Future income taxes	-	355,601
	<u>( 10,256 )</u>	<u>( 396,384 )</u>
Net change in non-cash working capital items (note 21)	<u>242,651</u>	<u>175,048</u>
Cash provided by (used for) continuing operating activities	<u>232,395</u>	<u>( 221,336 )</u>
<b>FINANCING ACTIVITIES</b>		
Deferred financing costs	-	( 37,172 )
Bank indebtedness	( 430,650 )	713,724
Issuing of a debenture	500,000	-
Long-term borrowings	260,609	1,006,437
Repayment of long-term debt	( 263,256 )	( 486,939 )
Cash provided by continuing financing activities	<u>66,703</u>	<u>1,196,050</u>
<b>INVESTING ACTIVITIES</b>		
Acquisition of capital assets	( 42,284 )	( 554,029 )
Proceeds from disposal of capital assets	<u>115,428</u>	<u>55,763</u>
Cash provided by (used for) continuing investing activities	<u>73,144</u>	<u>( 498,266 )</u>
<b>Net increase in cash and cash equivalents of continuing operations</b>	<b>372,242</b>	<b>476,448</b>
<b>Net cash and cash equivalents used in discontinued operations (note 12)</b>	<b>( 278,321 )</b>	<b>( 460,025 )</b>
<b>CASH, BEGINNING OF YEAR</b>	<u>29,718</u>	<u>13,295</u>
<b>CASH, END OF YEAR</b>	<u><u>123,639</u></u>	<u><u>29,718</u></u>

See accompanying notes to consolidated financial statements

**CLEMEX TECHNOLOGIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**APRIL 30, 2004**

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**1. STATUTES OF INCORPORATION AND NATURE OF ACTIVITIES**

The Corporation is incorporated under the *Canada Business Corporations Act*. It specializes in research and development and the sale of image analysis systems.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**CHANGE IN ACCOUNTING POLICIES**

The Company has made certain changes in accounting policies to conform to new accounting standards.

i) Disposal of long-lived assets and discontinued operations

The CICA issued Handbook Section 3475, "Disposal of long-lived assets and discontinued operations", which applies to disposal activities initiated by an enterprise's commitment to a plan on or after May 1, 2003. The new section provides guidance on recognizing, measuring, presenting and disclosing long-lived assets to be disposed of and replaces the disposal provisions in Section 3475, "Discontinued operations" and Section 3061, "Property, plant and equipment".

ii) Stock-based compensation

On May 1, 2003, the Corporation adopted the new recommendations of Section 3870 of the CICA Handbook, "Stock-based Compensation and Other Stock-based Payments" with respect to the accounting for stock-based compensation. The Corporation accounts for all stock-based awards to non-employees and to employees that are direct awards of stock that call for settlement in cash or other assets, including stock appreciation rights, by the fair value method. No compensation cost is recorded for all other stock-based employee compensation awards and in this case, consideration paid by employees on the exercise of stock options is recorded as share capital. Under the fair-value based method, compensation cost attributable to awards to non-employees and employees that call for settlement in cash or other assets is recognized over the vesting period in each quarter in operating expenses. Changes in the fair value between the grant date and the measurement date result in a change in the measure of compensation cost.

**CONSOLIDATION POLICIES**

The consolidated financial statements include the accounts of CLEMEX TECHNOLOGIES INC. and its wholly-owned subsidiary, CLEMEX CORP., based in the United States.

**REVENUE RECOGNITION**

Revenue from product sales are recognized when persuasive evidence of an arrangement exists, delivery has occurred, price is fixed or determinable, collection of the resulting receivable is deemed probable and no other significant vendor obligations exist.

Deferred revenue from service contracts is charged to earnings when services are rendered.

**CLEMEX TECHNOLOGIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**APRIL 30, 2004**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**FOREIGN CURRENCY TRANSACTIONS**

The subsidiary is considered to be an integrated foreign operation; accordingly, its accounts are translated using the temporal method. Under this method, all monetary assets and liabilities are translated at the year-end exchange rate and non-monetary assets and liabilities are translated at the exchange rate at the date of transaction. Revenue and expenses are translated at the average exchange rate for the year, except for depreciation of capital assets which is translated at the historical date the asset was purchased. Translation gains and losses are recognized as revenue or expenses. Assets and liabilities denominated in foreign currencies are translated at rates of exchange in effect at the balance sheet date. Gains or losses during the period are included in net loss. Translation of foreign currency transactions in the statement of earnings is recorded at the monthly average rate of exchange in effect in each period.

**INVENTORIES**

Inventories are valued at the lower of cost and net realizable value. Cost is determined by the first-in first-out method.

**CAPITAL ASSETS**

Capital assets are recorded at cost less related investment tax credits. The Corporation provides for depreciation of the capital assets based on the following annual rates and methods:

Equipment	Declining balance	30 %
Moving laboratory	Straight-line	10 years
Research and development equipment	Declining balance	30 %
Computer equipment	Declining balance	30 %
Furniture and fixtures	Declining balance	20 %
Automotive	Declining balance	30 %
Leasehold improvements	Straight-line	Lease term

**DEFERRED FINANCING COSTS**

Deferred financing costs represent unamortized long-term debt financing costs and are amortized on a straight-line basis over the term of the related long-term debt. Amortization is included in the interest on long-term debt expense.

**RESEACH AND DEVELOPMENT COSTS**

Research and development costs are expensed as incurred. Related government grants and tax incentives are recorded as a reduction of expenditures in the period when reasonable assurance of realization is obtained.

**RESEARCH AND DEVELOPMENT TAX CREDITS**

Research and development tax credits are recorded using the deferral method. Under this method, tax credits related to eligible expenses are charged against the related costs in the period during which the expenses are incurred or the capital asset is acquired, provided there is a reasonable assurance that they will be realized.

**CLEMEX TECHNOLOGIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**APRIL 30, 2004**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

INCOME TAXES

The Corporation uses the asset and liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying values and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is included in income in the period that includes the enactment or substantively enactment date. Future tax assets are only included when it is more likely than not that they will be realized.

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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Significant areas requiring the use of estimates relate to the assessment of the useful life of capital assets and assessing their net realizable values. The valuation of research and development tax credits also requires the use of estimates and assumptions. The receipt of these credits is dependent on the taxation authorities' review and acceptance of the eligibility of expenditures. Consequently, actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

The policy of the Corporation consists in presenting in cash and cash equivalents bank balances including bank overdrafts which often fluctuate between the overdraft, the amount available and liquid short-term investments with maturities not exceeding three months. Furthermore, the short-term investments which the Corporation cannot use for the current operations because they are allocated to guarantees are not included in the cash and cash equivalents.

**3. ACCOUNTS RECEIVABLE**

	<b>2004</b>	2003
	<b>\$</b>	<b>\$</b>
Trade	<b>901,665</b>	1,001,593
Sales tax receivable	<b>16,069</b>	22,441
Other	<b>71,514</b>	14,876
	<b><u>989,248</u></b>	<u>1,038,910</u>

**CLEMEX TECHNOLOGIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**APRIL 30, 2004**

**4. CAPITAL ASSETS**

	<b>2004</b>			<b>2003</b>
	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>Net book value</b>	<b>Net book value</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Equipment	<b>299,203</b>	<b>215,785</b>	<b>83,418</b>	178,245
Moving laboratory	<b>217,849</b>	<b>25,471</b>	<b>192,378</b>	214,218
Research and development equipment	<b>620,202</b>	<b>514,879</b>	<b>105,323</b>	148,694
Computer equipment	<b>156,578</b>	<b>101,311</b>	<b>55,267</b>	73,441
Furniture and fixtures	<b>199,768</b>	<b>146,398</b>	<b>53,370</b>	63,853
Automotive	<b>34,516</b>	<b>13,375</b>	<b>21,141</b>	30,201
Leasehold improvements	<b>59,149</b>	<b>45,868</b>	<b>13,281</b>	25,787
	<b><u>1,587,265</u></b>	<b><u>1,063,087</u></b>	<b><u>524,178</u></b>	<b><u>734,439</u></b>

**5. BANK INDEBTEDNESS**

The Corporation has at its disposal a revolving operating line of credit of \$750,000. This credit bears interest at bank prime rate plus 1.25% and is secured by a first rank moveable hypothec of \$1,275,000 on the universality of inventories, accounts receivable and research and development tax credits receivable and by assignment of inventories under Section 427 of the Bank Act. Borrowings under this credit are limited to eligible accounts receivable, inventories and research and development tax credits receivable.

Under the loan agreement, the Corporation must comply with several restrictive covenants, which require to respect financial covenants. As at April 30, 2004, the Corporation was in violation of certain restrictive covenants. Subsequent to year-end, the Corporation renegotiated its credit facilities, including its restrictive covenants (see note 23).

**6. ACCOUNTS PAYABLE**

	<b>2004</b>	<b>2003</b>
	<b>\$</b>	<b>\$</b>
Trade accounts payable	<b>344,282</b>	397,719
Accrued liabilities	<b>220,307</b>	190,438
Salaries and fringe benefits	<b>88,977</b>	74,195
	<b><u>653,566</u></b>	<b><u>662,352</u></b>

**CLEMEX TECHNOLOGIES INC.**  
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**7. LONG-TERM DEBT**

	<b>2004</b>	2003
	<b>\$</b>	\$
Loan from Investissement-Québec, at prime rate, reimbursed during the year	-	85,827
Term loan, prime rate plus 1.5%, payable by monthly instalments of \$3,064 plus interest, due in August 2005, secured by a first rank mortgage of \$125,000 on assets funded with a net book value of \$59,097 <sup>(1)</sup>	<b>49,023</b>	85,790
Term loan, prime rate plus 1.5%, payable by monthly instalments of \$4,167 plus interest, due in February 2006, secured by a first rank mortgage of \$150,000 on equipment with a net book value of \$83,773 <sup>(1)</sup>	<b>91,667</b>	141,667
Term loan with a maximum of \$750,000, at prime rate plus 2.5%, payable by monthly instalments of \$15,625 plus interest, due in November 2007, secured by a first rank mortgage of \$750,000 on all assets and by a collateral loan of 80% by Garantie-Québec <sup>(1)</sup>	<b>671,875</b>	489,391
Instalment loan, without interest, payable by monthly instalments of \$615, due in December 2007, secured by a vehicule with a net book value of \$21,141	<b>27,069</b>	34,451
Instalment loan, bearing interest at 7.25%, payable by monthly instalments of \$1,178, principal and interest, due in September 2017, secured by equipment with a net book value of \$192,379 <sup>(1)</sup>	<b>121,006</b>	126,161
	<b>960,640</b>	963,287
Current portion of long-term debt	<b>287,191</b>	246,305
	<b>673,449</b>	716,982

Principal repayments on long-term debt in each of the five following years are as follows: 2005, \$287,191; 2006, \$254,761; 2007, \$201,285; 2008, \$121,180; 2009, \$ 7,398.

(1) As at April 30, 2004, the Corporation did not comply with certain covenants with its banker. Subsequent to year-end, the Corporation renegotiated its long-term debt with its banker, including its restrictive covenants (see note 23).

**CLEMEX TECHNOLOGIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**8. CONVERTIBLE DEBENTURES**

On October 9, 2003, the Corporation issued a debenture for a total amount of \$500,000 at a 9% rate. The debenture can be converted at any time by the holder at a conversion rate of \$0.20 per Class A share. After August 27, 2005, it will be possible for the Corporation to force the conversion of the principal amount at the above-mentioned conversion rate, provided the average quotation price for Class A shares bought or sold at the stock exchange where the corporate security is registered remains at a minimum amount of \$0.70 for a period of 20 days prior to the date when the Corporation requests the forced conversion. The debenture can be reimbursed at the nominal value plus accrued and unpaid interests on August 27, 2008.

The convertible debenture is classified according to its components. The element of financial liability representing the interests is classified under long-term debt and the shareholders' equity element representing the conversion option held by the holder as well as the settlement option held by the Corporation are classified under equity capital. Other component for debentures convertible to the shareholders' equity. The value of the liability component for the convertible debentures was determined by updating future interest payments until August 27, 2008, at the discount rate representing the borrowing rates available to the Corporation for similar debentures without conversion rights.

**9. SHARE CAPITAL**

AUTHORIZED

Unlimited number of Class A shares, voting, participating, without par value

ISSUED

	2004 \$	2003 \$
18,543,560 Class A shares	4,220,858	4,220,858
Note receivable from an officer and employees	( 34,500 )	( 34,500 )
	<u>4,186,358</u>	<u>4,186,358</u>

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**10. STOCK OPTION PLAN**

Under its stock option plan (the "Plan") established on June 30, 1997, the Corporation may grant options to directors, officers, employees and consultants. The Plan contemplates a maximum of 10% of the issued and outstanding Class A shares which may be available under the stock option plan.

Changes in the number of outstanding options related to the stock option plan and options issued at the initial public offering in April 1998 were as follows:

	<u>2004</u>		<u>2003</u>	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Options outstanding, beginning of year	1,312,448	0.35	1,539,311	0.43
Options granted	80,000	0.10	497,000	0.20
Options cancelled	( 93,000 )	0.27	( 723,863 )	0.42
Options outstanding, end of year	<u>1,299,448</u>	<u>0.34</u>	<u>1,312,448</u>	<u>0.35</u>

The following table summarizes information about stock options outstanding at April 30 2004:

Exercise Price	<u>Options Outstanding</u>		<u>Options Exercisable</u>	
	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable	Weighted average exercise price
0.10 \$	80,000	4.48	80,000	0.10
0.16 \$	60,000	3.44	60,000	0.16
0.18 \$	190,000	3.59	190,000	0.18
0.20 \$	200,000	3.15	200,000	0.20
0.22 \$	239,400	2.52	239,400	0.22
0.23 \$	40,000	2.45	40,000	0.23
0.30 \$	2,048	0.36	2,048	0.30
0.32 \$	20,000	2.84	20,000	0.32
0.52 \$	50,000	1.62	50,000	0.52
0.60 \$	418,000	1.10	418,000	0.60

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**10. STOCK OPTION PLAN (cont'd)**

The fair value of each option granted was estimated using the "Black-Scholes" option pricing model. On the date of the grant, the options' weighted average fair value was \$0.08 per option. The following weighted average assumptions were used for the calculation:

Risk-free interest	3.90%
Expected life	5 ans
Expected volatility	109%
Expected dividend yield	\$0.00

**11. CONTRIBUTED SURPLUS**

The increase of the contributed surplus results from the posting in the expense of the stock option plan granted during the year.

**12. DISCONTINUED OPERATIONS**

During the period, the Corporation decided to discontinue distribution of ATM products and consumable products. The inventories were offered for sale and management anticipate that disposal will be carried out during the first term of the next period. The balance sheet on April 30, 2003 and April 30, 2004 includes the following assets and liabilities related to the discontinued activities:

	2004	2003
	\$	\$
Accounts receivable	260,944	222,545
Inventories	49,371	226,253
Equipment	69,249	84,305
Trade accounts payable	122,920	109,170

The sales related to the discontinued activities amounts to \$1,147,234 in 2004 (\$1,364,826 in 2003). Furthermore, an amortization value of \$47,661 in 2004 (\$14,938 in 2003) is included in the operating expenses related to discontinued activities. Finally, there is no income tax according to discontinued operations.

The income statement for the discontinued activities, including a distribution of interests receivable, are as follows:

	2004	2003
	\$	\$
Sales for the exercise	5,505,703	6,029,750
Sales from continuing operations	( 4,358,469 )	( 4,664,924 )
Sales from discontinued operations	1,147,234	1,364,826
Operating expenses related to discontinued operations	1,614,684	1,630,803
Loss from discontinued operations	( 467,450 )	( 265,977 )

**CLEMEX TECHNOLOGIES INC.**  
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**12. DISCONTINUED OPERATIONS (cont'd)**

The cash flow statement for the discontinued operations are as follows:

	2004 \$	2003 \$
Net cash used in operating activities	( 267,556 )	( 364,413 )
Net cash used in investing activities	<u>( 10,765 )</u>	<u>( 95,612 )</u>
Net cash and cash equivalents used in discontinued operations	<u><u>( 278,321 )</u></u>	<u><u>( 460,025 )</u></u>

**13. FINANCIAL EXPENSES**

Loss on foreign exchange	46,782	100,912
Interest and bank charges	59,525	73,697
Interest on long-term debt	96,195	26,614
Increase of the value of the convertible débenture	10,486	-
Interest income	<u>( 2,190 )</u>	<u>( 3,055 )</u>
	<u><u>210,798</u></u>	<u><u>198,168</u></u>

**14. DEPRECIATION**

Capital assets	146,433	179,565
Intangible assets	<u>-</u>	<u>7,585</u>
	<u><u>146,433</u></u>	<u><u>187,150</u></u>

**15. RESEARCH AND DEVELOPMENT**

Research and development costs	635,992	736,822
Research and development tax credits	<u>( 187,953 )</u>	<u>( 311,433 )</u>
	<u><u>448,039</u></u>	<u><u>425,389</u></u>

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**16. INCOME TAXES**

The income tax provision differs from the amounts computed by applying the combined federal and provincial income tax rate to loss before income taxes. Explanations and fiscal impacts of this difference are as follows:

	2004 \$	2003 \$
Loss before income taxes	( 617,288 )	( 846,416 )
Tax rate	<u>32.4%</u>	<u>34.5%</u>
Expected income tax recovery	( 199,816 )	( 292,014 )
Non-deductible items and others	9,297	( 9,133 )
Reduction of future taxes resulting from reduction of the statutory income tax rate	( 43,610 )	164,892
Research and development tax credits	( 117,307 )	( 491,309 )
Impact of different tax rate from foreign subsidiary	19,119	15,510
Change in valuation allowance	<u>332,317</u>	<u>967,655</u>
Income tax expense	<u>-</u>	<u>355,601</u>

The income tax effect of temporary differences that give rise to future tax assets and liabilities is as follows:

	2004 \$	2003 \$
Future tax assets:		
Difference between carrying value and tax value of research and development expenses	1,163,550	1,056,000
Research and development tax credits carry forward	1,341,718	1,224,411
Operating losses carry forward	217,746	178,447
Difference between carrying value and tax value of capital assets and intangible assets	<u>41,486</u>	<u>-</u>
	<u>2,764,500</u>	<u>2,458,858</u>
Valuation allowance	<u>( 2,619,506 )</u>	<u>( 2,287,189 )</u>
	<u>144,994</u>	<u>171,669</u>
Future tax liabilities:		
Difference between carrying value and tax value of capital assets and intangible assets	-	15,376
Intercompany tax liability unrecognized	143,239	155,089
Others	<u>1,755</u>	<u>1,204</u>
Net future tax	<u>-</u>	<u>-</u>

**CLEMEX TECHNOLOGIES INC.**  
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**16. INCOME TAXES (cont'd)**

The Corporation has research and development expenditures in Canada available to reduce taxable income in the future. These expenditures are as follows:

	<b>2004</b>	2003
	<b>\$</b>	\$
Federal	<b>2,830,711</b>	2,569,644
Provincial	<b>5,602,564</b>	5,080,158

The Corporation's US has loss carry forwards available to reduce taxable income in the future which expire as follows:

	\$
2019	407,282
2020	170,611
2021	31,516
2022	4,168
2023	129,100
2024	204,044
	<u>946,721</u>

The Corporation also has income tax credits that can be used to reduce federal taxes payable in the future:

	\$
Deductible income tax credits expiring in :	
2005	13,486
2006	14,851
2007	10,809
2008	189,194
2009	198,742
2010	235,110
2011	255,714
2012	141,962
2013	152,933
2014	128,917
	<u>1,341,718</u>

**17. COMMITMENTS**

The Corporation has signed long-term leases agreements for a total of \$145,932 as at April 30, 2004. Annual payments under the terms of the leases are approximately as follows: 2005, \$87,620; 2006, \$34,580; 2007, \$17,760; 2008, \$5,972.

**CLEMEX TECHNOLOGIES INC.**  
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**18. CONTINGENCIES**

During the period, the Corporation was sued by a trustee for approximately \$42,000 on the allegation that it received a payment from a bankrupt client. The Corporation is currently in negotiations and plans to pay an amount of \$23,000. This amount has been charged during the year.

**19. FINANCIAL INSTRUMENTS****CREDIT RISK**

The Corporation provides credit to its clients in the normal course of its operations. It carries out, on a continuing basis, credit checks on its clients and maintains provisions for contingent credit losses which, once they materialize, are consistent with management's forecasts. The Corporation does not normally require a guarantor.

For the other debts, the Corporation determines, on a continuing basis, the probable losses and sets up a provision for losses based on the estimated realizable value.

**CURRENCY RISK**

International sales represented 69% (2003: 58%) of total sales. The Corporation also realized 55% (2003: 54%) of its purchases in foreign currencies. Consequently, some assets, liabilities, revenues and expenses are exposed to foreign exchange fluctuations. As at April 30, 2004, cash, accounts receivable and accounts payable of \$114,574, \$831,065 and \$160,960 respectively (2003: \$24,862, \$884,873 and \$169,261) are shown in US dollars and converted into Canadian dollars. Also, accounts payable for an amount of \$125,292 (2003: \$51,708) are shown in Euros and converted into Canadian dollars.

**FAIR VALUE**

The book value of cash and cash equivalents, accounts receivable, research and development tax credits receivable, bank indebtedness, and accounts payable and accrued liabilities approximates their fair value due to the relatively short periods to maturity of the instruments. The fair value of the long term debt with Investissement-Québec and term loans approximates its carrying value since interest rates are at market value. The fair value of instalment loans approximates their carrying value since these instruments bear interest at current market rates that the Corporation could obtain for debt instruments with similar conditions and terms. Finally, the fair market value of debenture is almost identical as the book value since the market condition are stable since the issue of the debenture.

**INTEREST RATE RISK**

Certain long-term debt bears interest at variable rate. But a variation of 1% would not have significant incidence on income and cash flow of the Corporation.

**CLEMEX TECHNOLOGIES INC.**  
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**20. SEGMENTED INFORMATION**

The Corporation carries on business in software and integrated image analysis systems and defines its business segment based on the nature of the product and services rendered to the clients. The Corporation has established two distinctive business segments, image analysis and distribution. The image analysis sector includes development, manufacturing and marketing of software and image analysis systems used by quality control and research laboratories for microscopy applications. The distribution sector includes distribution of specialized products, developed by another company, required for sampling in the metallographic equipment and supplies market.

Accounting policies for each sector are identical to the ones described in the summary of significant accounting policies.

Segmented information for the years ended April 30, 2004 and 2003 is summarized as follows:

	<b>2004</b>	2003
	\$	\$
i) BUSINESS SEGMENT		
Revenues		
Image analysis	<b>4,358,469</b>	4,664,924
Distribution (note 12)	-	-
	<u><b>4,358,469</b></u>	<u>4,664,924</u>
ii) GEOGRAPHIC INFORMATION		
Sales derived from operations in:		
Canada	<b>903,065</b>	1,239,277
United States of America	<b>2,987,597</b>	2,649,994
International	<b>467,807</b>	775,653
	<u><b>4,358,469</b></u>	<u>4,664,924</u>

Sales are attributed to geographic locations based on the location of the customer.

iii) INFORMATION ABOUT MAJOR CUSTOMERS

No customer represented more than 10% of total sales for 2004 and 2003.

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**21. NET CHANGE IN NON-CASH WORKING CAPITAL ITEMS**

	<b>2004</b>	<b>2003</b>
	<b>\$</b>	<b>\$</b>
Accounts receivable	49,662	( 108,180 )
Income taxes receivable	55,000	( 87,184 )
Inventories	106,981	210,413
Prepaid expenses	6,498	( 14,129 )
Accounts payable	( 8,786 )	136,626
Customer deposits and deferred revenue	33,296	37,502
	<b>242,651</b>	<b>175,048</b>
	<b>242,651</b>	<b>175,048</b>

**22. CASH FLOW**

Cash flow from interest are as follows:

Interest paid	<b>148,220</b>	<b>100,311</b>
	<b>148,220</b>	<b>100,311</b>

**23. SUBSEQUENT EVENT**

On August 24, 2004, the Corporation renegotiated its revolving operating line of credit as well as its term loans with its banker. Following this event, the Corporation complies with covenants with the banker. The Corporation has now at its disposal a \$500,000 revolving operating line of credit.

**24. COMPARATIVE FIGURES**

Certain figures for 2003 have been reclassified to make their of presentation identical to that adopted in 2004.









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