

**FYTOKEM PRODUCTS INC**  
**ASE:FYT**

**SECOND QUARTER REPORT**  
**PERIOD ENDING JUNE 30, 1998**

## REPORT OF THE PRESIDENT

As we move into the third quarter of 1998, the company is making excellent progress towards achieving its goals and objectives. As it is very important, let me remind everyone of our corporate vision and mission statement.

Our Vision: to become the premier source of safe functional ingredients derived from northern plants.

Our Mission: to grow a profitable business based on developing and marketing plant products for cosmetic, personal care, therapeutic and nutraceutical markets.

Fytokem Products Inc. was incorporated in 1994. In the initial years we focused on building our technology base. As the first products emerged, we began developing a management and marketing team to complement the research team already in place. Now, Fytokem is a market driven company using advanced technologies to develop new products for identified needs. We are poised to grow and become profitable through ongoing product development, manufacturing and sales.

For the balance of 1998 and beyond, the prime focus of the company has to be on marketing and sales. Of course we can not neglect the manufacturing of our products, the development of new products, the after sale technical support for our products, nor can we fail to devote sufficient time to investor relations.

Let me review the key activities in our Marketing Plan.

We have deliberately chosen to focus first on the Cosmetic and Personal Care industry. It is an industry that we know and one that has a minimum of Government regulation. Experience has shown that there are many steps involved in developing the market for new natural products for the cosmetic and personal care industry. First and foremost one must have functional products, (we have three and two more under development). Given demonstrably functional products, there are a number of activities that must be performed, many of these requiring repeated contacts with each potential customer. Thirdly, in order to adequately cover the market place, we require knowledgeable sales agents in North America, (these we have), and first class distributors offshore, (these we plan to recruit this fall).

Market development activities include:

1. Thorough functional, shelf life, preservative, and safety testing of the product.
2. Preparation of product specification literature, registration with CTFA (INCI name).
3. Preparation of material safety data sheets.
4. Specific advertising in certain trade publications.
5. Preparation of sample formulations of finished products containing the new ingredient.
6. Exhibiting at industry trade shows.
7. Group presentations to product development people at each potential customer.
8. One on one meetings with product formulation specialists at each company.
9. Solve technical problems that may arise in product formulation.

By rigorously pursuing the nine activities, in close co-operation with our North American agents, we have achieved recognition for the Company throughout the North American Personal Care Industry and have attracted attention from Europe, Asia, and South America. Most of the leading personal care companies in North America and two in Europe are actively working to formulate finished products containing our ingredients. Smaller companies have already launched products containing our Willowherb Extract. Our challenge now is to target in on those companies who we believe to have the greatest potential for early purchases of our ingredients, while continuing to pursue the nine activities that are essential for continued growth in the industry. Given the relatively long lead-time between first sales call and actual sale of product, we will be commencing our marketing activities in Europe and Asia in the very near future.

Marketing was the dominant activity for the company in the second quarter of 1998. Each of our major potential customers was visited with our agents and presentations of our product line made. These major companies included Estee Lauder, Procter & Gamble, Avon, Unilever, Chesebrough-Ponds, Elizabeth Arden, L'Oreal, and Johnson & Johnson. Based on anticipated sales resulting from these presentations, we have been able to complete the planning for our contract growing and wildcrafting for the summer growing and harvesting season. We have scaled up our manufacturing processes at our Contract Manufacturer, Nuvotech International Inc. We are now positioned to manufacture and supply our ingredients to a growing number of personal care company customers.

In financial matters, the company anticipates closing its special warrant offering early in the fall. This capital will enable us to further develop our markets, plan for a manufacturing facility that we will need when we outgrow our current contract manufacturer's capacity, and to have sufficient working capital to finance growth. Recognizing the need for first class financial controls and reporting, the company has recruited a full time controller, Mark Pasloski.

From all indications, the second half of 1998 will see continuing sales growth with orders getting larger as more of our customers move from the product development stage to the commercialization stage of finished consumer products. We do live in exciting times.

John Schaw, President and CEO

**BALANCE SHEETS**  
(Unaudited)

	June 30	
	1998	1997
<b>CURRENT ASSETS</b>		
Cash and temporary investments	\$ 403,042	\$ 298,736
Accounts receivable	45,527	9,798
Inventory	38,696	-
Investment tax credits receivable	-	4,495
Prepaid expenses	7,641	20,193
Deferred initial public offering costs	-	55,799
Deferred offering memorandum costs	43,949	-
	538,855	389,021
<b>NOTES RECEIVABLE</b>	7,000	7,000
<b>EQUIPMENT - NET</b>	111,976	17,149
	\$ 657,831	\$ 413,170
<b>CURRENT LIABILITIES</b>		
Accounts payable and accruals	\$ 64,085	\$ 17,662
Current portion long term debt	18,319	-
	82,404	17,662
<b>CONVERTIBLE DEBENTURE</b>	-	52,620
<b>LONG TERM DEBT</b>	39,523	-
<b>SHAREHOLDERS' LOANS</b>	3,521	3,521
	125,448	73,803
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	1,450,113	604,955
Convertible debenture	-	1,980
Deficit	(917,730)	(267,568)
	532,383	339,367
	\$ 657,831	\$ 413,170

**STATEMENTS OF LOSS**  
(unaudited)

	Three months ended June 30		Six months ended June 30	
	1998	1997	1998	1997
<b>REVENUE</b>				
Project revenue	\$ 9,209	\$ 29,791	\$ 52,013	\$ 55,836
Other	6,389	2,998	14,323	3,688
	<u>15,598</u>	<u>32,789</u>	<u>66,336</u>	<u>59,524</u>
<b>EXPENSES</b>				
Product development	48,452	65,329	116,034	116,114
Marketing	69,728	27,029	148,018	33,352
Administration	74,268	43,912	141,312	73,001
Depreciation	4,622	1,435	8,376	3,904
	<u>197,070</u>	<u>137,705</u>	<u>413,740</u>	<u>226,371</u>
<b>NET LOSS</b>	<u>\$ 181,472</u>	<u>\$ 104,916</u>	<u>\$ 347,404</u>	<u>\$ 166,847</u>
<b>LOSS PER SHARE</b>				
Basic	<u>\$ 0.02</u>	<u>\$ 0.02</u>	<u>\$ 0.04</u>	<u>\$ 0.03</u>
Shares Outstanding	<u>8,559,200</u>	<u>6,250,000</u>	<u>8,559,200</u>	<u>6,250,000</u>

**STATEMENTS OF CHANGES IN FINANCIAL POSITION**  
(Unaudited)

<b>CASH INFLOW (OUTFLOW)</b> <b>FROM:</b>	Three months ended		Six months ended	
	June 30		June 30	
	1998	1997	1998	1997
<b>OPERATING</b>				
Net loss	\$ (181,472)	\$ (104,916)	\$ (347,404)	\$ (166,847)
Items not affecting cash				
Depreciation and amortization	4,622	1,435	8,376	3,904
	<u>(176,850)</u>	<u>(103,481)</u>	<u>(339,028)</u>	<u>(162,943)</u>
Changes in non-cash working capital				
Accounts receivable	28,820	14,467	32,345	2,806
Inventory	(3,471)	-	(21,166)	-
Investment tax credits receivable	-	-	4,495	11,276
Prepaid expenses	(1,240)	33,246	12,547	(20,193)
Deferred initial public offering costs		(44,614)	-	(55,799)
Deferred offering memorandum costs	(43,949)	-	(43,949)	-
Accounts payable and accruals	(4,208)	(377)	17,800	13,851
Unearned government assistance	-	-	-	(2,902)
Notes payable	-	-	-	(10,000)
	<u>(200,898)</u>	<u>(100,759)</u>	<u>(336,956)</u>	<u>(223,904)</u>
<b>FINANCING</b>				
Proceeds from convertible debentures	-	-	-	54,600
Net proceeds from Class A shares	-	50,000	54,600	574,955
Redemption of Class A Shares	-	-	-	(1,000)
Redemption of Class D shares	-	-	-	(54,600)
Repayment of contributed surplus	-	-	-	(63,530)
Repayment of long term debt	(4,300)	-	(60,614)	-
	<u>(4,300)</u>	<u>50,000</u>	<u>(6,014)</u>	<u>510,425</u>
<b>INVESTING</b>				
Acquisition of equipment	(2,202)	(8,705)	(4,644)	(15,767)
Increase in notes receivable				(7,000)
	<u>(2,202)</u>	<u>(8,705)</u>	<u>(4,644)</u>	<u>(22,767)</u>
<b>NET CASH INFLOW (OUTFLOW)</b>	(207,400)	(59,464)	(347,614)	263,754
<b>CASH, BEGINNING OF PERIOD</b>	610,442	358,200	750,656	34,982
<b>CASH, END OF PERIOD</b>	<u>\$ 403,042</u>	<u>\$ 298,736</u>	<u>\$ 403,042</u>	<u>\$ 298,736</u>