

FYTOKEM PRODUCTS INC
ASE:FYT

THIRD QUARTER REPORT
PERIOD ENDING SEPTEMBER 30, 1998

REPORT OF THE PRESIDENT

Financing

The downturn in the stock markets and in microcap stocks in particular during our \$1 million special warrants offering has focused our attention on financing activities. Our special warrant issue closed prematurely raising a gross of only \$200,000, not the \$1 million that we had planned. Given market conditions, we have sought private placement financing to enable us to continue our push into the marketplace. I am pleased to report that we are near completion of a \$1.5 million private placement and expect to make an announcement in December. This financing will enable us to operate the company and increase our marketing activities through the critical period of the next year, until we reach a position of positive cash flow.

Research and Development

On September 23, 1998, we announced the filing of a patent application for the production of phytosterols from Canola. This is a major breakthrough for the company. This process will allow the company to produce our Fytosterol-85[™] and other phytosterol products at significantly lower cost. Fytosterol-85[™] has an excellent potential as a skin moisturizer for dry, irritated skin according to Swedish research. Fytosterol-85[™] is being evaluated by several of the world's largest skin care companies.

Canadian Willowherb extract has received tremendous attention following the publication of an independent clinical study demonstrating the speed at which our product reduces redness due to irritation, compared to the drug hydrocortisone. Potential applications included many "relief of irritation" type products (after-shave, after sun, anti-itch) and counter-acting irritating ingredients (AHA). Being opaque, the Canadian Willowherb extract could not be used in products such as anti-perspirants where a "see-through" product is desired. Rising to the challenge, our R&D team developed a process to produce a transparent product and open up new market opportunities. The first samples were released to major potential customers in mid-October.

Exciting work continues on two new products; a plant extract to prevent skin wrinkling, and a plant extract that can prevent skin damage due to exposure to the sun. These products should be available for release to the industry early in the New Year. I am very proud of our Research and Product Development Group. Our technological superiority is being recognized throughout the industry. More and more we are being asked to present papers and to give presentations, at scientific conferences and to research departments of major personal care companies. 'We have the Technology.'

Marketing & Sales

The prime market focus for our plant-based ingredients is the personal care industry. As I discussed in our June 30th report, acceptance of new products by major companies in the personal care industry can be a relatively slow process, taking anywhere from 18 months to 2 years or more. Although slow to us, the process is extremely fast when compared to the health care industry where 10 years is fast and 15 years fairly common. I am pleased to report that our products have been well received by the major companies in the personal care business and that many of these companies are well into the cycle of testing, proto-type formulations, and market testing. Given the large number of these major companies working with various of our products, I am confident that sales to these major companies will commence in the New Year. We are, however, seeing the volume of sales to smaller companies starting to increase and repeat orders starting to come in.

Over the past few months, Fytokem has received a number of inquiries and sample requests for Fytosterol-85[™] from European and North American companies interested in adding phytosterols to their food products. This has likely

been prompted by the scientific literature, which indicates that phytosterols, if taken as a dietary supplement, can reduce serum cholesterol levels. While the company is not focused on the food supplement business, we are maintaining a close watch on developments in this industry.

On September 1, 1998, the company announced that we have signed an agreement with the Senex Group of Calgary and Yokohama to be our distributors in Japan. This is the company's first step outside of North American and a key strategic move to becoming a global player in the personal care industry. We have had a large number of inquiries from Japan with respect to our products and we are very pleased to be able to start distribution of our products in this very important market segment. One of the first activities to be undertaken by Senex is to obtain approvals for use in Japan of all of Fytokem's products. Once approvals have been obtained, Senex forecasts rapid acceptance in the personal care industry in Japan. Closely following this announcement, we were pleased to welcome Canada Colors Inc. as our distributor for Canada. Fytokem has three agent/distributor companies actively selling our products throughout the United States. Discussions have started with potential distributors for Europe. Marketing and Sales continues to be the prime focus of the company.

Production

We have had a very successful season in procuring raw material stocks and now have sufficient inventories to meet our projected needs through 1999.

We have been very fortunate to have the Protein Oil and Starch Pilot Plant in Saskatoon, available to us as a contract manufacturer, through their wholly owned subsidiary, Nuvotech Ventures International. Forecasts indicate that we will likely outgrow the capacity of this facility before the end of the year 2000. We have started to look towards our manufacturing needs and are in the process of identifying a number of options. These options include finding a contract manufacturer with larger capacity, acquiring an existing facility, and constructing a new facility specifically designed for our requirements. Given that solvents are used in some of our processes, the facility will have to meet fairly stringent fire and safety regulations.

CONCLUSION

The company has made tremendous strides in all of the key areas. Our technological superiority is being more and more recognized throughout the personal care industry. Channels of Distribution are in place. Our products have been well received by virtually all of the major North American Personal Care Companies. Initial sales have been made.

We have the resources; financial, technological, and human to do the job. 1999 is going to be a very exciting year.

John Schaw, President and CEO

BALANCE SHEETS
(Unaudited)

	September 30	
	1998	1997
CURRENT ASSETS		
Cash and temporary investments	\$ 319,866	\$ 998,752
Accounts receivable	19,540	47,236
Inventory	84,867	7,921
Investment tax credits receivable	-	4,495
Prepaid expenses	11,181	25,690
	435,454	1,084,094
NOTES RECEIVABLE	7,000	7,000
EQUIPMENT - NET	112,913	35,804
	\$ 555,367	\$ 1,126,898
CURRENT LIABILITIES		
Accounts payable and accruals	\$ 62,020	\$ 80,676
Current portion long term debt	18,298	-
	80,318	80,676
CONVERTIBLE DEBENTURE	-	52,620
LONG TERM DEBT	34,651	-
SHAREHOLDERS' LOANS	3,521	3,521
	118,490	136,817
SHAREHOLDERS' EQUITY		
Share capital	1,450,113	1,399,013
Share warrants	116,386	-
Convertible debenture	-	1,980
Deficit	(1,129,622)	(410,912)
	436,877	990,081
	\$ 555,367	\$ 1,126,898

STATEMENTS OF LOSS
(unaudited)

	Three months ended September 30		Nine months ended September 30	
	1998	1997	1998	1997
REVENUE				
Project revenue	\$ 6,917	\$ 38,763	\$ 58,930	\$ 95,710
Other	5,260	4,022	19,583	6,599
	<u>12,177</u>	<u>42,785</u>	<u>78,513</u>	<u>102,309</u>
EXPENSES				
Product development	59,060	69,575	175,094	185,689
Marketing	71,259	51,572	219,277	84,924
Administration	88,603	63,548	229,915	136,548
Depreciation	5,147	1,435	13,523	5,340
	<u>224,069</u>	<u>186,130</u>	<u>637,809</u>	<u>412,501</u>
NET LOSS	<u>\$ 211,892</u>	<u>\$ 143,345</u>	<u>\$ 559,296</u>	<u>\$ 310,192</u>
LOSS PER SHARE				
Basic	<u>\$ 0.02</u>	<u>\$ 0.02</u>	<u>\$ 0.07</u>	<u>\$ 0.04</u>
Fully Diluted	<u>\$ 0.02</u>		<u>\$ 0.06</u>	
Shares Outstanding	<u>8,534,000</u>	<u>8,450,000</u>	<u>8,534,000</u>	<u>8,450,000</u>
Fully Diluted Shares Outstanding	<u>8,708,667</u>		<u>8,708,667</u>	

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(Unaudited)

CASH INFLOW (OUTFLOW) FROM:	Three months ended September 30		Nine months ended September 30	
	1998	1997	1998	1997
OPERATING				
Net loss	\$ (211,892)	\$ (143,345)	\$ (559,296)	\$ (310,192)
Items not affecting cash				
Depreciation and amortization	5,147	1,435	13,523	5,340
	<u>(206,745)</u>	<u>(141,910)</u>	<u>(545,773)</u>	<u>(304,852)</u>
Changes in non-cash working capital				
Accounts receivable	25,987	(37,439)	58,332	(34,633)
Inventory	(46,171)	(7,921)	(67,337)	(7,921)
Investment tax credits receivable	-	-	4,495	11,276
Prepaid expenses	(3,540)	(5,497)	9,007	(25,689)
Deferred initial public offering costs	-	55,800	-	-
Deferred offering memorandum costs	43,949	-	-	-
Accounts payable and accruals	(2,065)	63,014	15,735	76,865
Unearned government assistance	-	-	-	(2,902)
Notes payable	-	-	-	(10,000)
	<u>(188,585)</u>	<u>(73,953)</u>	<u>(525,541)</u>	<u>(297,856)</u>
FINANCING				
Net proceeds from Share Warrants	116,386	-	116,386	54,600
Net proceeds from Class A shares	-	794,058	54,600	1,369,013
Redemption of Class A Shares	-	-	-	(1,000)
Redemption of Class D shares	-	-	-	(54,600)
Repayment of contributed surplus	-	-	-	(63,530)
Redemption of convertible debenture	-	-	(1,980)	-
Repayment of long term debt	(4,893)	-	(63,527)	-
	<u>111,493</u>	<u>794,058</u>	<u>105,479</u>	<u>1,304,483</u>
INVESTING				
Acquisition of equipment	(6,084)	(20,089)	(10,728)	(35,857)
Increase in notes receivable	-	-	-	(7,000)
	<u>(6,084)</u>	<u>(20,089)</u>	<u>(10,728)</u>	<u>(42,857)</u>
NET CASH INFLOW (OUTFLOW)	(83,176)	700,016	(430,790)	963,770
CASH, BEGINNING OF PERIOD	403,042	298,736	750,656	34,982
CASH, END OF PERIOD	<u>\$ 319,866</u>	<u>\$ 998,752</u>	<u>\$ 319,866</u>	<u>\$ 998,752</u>