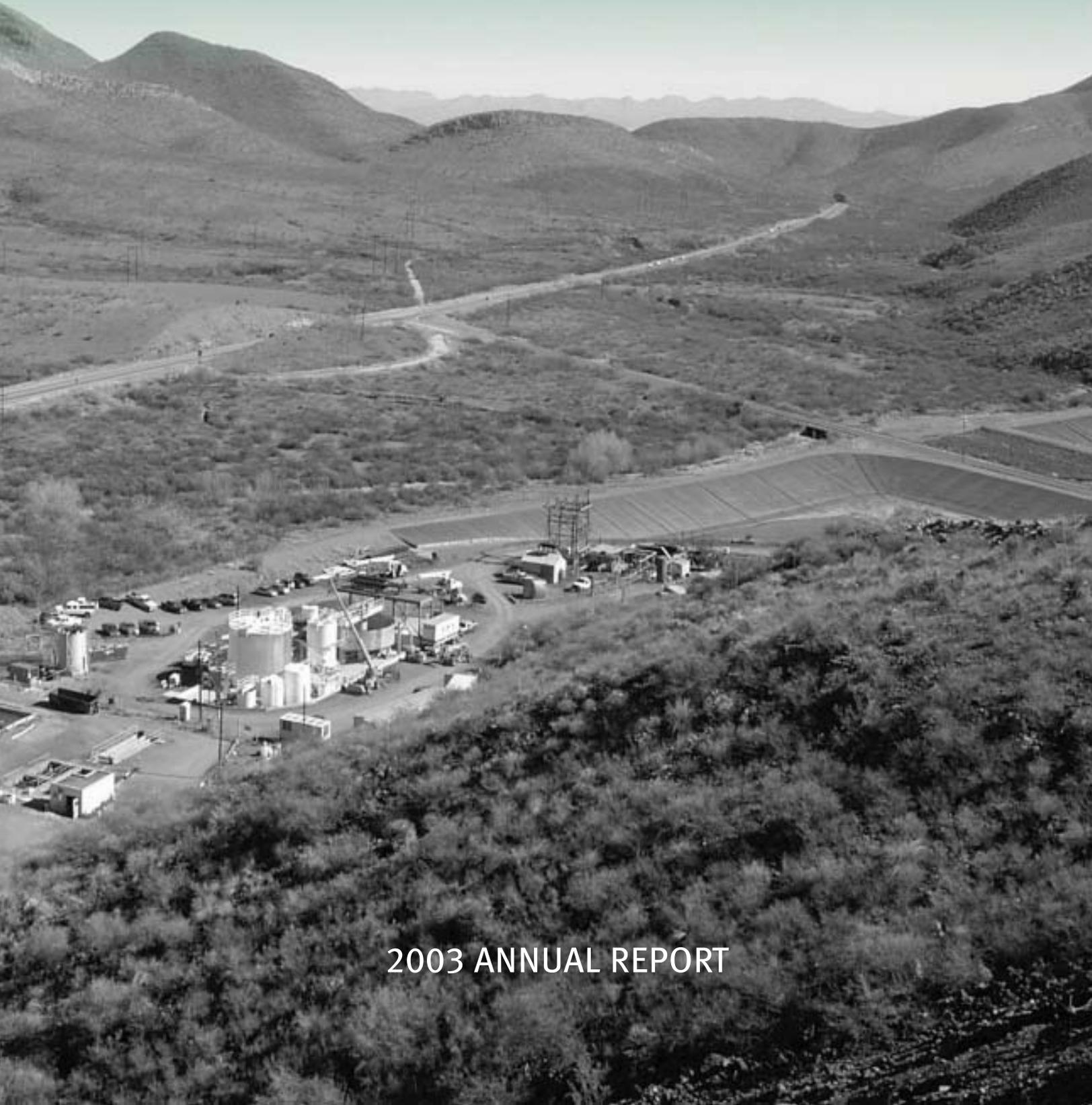


BIOTEQ

Environmental Technologies Inc.



2003 ANNUAL REPORT

COMPANY PROFILE

BioteQ is a Canadian industrial process company that has developed the patented BioSulphide® Process for water treatment and sulphide reagent production. BioteQ is currently focused on applications of its technology in the mining industry where BioteQ's process plants allow the treatment of acid contaminated water with concurrent recovery of saleable metals from the water. Water from the process plants can be discharged to the environment or recycled for industrial re-use. In addition, chemical grade sulphide reagent can be produced on demand from BioteQ's process. Potential revenue streams from BioteQ's technologies are plant sales, recovered metals, treatment fees, and sulphide reagent sales.

BioteQ's process plants can treat metal-laden acid contaminated water, including acid rock drainage (ARD), contaminated surface and ground waters, metallurgical bleed streams and sulphate-rich municipal and industrial water. BioteQ is currently focused on metal contaminated mine drainage, one of the most significant challenges facing the mining industry worldwide. BioteQ's technologies can offer significant environmental and economic benefits when compared with conventional lime treatment of the same acid waste streams, including:

- reduction or elimination of metal-laden sludge by-products,
- sale of valuable contained metals which can off-set treatment costs or, in some cases, result in a profit from the water treatment plant,
- overall reduction of long term water treatment costs and environmental liability.

Front Cover... BioSulphide® Process Plant under construction for copper recovery at the Copper Queen Mine, Bisbee, Arizona, in joint venture with Phelps Dodge Corporation (photograph by Michael Bratty)

BioteQ's business plan is to focus on its core water treatment technologies in the development, construction and operation of waste water treatment plants. The Company can operate on three commercial bases: design, build, own and operate; design, build and transfer; and third party process license. The Company has built and owns three commercial water treatment plants in the US and Canada at the Caribou Mine in New Brunswick (Breakwater Resources Ltd.), the Raglan Mine in northern Quebec (Falconbridge Limited), and at the Copper Queen Mine in Arizona (joint venture with Phelps Dodge Corporation).

BioteQ is based in Vancouver, Canada with a branch office in Montreal and an operating joint venture in Arizona. The Company is listed on the TSX Venture Exchange under the symbol BQE.

Annual Meeting

The Annual General meeting of Shareholders will be held on April 22, 2004 at 2pm at the Conference Centre, Second Floor, 888 Dunsmuir Street, Vancouver, B.C.

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PRESIDENT'S MESSAGE TO SHAREHOLDERS

2003 was a defining year for BioteQ and its staff towards meeting the goals set out in our business plan that is, to build and operate water treatment plants incorporating our unique biological treatment process. The Company signed a contract with Falconbridge Limited for the construction of a plant at the Raglan Mine in northern Quebec, completed in November, and entered into a joint venture agreement with Phelps Dodge Corporation for the construction of a plant at their Copper Queen Mine, Bisbee, Arizona, which is scheduled for commissioning in early 2004. Combined with our Caribou plant in New Brunswick, these two new plants provide BioteQ with confirmation of our business plan:

- BioteQ has an environmental process that is of interest to major mining companies and is accepted by regulators,
- BioteQ has the internal expertise to design, procure and construct plants in a variety of locations within tight cost and schedule constraints,
- Based on the contract terms in place for operation of the three plants during 2004, we anticipate producing financial results that show we will start being cash flow positive from operations.



Commercial Highlights

During the last two years BioteQ has been successful in the conversion from a research organization to commercial operations, starting in early 2004. The commissioning and operation of our first plant at the Caribou Mine during 2002 provided a commercial scale demonstration of our capabilities and the commercial confidence to finance and construct the Raglan and Bisbee projects in 2003. Commercial highlights for the company in the last year include:

- Completion of our second commercial plant, at Raglan, and commencement of revenues from Falconbridge
- Construction of our third commercial plant, in joint venture with Phelps Dodge Corporation, and the rapid increase in copper price to coincide with commissioning of this plant in 2004
- Continued development of our international pipeline of projects of more than 30 prospects, in various stages of engineering and evaluation
- After reviewing potential applications in Quebec as a result of our partnership with SOQUEM Inc., four projects have been identified for detailed follow up.

Financing Highlights

In addition to the commercial successes and growth, 2003 was highlighted by advances in corporate finance. To meet its obligations for construction projects in 2003, the Company completed two new equity financings priced at \$0.70 per share, totaling \$4,118,000 (net of costs). In addition, the Company signed a debt financing agreement

PRESIDENT'S MESSAGE TO SHAREHOLDERS

with HSBC Bank Canada to provide senior debt project financing for the Raglan plant, for up to \$800,000.

Personnel Highlights

The Company was pleased to add additional personnel during 2003 to contribute to the growth of the Company including: David Lindeman, a senior project engineer previously at AMEC, a Vancouver based engineering contractor; Pascale St-Germain, a project biologist previously with Noranda, joined our Montreal office as a consultant; Ian MacLean, previously at the Caribou Mine, joined BioteQ full time to manage our Caribou plant; Max Nodwell, a recent UBC graduate in metallurgical engineering, joined us late in 2003 to begin training as a project engineer; and Doreen Jeffery signed on as our much needed Administrator.



Safety

The Company was very active in construction activities during 2003 and continued to adhere to strict safety regulations and policy. The Company reported no safety incidents at its projects in 2003 and we will continue to strive for safety excellence in the future for construction and operations.

Expectations for 2004

Based on our existing commercial contracts and joint venture agreements, the Company expects continued growth in 2004, highlighted by:

- operation of our Raglan and Bisbee plants
- expansion of our Caribou operation and management of two waste water treatment plants under contract with Breakwater Resources
- positive cash flow from operations
- project debt financing from HSBC Bank Canada
- two new commercial contracts from our project pipeline and SOQUEM partnership
- expansion of marketing and project development into China and South America
- strategic partnerships to increase our project capacity in engineering and construction as well as plant operations and management

2003 was a significant year of transition for the Company. The construction of two new plants was an important step in its long term business plan, although contract delays prevented the expected commissioning of the two new plants until 2004. The Company now has the people, proven technology and financial strength to continue to build its business towards long term earnings from operations. I would like to thank our employees, directors and business partners for their unselfish dedication to meeting the challenges of 2003. I look forward to an exciting and prosperous 2004.

On behalf of the Board of Directors

Brad Marchant
President & CEO
Vancouver, Canada
Feb 5, 2004

OVERVIEW OF TECHNOLOGIES

Water Treatment and Metal Recovery

Protection of water quality has become one of the most important environmental challenges facing the mining, metallurgical and related industries. Although new mining projects and metallurgical processes can be designed to minimize impacts to the environment, many existing and abandoned mining operations and metallurgical facilities have water quality problems. The principal cause of water contamination in mining is acid rock drainage (ARD), which is generated when residual sulphide minerals in waste rock, tailings and other mine components and products are exposed to air and water. These reactions can produce acidity and elevated concentrations of metals in drainage and seepage that can adversely affect surface and groundwater resources. Water can be contaminated due to similar reactions in wastes from other industries.

To meet regulatory criteria for water quality in the receiving environment, many operators of mines and metallurgical plants must consider treatment of mine water and effluents prior to discharge. The most widely used treatment process has been one in which lime is added to remove metals and neutralize acidity in ARD and other acidic effluents. This treatment method produces water that has usually met discharge criteria although many jurisdictions have introduced, or are considering, more stringent discharge standards, which might be difficult to meet.

The quantities of valuable metals contained in contaminated mine water and effluents can be significant but these cannot be recovered by lime treatment. Instead, the metals are captured into a sludge product that must be stored and managed to prevent the release of the metals back into the environment. Metal recovery from the sludge is, in virtually all cases, uneconomic and sludges usually remain as a long term environmental liability.



The BioSulphide® Process

BioteQ's approach to water treatment and metal recovery is to precipitate metals using sulphide reagent generated by its patented BioSulphide® Process. In addition to producing water with very low residual metal concentrations, the anaerobic biological process can be used for selective removal of toxic metals from water by precipitating them as high-grade sulphide products. The process can, therefore, be applied exclusively for environmental purposes, or for exclusively metal recovery, or both concurrently. The range of applications for the technology includes:

- Treatment of ARD with concurrent selective recovery of metals
- Treatment and metal recovery from other contaminated surface waters and groundwaters
- Treatment of refinery and smelter waste streams
- Recovery of metals for revenue as an alternative to conventional processes
- Process control by treatment of bleed streams for metallurgical process enhancement
- Treatment of industrial, municipal, surface waters and groundwater with high sulphate
- Supply of high grade sulphide reagent for industrial use

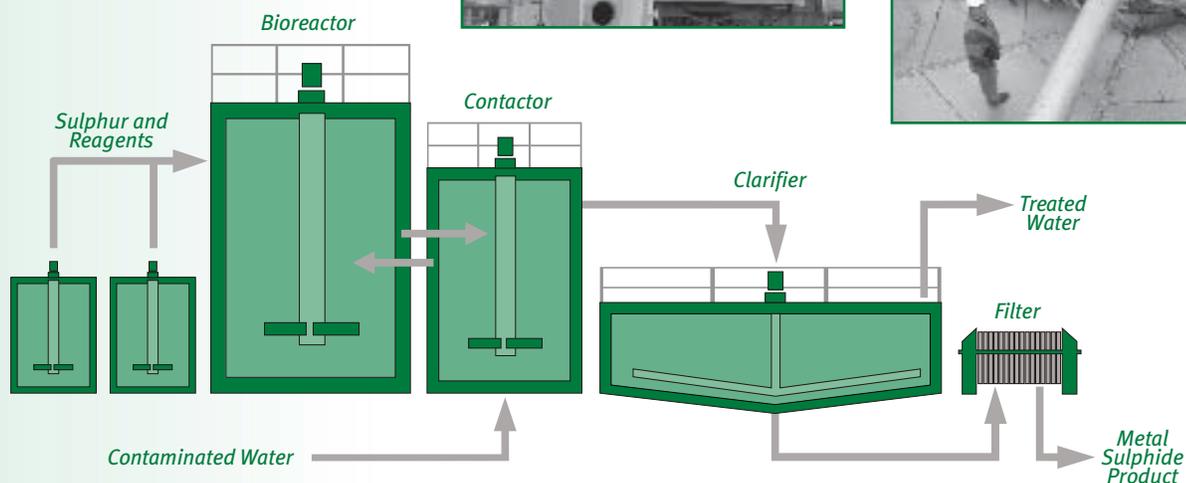
OVERVIEW OF TECHNOLOGIES

Metals recovered by the process can represent a significant revenue stream which can either offset operating costs or result in profitable operation. The technology can also be used in combination with other water treatment processes for more comprehensive treatment. For example, application of the technology upstream of an existing lime treatment plant can not only produce a revenue stream through the recovery of metal products, but can also reduce lime consumption and reduce the volume of the sludge produced. In addition, the sludge would no longer contain the toxic heavy metals which are removed in the BioSulphide® plant and shipped offsite. Long term liabilities associated with sludge disposal would be eliminated or significantly reduced.

systems utilizing elemental sulphur. Sulphate reduction should be considered, therefore, only for applications where sulphate concentrations must be lowered for environmental or process recycle purposes. For metal removal for environmental and/or metal recovery applications, sulphur reduction is preferred. Metal precipitation and recovery is carried out using conventional precipitation, solid-liquid separation and filtration equipment.



Simplified flowsheet of BioSulphide® Process showing reduction of sulphur to produce sulphide reagent for the precipitation and recovery of a single metal sulphide product



In the BioSulphide® process, metals such as copper, nickel and zinc can be precipitated and separated from contaminated water into saleable metal products utilizing biogenic sulphide reagent produced in a bioreactor. The biogenic sulphide is produced by reduction of sulphur species such as elemental sulphur or sulphate, with the addition of ethanol or hydrogen as an electron donor. In the case of sulphate reduction, the contaminated water itself can provide the sulphur source but capital and operating costs are higher for sulphate reduction than for

Other Technology Initiatives

Partial Oxidation Burner for Hydrogen Production

The Company has developed a partial oxidation system (POS) which produces hydrogen-rich gas using most fossil fuels (diesel, natural gas, propane). The POS was developed to produce the gas for use as an efficient electron donor for BioteQ's biological reduction technologies. Studies and independent assessments carried out since 2001 have also indicated the potential for its use as a fuel processor for fuel cells. A 2002 report

OVERVIEW OF TECHNOLOGIES

by Fuel Cell Intelligence, Ltd. concluded that it should be relatively easy to integrate the POS technology with both solid oxide and molten carbonate fuel cells. Waste heat generated by the POS could also be used to maintain the operating temperature of the fuel cells or for cogeneration applications such as space heating and water heating. The ability of the BioteQ system to process diesel fuel simply and economically is viewed as a major advantage of the technology. Using the POS system as a pre-processor for advanced gas turbines was also identified as a potentially commercially attractive application. The addition of small quantities of hydrogen to the fuel intake of a gas turbine should result in improvements in efficiency and reduction in emissions of oxides of nitrogen. This study will assist the company with the technical and market direction for commercial feasibility analysis of the POS burner.

Sulphate Reduction

Although the biological reduction of elemental sulphur to produce sulphide reagent has formed the basis of the three commercial plants constructed to date, the BioSulphide Process® was initially developed to exploit the biological reduction of sulphate. BioteQ has gained significant sulphate reduction expertise through operating large scale pilot plants and has carried out advanced engineering for selected projects. Interest in sulphate reduction in the mining sector has, however, been low, particularly in North America where the company has focused its attention in these early years. The Company is, however, receiving more enquiries concerning projects in which the reduction of TDS (total dissolved solids), caused by elevated sulphate concentrations, is desirable both in North America and elsewhere in the world due to more attention by regulators on the long term impact of sulphate into receiving waters.

High rate H₂S generation by sulphate reduction is more technologically complex and expensive in terms of both

capital and operating costs compared with sulphur reduction. Consequently, the niche market for biological sulphate reduction is limited to industrial effluent cases where sulphate concentrations must be reduced below those that can be produced in lime plants due to new regulations and where the cost of expensive sulphide produced biologically can be offset by the recovery of metals. In this capacity, sulphate reduction has a unique advantage over lime treatment, since the latter cannot produce effluents with sulphate concentrations lower than around 1600 mg/L. In contrast, sulphate reduction removes metals to very low concentrations, can reduce sulphate to well below any foreseeable future standard, and produces its own alkalinity.

PROJECTS

Caribou, New Brunswick, Canada

Caribou is a zinc mine owned by Breakwater Resources Ltd., which is currently not operating due to low metal prices. The mine operates a lime plant to treat underground mine drainage. The Company reached an agreement with Breakwater in June 2001 to

construct a treatment plant to remove metals from the mine drainage upstream of the existing lime plant. The plant was designed to recover zinc together with copper, cadmium and lead from the acidic mine drainage to augment the overall water treatment. The plant was started up in November 2001 and by January 2002 had reached a steady state operating capacity required to meet water treatment needs at that time of the year.

The plant operated throughout 2002 and demonstrated that the process can accommodate highly variable contaminated water quality. Metal recovery exceeded



PROJECTS

design expectations for copper. Zinc recovery was within design expectations, even though metal concentrations in the feed water of up to 100% over design were experienced. The high metal loadings resulted in the plant not being able to treat the entire mine water flow at all times. However, the rate of sulphide generation in the bioreactor per unit volume of mine drainage exceeded design expectations and overall metal treatment exceeded design capacity per unit volume of the mine drainage. During its operation in 2002, the plant recovered nearly 35 tonnes of zinc concentrate, which also contains copper, cadmium and lead. The concentrate was delivered and accepted for sale at the nearby Brunswick Mine under contract with Noranda. Concentrate production was suspended at the end of October 2002 due to the site owner's planned shut-down of minewater collection and treatment. These operations remained shut down through 2003 while the mine workings were flooded and it is now anticipated that water treatment will restart in April 2004.

On January 26, 2004, the Company signed a new agreement with CanZinco Ltd., (a wholly owned subsidiary of Breakwater Resources Limited) which will provide the Company control of all aspects of water management at the Caribou and Restigouche sites of CanZinco in New Brunswick and which replaces the previous agreements regarding the Caribou site. The contract is for an initial term of six years and will commence after a three month transition period, during which time the definitive details of an operating agreement will be finalized. In addition, a project to re-treat tailings containing soluble copper and zinc, stored at the Caribou site by a previous operator, will commence at CanZinco's option. Tailings re-treatment is expected to commence in 2005 and the Company plans to modify its biological reduction plant during 2004 to continue treatment of the mine drainage and to also retreat the tailings. BioteQ owns the metals recovery treatment plant and all metals recovered will be owned by BioteQ.



Bisbee, Arizona, U.S.

Following evaluation of several potential project opportunities in the southwestern US, BioteQ signed a joint venture agreement with Phelps Dodge Corporation in October 2002 to carry out an engineering study with Phelps Dodge leading to the construction and operation of a BioSulphide® plant at Phelps' Bisbee property in southern Arizona. The Bisbee project will recover copper from the drainage of a large low-grade stockpile, which historically has been under leach with copper being recovered by cementation with iron.

Basic engineering for the Bisbee plant was completed in March 2003 and the project proceeded following the signing of an Operating Agreement between the companies in June and a Construction Agreement with the Joint Venture Company, Copreco LLC, which is owned equally by BioteQ and Phelps Dodge. Plant construction at Bisbee was largely completed in February 2004 to the point of commencement of plant commissioning. The Company estimates that commissioning will take approximately three months to reach the acceptance criteria established by the Joint Venture for completion of the plant. The current estimate of total construction cost is \$US 2,550,000.

PROJECTS

Based on the recent increase in the price of copper, up to \$US 1.30 per pound of copper, BioteQ has revised the revenue estimate from BioteQ's share of the project which, combined with current contracts for consumable supplies and copper product refining, shows that BioteQ's capital payback is now less than two years.



Raglan, Québec, Canada

Falconbridge Limited operate the Raglan Mine located on the Ungava Peninsula in northern Quebec, and extracts nickel ore, which is processed at site and shipped as a nickel sulphide concentrate to Sudbury. Following successful piloting at the site during 2002, BioteQ completed its feasibility study in early 2003 for a project to construct a water treatment plant to treat contaminated water at the site. The Company agreed to commercial terms with Falconbridge in April 2003 for the construction of a BioSulphide® treatment plant.

The contaminated water arises due to the oxidation of residual sulphide minerals in open pits and waste rock piles, as well as contact of mine water with exposed metal bearing minerals in the underground operations. The water has a neutral pH but contains elevated acidity levels in the form of dissolved nickel and must be treated before it is discharged to local receiving waters. Currently the water is stored in a collection basin, is treated for approximately four months of the year in a low-density sludge lime treatment plant and discharged on a campaign basis to the receiving waters.

Construction of the plant was completed in November 2003 in readiness for full duty during the water treatment season in 2004. The treatment plant design provides for a capacity to treat at least 140 cubic meters of water per hour and BioteQ expects to treat a minimum of 530,000 cubic meters of water each year, on average, during the operating season between May and November. The plant will recover the nickel in the contaminated water to produce a nickel-rich concentrate that can be transported with the Raglan production concentrate for refining off site. The nickel-rich product from the BioteQ plant will also contain minor amounts of other heavy metals that will be removed from the waste water to allow discharge of the treated water to the environment. It is the objective that in the future the BioteQ treatment process will replace the existing lime treatment plant. BioteQ provided for all capital costs of the plant, which, as of December 31, 2003, was \$1,570,000. BioteQ owns the plant, and charges a fixed fee on a monthly basis for the plant capital recovery as well as a variable monthly fee for water treatment.

The BioSulphide® plant at Raglan will have the following potential benefits:

- elimination of sludge production and storage
- improved treated water quality
- revenue from nickel recovery will partially offset treatment costs
- more reliable cold weather treatment
- reduced overall water treatment costs

Project Pipeline

The Company is evaluating over 30 potential commercial projects for water treatment and metal recovery in Canada, USA, Europe, Asia, Australia and South America. These projects are in various stages of development from initial scoping and due diligence to advanced engineering.

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Corporation for the year ended December 31, 2003.

Description of Business

BioteQ is a Canadian industrial process technology company that has developed the patented BioSulphide® Process for water treatment and sulphide reagent production. The process allows the treatment of acid contaminated water with concurrent recovery of saleable metals from the water.

BioteQ has met its 2003 objective of building two new plants and now owns, either solely or in joint venture, three commercial plants. The Company continues to market its process at a number of other sites in North America and elsewhere.

Operating Results

During 2003, like 2002, the Company has continued to emphasize marketing its water treatment process. Success was achieved in the first half of 2003 with the signing of contracts to construct two significant new treatment plants. This was a few months later than expected and prevented commissioning or operation in 2003, however both plants are expected to be fully operational in the first half of 2004. The Company has a current project list of over 30 potential sites which could benefit from the Company's technology. These projects range from early stage enquiries where an initial review of potential has been completed, to advanced stage projects where either preliminary or detailed engineering has been finalised and the decision to construct plants is imminent.

The Company incurred a loss for the year of \$1,174,305, compared to \$1,081,034 in 2002. Revenue for the year of \$89,239 was earned from engineering services for

potential projects and also from monthly fees which commenced late in the year when the Raglan plant was completed.

General and Administrative costs for 2003 were \$985,452 compared to \$585,229 for 2002. The increase was due to generally higher costs in all categories, due to increased corporate activity, including activity caused by the two new contracts, which were both built largely in 2003. More specifically, management services increased by \$126,000, due partially to one person being added to administrative support, business development and travel costs increased by \$93,000 and legal and audit costs increased by \$56,000. In addition, a move to larger premises increased rental costs by \$27,000, insurance costs rose by \$32,000. The Company anticipates the 2004 general and administrative costs to be similar, in total, to 2003.

Development costs amounted to \$187,208 (net of government grants of \$29,383), compared to \$465,607 in 2002 (net of government grants of \$184,182). The decrease was largely due to \$142,000 for the cost of start-up, operating and testing at the Caribou plant in 2002, which did not operate in 2003 and lower marketing/engineering costs by \$116,000, since resources were directed to new plant construction in 2003.

Interest income increased in 2003 by \$32,000 due to increased cash balances and interest expense increased due to a full year of interest being paid in 2003, with associated accretion costs, on the 10% debentures issued in September 2002.

The Company has one related party transaction. During 2002 a director invested \$100,000 in BioteQ's convertible debentures. Interest is paid twice annually at a rate of 10% per annum.

MANAGEMENT DISCUSSION AND ANALYSIS

A new accounting policy will be adopted in 2004. The Company will adopt the new recommendations for the accounting for stock-based compensation in CICA Handbook Section 3870 and will expense all amounts determined by the fair value based method at the time options are issued.

Raglan plant

A contract was signed in April 2003 to build a water treatment plant to operate at Falconbridge's Raglan site in northern Quebec. The client was keen to see the plant operational for 2004, therefore with the constraints of transportation to the area and the short summer construction period, there was pressure to move quickly. The plant was completed in November 2003, in readiness for full operation in 2004. The Company has funded construction and owns the plant. The contract provides for a fixed monthly fee of \$24,500, which has already commenced on completion of construction and a treatment fee based on the quantity of water processed. The treatment fee of \$1.06 per cubic metre of water processed will commence when the plant is started up and performs as designed, anticipated in mid-2004. The fixed monthly fee is unconditional for nine payments, but thereafter depends on satisfactory plant performance. BioteQ expects to treat a minimum of 530,000 cubic meters of water during the typical May to November operating season.

The plant was estimated to cost \$1,375,000 and by completion in November 2003, the company had incurred costs of \$1,570,000. The hardware components of the water treatment plants are relatively straightforward and actual costs were in line with estimates. The overruns have occurred in the construction labour and the building to house the plant, due largely to difficulty and costs of construction in the north of Quebec. Particularly, weather conditions caused significant extra cost in erection of the steel building.

Bisbee plant

In June 2003, the Company entered into a joint venture with Phelps Dodge Corporation to construct and operate a copper recover plant at their site in Bisbee, Arizona. BioteQ was appointed contractor to build the plant with an estimated cost before contingency of US\$1,900,000, to be equally shared. BioteQ agreed to fund any cost overruns. By December 31, 2003 US\$1,800,000 had been spent on the project, with an additional amount of approximately US\$750,000 remaining to be spent. Much of the overrun can be attributed to the extremely high standard of construction and safety required by our partner on their site. Although the overrun is significant, a first class plant has been built, including many enhancements to the plant for the safest possible operation.

In late February 2004, commissioning of the plant has commenced and is expected to last approximately three months before full operation is achieved. The latest operating estimates for the plant at the current copper price of US\$1.30 and with current costs, indicate a plant payback less than the original estimate of two years. The plant was designed to recover approximately 3 million pounds of copper per year from the drainage from a large, low-grade stockpile, which is estimated to contain over 300 million pounds of copper.

Caribou plant

The Company's plant has not operated since late 2002, due to the site owner shutting down minewater collection and treatment. Their original intention was to restart operations in the spring, however the shutdown was extended in order to fill the underground workings with contaminated water. This is expected to be complete in April 2004 and then water treatment will recommence.

MANAGEMENT DISCUSSION AND ANALYSIS

In January 26, 2004, the Company signed an agreement with the owner to control all aspects of water management at both Caribou and an adjacent site, commencing in the second quarter of 2004. The Company will earn fees for managing the sites and will own all metals recovered from its treatment plant. The Company will spend approximately \$70,000 to modify its plant in 2004, to continue treatment of the mine drainage and to also enable treatment of tailings containing copper and zinc, stored at the site.

Liquidity and Capital Resources

At December 31, 2003, the Company had cash of \$2,798,226, an increase of \$1,021,769 compared to \$1,776,457 at December 31, 2002. During 2003, the Company raised \$4,536,929, net of cash expenses, from issues of shares and warrants, compared to \$2,111,051 raised from equity and debenture financing in 2002. The Company also received \$29,383 (2002-\$152,340) from government funds in support of demonstrating the company's innovative environmental technology at the Caribou plant. This arrangement ceased on March 31, 2003 and repayments calculated at 2% of revenues will commence in 2004.

The Company used its cash resources to fund its 2003 operating loss of \$1,067,663, net of non-cash items (2002-\$932,002), and to fund the building of two new water treatment plants with expenditures in 2003 of \$2,831,601 (2002-\$5,339). The Bisbee plant was incomplete at December 31, 2003, with approximately \$900,000 remaining to be spent by the Company.

As a result of the financings and plant expenditures, working capital at the year-end showed an improvement to \$2,447,000 from \$1,682,000 in 2002. These resources will be used to complete Bisbee, commence operations at both new plants and fund other corporate operating costs

until cash flow commences, which is expected in the second quarter of 2004.

Early in 2004, the Company finalised arrangements with HSBC Bank Canada for debt refinancing of its Raglan project. The Company has received \$200,000 in 2004 of a \$800,000 loan, with interest payable at prime plus 1.5%, which will be fully drawn when the plant operates successfully on start-up with the spring thaw and is repayable over 4 years. The Company anticipates this financing arrangement will provide the basis for similar debt financing of future projects.

The Company is expecting that the two new projects, which should both be fully commissioned by mid-year, will move BioteQ to positive cash flow and therefore ensure adequate resources for the coming year, in conjunction with existing cash balances.

Risks and Uncertainties

Any new commercial application of the BioSulphide® Process will have certain construction and process risks associated with building and operating a new plant. Revenue will depend on the successful operation of the plants and will fluctuate with the price of the commodities being recovered and the exchange rate for the United States dollar. Operating costs will be largely dependent on the cost of consumables and power, which may fluctuate. The Company will be selecting projects which demonstrate good profit margins which should allow for the adverse effect of price changes.

The economics of some projects under review by the Company are based largely on estimates of metals to be recovered. Although there is often a significant amount of data upon which estimates can be based, there can never be absolute certainty as to the continuity of flow of water to be treated and the concentrations of metals contained.

MANAGEMENT DISCUSSION AND ANALYSIS

Outlook

The year of 2004 marks a significant change for the Company. After many years of development, the Company has now built three significant projects, which are planned to be fully operational by mid-year and should contribute significantly for a number of years. The Company is actively reviewing new projects, with the expectation of new contracts in the near future.

Cautionary Note Regarding Forward-Looking Statements

Certain statements contained in the foregoing Management's Discussion and Analysis and elsewhere in this Annual Report to Shareholders constitute forward-

looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made and readers are advised to consider such forward-looking statements in light of the risks set forth above.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of BioteQ Environmental Technologies Inc. is responsible for the preparation of the consolidated financial statements as well as the financial and other information contained in the annual report. Management maintains an internal control system to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The consolidated financial statements are prepared in accordance with generally accepted accounting principals in Canada and necessarily include amounts determined in accordance with estimates and judgements made by management. The external auditors, PriceWaterhouseCoopers, Chartered Accountants, express their opinion on the consolidated financial statements in the annual report.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control.

The financial statements of the Company have been approved by the Board of Directors.



P. Bradley Marchant
President and CEO



John York
Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of

BioteQ Environmental Technologies Inc.

We have audited the consolidated balance sheets of **BioteQ Environmental Technologies Inc.** (a development stage company) as at December 31, 2003 and 2002 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the 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 financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, B.C.

February 13, 2004

(except for note 16, which is as of February 23, 2004)

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP and the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

CONSOLIDATED BALANCE SHEETS

As at December 31, 2003 and 2002

	2003	2002
Assets		
Current assets		
Cash	\$ 2,798,226	\$ 1,776,457
Short-term investments	-	27,068
Trade receivables	56,362	-
Receivable from joint venture partner	424,009	-
Government grant receivable (note 6)	-	49,048
Sales tax receivable and other	231,023	95,760
	3,509,620	1,948,333
Property, plant and equipment (note 7)	3,261,804	516,182
Deferred financing costs	77,434	70,596
	6,848,858	2,535,111
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	1,062,820	266,446
Liability component of Series A debentures (note 9)	309,882	285,302
	1,372,702	551,748
Shareholders' Equity		
Capital stock, warrants and contributed surplus (note 10)	10,373,161	5,706,063
Equity component of Series A debentures (note 9)	96,128	96,128
Deficit	(4,993,133)	(3,818,828)
	5,476,156	1,983,363
	\$ 6,848,858	\$ 2,535,111

Going concern (note 2)

Commitments (note 14)

Subsequent event (note 16)

Approved by the Board of Directors



Director



Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

For the years ended December 31, 2003 and 2002

	2003	2002
Revenue	\$ 89,239	\$ -
Operating expenses		
Operating costs	25,550	-
Amortization of property, plant and equipment	22,390	7,374
Amortization of deferred financing costs	11,914	3,970
General and administrative expenses	985,452	585,229
Development costs	187,208	465,607
	1,232,514	1,062,180
Loss from operations	1,143,275	1,062,180
Interest income	(36,393)	(4,194)
Interest expense	67,423	23,048
Loss for the year	1,174,305	1,081,034
Deficit - Beginning of year	3,818,828	2,737,794
Deficit - End of year	4,993,133	3,818,828
Loss per share - basic and diluted	\$ (0.06)	\$ (0.09)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2003 and 2002

	2003	2002
Cash flows from operating activities		
Loss for the year	\$ (1,174,305)	\$ (1,081,034)
Items not affecting cash		
Amortization of property, plant and equipment	85,979	97,353
Amortization of deferred financing costs	11,914	3,970
Accretion of Series A debentures	24,580	8,193
Stock-based compensation	-	39,516
Other	(15,831)	-
Change in non-cash working capital items	331,356	4,917
	(736,307)	(927,085)
Cash flows from financing activities		
Issuance of common shares and warrants	5,105,299	2,030,000
Share issuance costs	(568,370)	(232,620)
Exercise of warrants and options	71,500	-
Issuance of Series A debentures	-	400,000
Series A debenture issuance costs	-	(86,329)
Financing costs	(18,752)	(15,000)
	4,589,677	2,096,051
Cash flows from investing activities		
Purchase of property, plant and equipment	(2,831,601)	(5,339)
Cash receipts from third parties credited to property, plant and equipment	-	17,205
	(2,831,601)	11,866
Increase in cash	1,021,769	1,180,832
Cash - Beginning of year	1,776,457	595,625
Cash - End of year	2,798,226	1,776,457
Supplemental cash flow information		
Interest paid	42,843	14,855
Non-cash financing and investing activities		
Share capital issued in exchange for settlement of accounts payable	58,669	38,843
Government assistance receivable credited to property, plant and equipment	-	17,205
Units issued in settlement of issue costs (note 10)	228,695	101,500
Warrants issued in settlement of issue costs (note 10)	\$ 153,546	\$ 47,892

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

1 Company operations

BioteQ Environmental Technologies Inc. (BioteQ or the company) is a company in the development stage. Biomet Mining Corporation (Biomet), BioteQ's wholly owned subsidiary, acquired a patent from related parties in 1997 for a process to treat metal-laden, sulphate-rich waste water streams for acid neutralization and metal recovery. The result, the BioSulphide® Process (the Process), has been developed to the stage of building the first commercial scale plant, which operated in 2002. During 2003, the company commenced construction of two commercial plants, one of which was completed in 2003. The company is continuing to concentrate on marketing the Process.

The principal operations of the company will be to build process plants and earn revenues from plant sales, recovered metals, fees and process licenses.

2 Going concern

The company may require further capital to continue the commercialization and marketing of the Process.

These consolidated financial statements have been prepared on a going concern basis, which assumes that the company will be able to meet its commitments, continue its operations and realize its assets and discharge its liabilities in the normal course of business. These financial statements do not reflect adjustments to carrying values of assets and liabilities that may be necessary should the company be unable to achieve sufficient cash flows to continue as a going concern. Such adjustments could be material.

The company's ability to carry on as a going concern is dependent upon its ability to achieve cash flows from operations and arrange additional financing through equity and/or debt to establish process plants and maintain general operations. The company has raised working capital through the sale of equity and issuance of debt, but may require additional project financing to establish process plants. There is no assurance that this financing, or cash flow from operations, will be available to the company; accordingly, there is doubt about the company's ability to continue as a going concern.

3 Significant accounting policies

Generally accepted accounting principles

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada.

Principles of consolidation

The consolidated financial statements include the accounts of BioteQ and its wholly owned subsidiaries, Biomet and BioteQ Arizona, Inc. The accounts of the joint venture in which the company holds an interest are proportionately consolidated. All intercompany transactions and balances have been eliminated.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

Cash

Cash consists of cash on deposit and term deposits with maturities at the date of acquisition of three months or less.

Short-term investments

Short-term investments are recorded at the lower of cost or net realizable value.

Property, plant and equipment

Expenditures on property, plant and equipment are stated at cost, net of grants and contractual amounts received under feasibility studies. Amortization has been provided for in the financial statements using the following rates and methods:

Office equipment	5 years straight-line
Pilot plants	5 years straight-line
Water treatment plants	10 - 20 years straight-line

Costs relating to property, plant and equipment in the course of construction are capitalized. Upon commissioning, these costs will be amortized over the useful life of the asset.

The company evaluates the carrying value of property, plant and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The company recognizes an impairment loss when it is probable that estimated future non-discounted cash flows of the underlying asset will be less than the carrying value of the asset.

Financing costs

Costs incurred to obtain debt financing are deferred and amortized over the terms of the underlying debt. Costs incurred to obtain equity financing are applied against the proceeds when the related shares are issued.

Revenue

Revenue from the company's water treatment plants vary depending on the company's agreement with the various mining companies and can include:

- revenue from managing and operating the plants recognized as the services are performed
- revenue from concentrate sales recognized when the title of the concentrate passes to the customer and collection of proceeds is reasonable assured
- lease revenue on the plants recognized over the term of the lease contract.

Fees from engineering services are recognized as the services are rendered.

Development costs

The company expenses all costs associated with development activities in the statement of operations in the period in which they are incurred, unless the criteria for deferral of development costs have been met.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

Government assistance

Government assistance is recorded when reasonable assurance exists that the company has complied with the terms and conditions of the approved grant program. Government assistance is either recorded as a reduction of the cost of the applicable property, plant and equipment or credited in the statement of operations as determined by the nature of the assistance. Where assistance is contingently repayable, the repayment of these funds is treated as either an increase in the cost of the asset or an increase to expense, in the year it is incurred, as determined by the original accounting treatment of the assistance.

Loss per share

Loss per share is calculated using the weighted average number of shares outstanding during the period, excluding performance based escrow shares, and diluted loss per share is calculated to reflect the dilutive effect of exercising outstanding stock options, warrants or equivalents by application of the treasury stock method. For the years ended December 31, 2003 and 2002, the company excluded potential common share equivalents from the loss per share calculation as they were considered anti-dilutive.

Future income taxes

The company accounts for income taxes using the liability method of tax allocation. Future income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in rates is included in income in the period that includes the enactment date. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

Stock-based compensation

Effective January 1, 2002, the company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments".

The company accounts for all stock-based payments to non-employees granted on or after January 1, 2002 using the fair value based method. Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the equity instruments issued.

No compensation cost is recorded for stock-based employee compensation awards. Consideration paid by employees on the exercise of stock options is recorded as share capital. The company discloses the pro forma effect of accounting for stock options awarded to employees under the fair value based method.

4 Development agreements

The SOQUEM Inc. Partnership

In March 2003, the company signed a memorandum of understanding with SOQUEM Inc., a wholly owned subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

of SGF Mineral Inc., to build and operate BioSulphide® plants in Quebec. During 2003, the company incurred costs of \$33,694 in researching potential plant sites in Quebec. If results of the research are positive, the company and SOQUEM Inc. will form a partnership to build and operate the plants.

Raglan agreement

On April 15, 2003, the company entered into a 10-year agreement to construct and operate a BioSulphide® plant at the Raglan mine owned by Falconbridge Limited (Falconbridge) in northern Quebec.

The contract provides for a plant with a design capacity to treat at least 530,000 cubic meters of water per year. Construction of the plant was completed in November 2003 and cost the company \$1,570,000. Under the contract, the company charges a fixed monthly fee of \$24,500 and an operating fee based on cubic meters of water treated. The operating fee will be charged when the plant commences operations in 2004. The fees are subject to certain conditions and performance criteria that must be met by either Falconbridge or by the company, although the fixed monthly fee is unconditional for nine payments. During the year, the company recorded \$49,000 of revenue related to the contract. After 63 months from installation of the plant, Falconbridge has the option to purchase the plant at BioteQ's cost, less straight-line depreciation at 5% per annum, in which case the contract would cease and BioteQ would be entitled to an ongoing technology fee.

Caribou agreement

In 2001, the company entered into a development agreement with Breakwater Resources Ltd. (Breakwater). The agreement provided for the installation of a BioSulphide® plant at Breakwater's Caribou mine in New Brunswick. Construction of the plant was completed in 2001 and commissioned in 2002. During 2003, the BioSulphide® plant was not operated due to different water management objectives of Breakwater and the company. On January 26, 2004, the company signed a new agreement to control all aspects of water management at the site.

The new agreement with CanZinco Ltd. (a wholly owned subsidiary of Breakwater) provides for the operation of mine dewatering water collection and treatment at both the Caribou and Restigouche sites in New Brunswick. The agreement replaces all previous agreements regarding the Caribou site. The contract is for an initial term of six years and will commence after a three-month transition period during which the definitive details of an operating agreement will be finalized.

5 Bisbee Joint Venture

In June 2003, the company signed an operating agreement with Phelps Dodge Corporation (PD) for the operation of a 50:50 joint venture water processing project at PD's Bisbee property in southern Arizona. The plant will recover copper from a low-grade process stream. The operating and capital costs of the project will be shared equally; however, the company has provided a capital cost guarantee to PD that PD's contribution will not exceed 50% of US\$1,900,000, the estimated capital cost before contingency.

During July 2003, the company completed a construction contract with the joint venture operating company, Copreco, LLC, for the construction, management and commissioning of the Bisbee plant. The company is managing the project during construction and for the first year of operation. At December 31, 2003, the company's 50% proportionate

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

interest in the joint venture is represented in the consolidated financial statements by property, plant and equipment of \$1,210,757 and a current liability of \$424,099. Cash used in investing activities was \$1,210,757 and cash provided by operating activities was \$424,009. During the year, there were no revenue or expenses of the joint venture. The total estimated capital cost of the project upon completion is US\$2,550,000.

6 Government assistance

In June 2001, the company entered into an agreement with the National Research Council Canada, Industrial Research Assistance Program (IRAP) to provide funds to assist in developing and operating the Process plant at the Caribou mine.

The maximum IRAP contribution was the lesser of \$427,580 and 33% of the total cost incurred in the performance of the work to March 31, 2003. Funding for the project is repayable in the form of royalties at 2% of all gross revenues of the company from January 1, 2004. This repayment will be calculated and paid quarterly until January 1, 2010. The maximum repayment will be \$641,370.

During the year, the company received \$78,431 (2002 - \$339,343) of government assistance. Of this amount, \$49,048 (2002 - \$187,004) has been recorded against the government grant receivable outstanding as at December 31, 2002, \$29,383 (2002 - \$135,134) has been recorded as a reduction to development expenses, and in 2002, \$17,205 has been recorded as a reduction of the cost of property, plant and equipment.

7 Property, plant and equipment

	2003	2002
	\$	\$
Pilot plants	351,193	351,193
Less: Accumulated amortization	(351,193)	(311,293)
	-	39,900
Office equipment	73,939	41,594
Less: Accumulated amortization	(28,652)	(19,347)
	45,287	22,247
Water treatment plants - net	2,044,071	473,775
Less: Accumulated amortization	(56,514)	(19,740)
	1,987,557	454,035
Water treatment plant in progress	1,228,960	-
	3,261,804	516,182

To date, the company has received \$258,537 from third parties and \$22,764 in investment tax credits which are offset against the cost of the pilot plants. Government assistance of \$221,414 has been offset against the cost of the water treatment plant at the Caribou Mine. Amortization expense for the year ended December 31, 2003 amounted to \$85,979 (2002 - \$97,353). In 2003, \$63,589 (2002 - \$89,979) relates to the amortization of the pilot plants and the Caribou Mine water treatment plant and has been included within development costs on the statement of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

The recoverability of the water treatment plants is dependent upon successful continual operation of the plants and attainment of set performance criteria.

8 Development costs

Cumulative development costs incurred to date are as follows:

	2003	2002
	\$	\$
Laboratory process development		
Labour costs	760,557	734,822
Laboratory operations	320,605	308,636
Patents	33,546	33,546
Other	71,900	56,350
Investment tax credit	(67,287)	(67,287)
	<u>1,119,321</u>	<u>1,066,067</u>
Pilot plants		
Labour costs	149,033	149,033
Pilot plant operations	369,302	437,495
Other	66,670	66,670
Amortization of pilot plants	358,383	318,483
	<u>943,388</u>	<u>971,681</u>
Marketing - engineering labour and sundry	621,864	466,123
Government grant	(84,242)	(62,659)
	<u>537,622</u>	<u>403,464</u>
Caribou plant		
Commissioning	260,218	248,018
Amortization	43,429	19,740
Government grant	(129,323)	(121,523)
	<u>174,324</u>	<u>146,235</u>
Interest	7,706	7,706
Total cumulative development costs	<u>2,782,361</u>	<u>2,595,153</u>

All development costs are charged to the statement of operations.

The company has had the following cumulative transactions since inception with related parties:

	2003	2002
	\$	\$
Included in cumulative development costs:		
Intangible assets purchased from shareholders	20	20
Interest charged by a shareholder	4,284	4,284
Provision of engineering services by shareholders	265,383	265,383
Laboratory expenses incurred by shareholders	68,356	68,356

The amounts paid for the services are based on their exchange amount.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

9 Series A debentures

On September 5, 2002, the company completed a private placement of unsecured Series A debentures (debentures) of \$400,000 to fund working capital and plant construction. After deducting issue costs of \$86,329, the proceeds of the issue amounted to \$313,671. Each debenture matures on October 31, 2007 and bears interest at the rate of 10% per annum, payable semi-annually. The principal is convertible at the option of the holder into common shares of BioteQ at \$0.65 per common share. Under the terms of the Trust Indenture, the conversion price is adjusted if the company declares and pays a stock dividend, subdivides its outstanding common shares into a greater number of common shares, or consolidates its outstanding common shares into a lesser number of common shares. The conversion price will also be adjusted when the company fixes a record date for dividend distribution or the issuance of equity instruments with exercise prices less than the fair value at the grant date. After two years from the issuance date, the company may redeem the debentures if the common shares have traded for 30 consecutive days at 200% of the conversion price.

The debentures are being accounted for in accordance with their substance and are presented in the financial statements in their component parts, measured at their respective fair values at the time of issue. The liability component has been calculated as the present value of the required interest payments discounted at a rate approximating the interest rate that would have been applicable to non-convertible debt at the time the debentures were issued.

	\$
Issue price in 2002	400,000
Less: Liability component	<u>(277,109)</u>
Shareholders' equity component	122,891
Less: Issue costs applicable to shareholders' equity component	<u>(26,763)</u>
Net amount classified as shareholders' equity at issuance in 2002	<u>96,128</u>

Interest expense on the liability component is \$64,580 (2002 - \$21,124), of which \$24,580 (2002 - \$8,193) represents accretion of the liability component. All cash interest incurred to date related to the debentures has been paid.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

10 Capital stock, warrants and contributed surplus

Authorized

100,000,000 common shares without par value

Issued and outstanding

	Common Stock		Warrants	Contributed surplus	Total \$
	Number of shares	Amount \$	Amount \$	Amount \$	
Balance - December 31, 2001	18,875,884	3,812,324	-	18,000	3,830,324
Shares issued for accounts payable	77,686	38,843	-	-	38,843
Private placement for cash (a)	4,060,000	1,642,501	387,499	-	2,030,000
Share issuance costs (a)	-	(278,476)	(103,536)	-	(382,012)
Units issued in settlement of issue costs (a)	203,000	77,554	23,946	-	101,500
Warrants issued in settlement of issue costs (a)	-	-	47,892	-	47,892
Issuance of stock options and warrants for services rendered	-	-	-	39,516	39,516
Balance - December 31, 2002	23,216,570	5,292,746	355,801	57,516	5,706,063
Private placement for cash (b)	940,000	389,619	80,381	-	470,000
Share issuance costs (b)	-	(61,741)	(21,399)	-	(83,140)
Units issued in settlement of issue costs (b)	47,000	19,481	4,019	-	23,500
Warrants issued in settlement of issue costs (b)	-	-	8,725	-	8,725
Shares issued for accounts payable	93,125	58,669	-	-	58,669
Private placement for cash (c)	3,764,713	2,031,137	604,162	-	2,635,299
Share issuance costs (c)	-	(294,865)	(166,374)	-	(461,239)
Units issued in settlement of issue costs (c)	158,135	85,317	25,378	-	110,695
Warrants issued in settlement of issue costs (c)	-	-	78,385	-	78,385
Public offering for cash (d)	2,857,142	1,728,438	271,562	-	2,000,000
Share issuance costs (d)	-	(282,860)	(123,372)	-	(406,232)
Units issued in settlement of issue costs (d)	135,000	71,905	22,595	-	94,500
Warrants issued in settlement of issue costs (d)	-	-	66,436	-	66,436
Exercise of warrants and options	140,000	71,500	-	-	71,500
Balance - December 31, 2003	31,351,685	9,109,346	1,206,299	57,516	10,373,161

- a) On December 20, 2002, the company completed a private placement of 4,060,000 units at a price of \$0.50 for gross proceeds of \$2,030,000. Issue costs were \$382,012, of which \$101,500 was settled with the issue of 203,000 units and \$47,892 was settled with the issue of 406,000 warrants. Each unit comprised one common share and one non-transferable common share purchase warrant. Each warrant entitles the holder to acquire one additional common share for a period of two years from the issue date at a price of \$0.65 in the first year and \$0.75 in the second year. Of the gross proceeds, \$1,642,501 was attributable to the common shares and \$387,499 was attributable to the non-transferable common share purchase warrants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

- b) On January 15, 2003, the company completed an over-allotment on the above private placement by issuing a further 940,000 units for gross proceeds of \$470,000. Issue costs were \$83,140, of which \$23,500 was settled with the issue of 47,000 units and \$8,725 was settled with the issue of 94,000 warrants.
- c) During October and November 2003, the company completed a unit private placement of 3,764,713 units at \$0.70 per unit for gross proceeds of \$2,635,299. Issue costs were \$461,239, of which \$110,695 was settled with the issue of 158,135 units and \$78,385 was settled with the issue of 376,471 warrants. Each unit comprises one common share and one non-transferable common share purchase warrant. Each warrant entitles the holder to acquire one additional common share for a period of two years at a price of \$0.85 during the first year and \$1.00 during the second year. Of the gross proceeds, \$2,031,137 was attributable to the common shares and \$604,162 was attributable to the non-transferable common share purchase warrants.
- d) During November 2003, the company completed a public offering of 2,857,142 units at a price of \$0.70 per unit for gross proceeds of \$2,000,000. Issue costs were \$406,232, of which \$94,500 was settled with the issue of 135,000 units and \$66,436 was settled with the issue of 285,714 warrants. Each unit comprises one common share and one-half of one non-transferable share purchase warrant. Each warrant entitles the holder to purchase one additional common share for a period of two years at a price of \$0.85 during the first year and \$1.00 during the second year. Of the gross proceeds, \$1,728,438 was attributable to the common shares and \$271,562 was attributable to the non-transferable common share purchase warrants.
- e) Stock options

The company has a stock option plan available to directors, employees and consultants. Under the plan, 3,790,714 shares are available for issue. Options vest at the minimum rate of 33% every six months from award and have a maximum term of five years from the date of the grant. A summary of the change in the company's stock option plan for the year is as follows:

	2003		2003	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Outstanding - January 1	2,600,000	0.61	2,150,000	0.63
Options granted	850,000	0.72	750,000	0.54
Options cancelled	(200,000)	0.65	(300,000)	0.58
Outstanding - December 31	3,250,000	0.64	2,600,000	0.61
Exercisable at December 31	2,583,329	0.62	2,000,000	0.63
Available for future grant pursuant to company's stock option plan at December 31	540,714		1,190,714	

The following table summarizes information about common share options outstanding at December 31:

	Range of exercise prices \$	Number outstanding at December 31	Weighted average remaining contractual life (years)	Weighted average exercise price \$
2002	0.50 - 0.67	2,600,000	3.6	0.61
2003	0.50 - 0.72	3,250,000	3.1	0.64

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

Had compensation expense for stock options been determined by a fair value based method in accordance with the provision of CICA Handbook Section 3870, the company's loss for the year would have been reduced to the pro forma amount indicated below:

	2003	2002
	\$	\$
Loss - reported	1,174,305	1,081,034
Loss - pro forma as previously reported	1,475,882	1,317,922
Adjustment	-	(192,448)
Loss - pro forma as restated	1,475,882	1,125,474
Loss per share - as reported	0.06	0.09
Loss per share - pro forma as previously reported and restated	0.08	0.09

The 2002 pro forma loss has been restated to recognize compensation expense over the vesting period.

The fair value of stock options granted is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2003	2002
Expected dividend yield	0%	0%
Expected stock price volatility	73%	86%
Risk-free interest rate	3.90%	3.95%
Expected life of options (years)	3	5

The weighted fair value average price and weighted average exercise price of options granted in the years indicated were as follows:

	Weighted fair value average exercise price	Weighted average exercise price
	\$	\$
2002	0.47	0.54
2003	0.72	0.72

On April 22, 2002, the company granted 100,000 options to a consultant in return for investor relations services. At the date of grant, the market value of the underlying shares was \$0.45 and the option exercise price was \$0.54. At December 31, 2003, all the options had vested. The company recorded an expense of \$30,317 during 2002 based on the fair value of the options.

On September 5, 2002, the company granted 46,154 common share purchase warrants to the agent of the Series A debentures offering for services rendered. The warrants are convertible into the same number of common shares at a price of \$0.65 per common share until September 4, 2004. The company recorded an expense of \$9,199 during 2002 based on the fair value of the warrants at the date of grant.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

f) Warrants

As at December 31, 2003, the following warrants were outstanding.

	2003		2002	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Outstanding - January 1	4,845,154	0.74	370,000	0.50
Granted	7,229,604	0.90	4,715,154	0.75
Cancelled	(130,000)	0.50	(240,000)	0.50
Outstanding - December 31	<u>11,944,758</u>	0.84	<u>4,845,154</u>	0.74

On December 20, 2002, the company granted the agent for a private placement, common share purchase warrants to buy 406,000 common shares at a price of \$0.65 within the first year and \$0.75 within the second year from the grant date. On January 15, 2003, an over-allotment of the private placement resulted in a further 94,000 warrants being granted. The company has treated these costs as share issue costs based on their fair value.

In October and November 2003, the company granted the agent for the private placement, common share purchase warrants to buy 376,471 common shares at a price of \$0.85 within the first year and \$1.00 within the second year from the grant date. The company has treated these costs as share issue costs based on their fair value.

On November 18, 2003, the company granted the agent for the public offering, common share purchase warrants to buy 285,714 common shares at a price of \$0.85 within the first year and \$1.00 within the second year from the grant date. The company has treated these costs as share issue costs based on their fair value.

g) Escrow shares

The shares issued at December 31, 2003 include 7,000,000 performance shares which will be released from escrow based upon the cash flow performance of the company determined annually in accordance with the policies of the exchange. The company must generate a cash flow of \$0.30 for each performance share to be released from escrow. Any performance shares that have not been released within 10 years from issuance will be cancelled and returned to the company's treasury.

11 Related party transactions and balances

At December 31, 2003, a director holds \$100,000 of the convertible debentures (note 9) issued on September 5, 2002.

12 Tax loss carry-forward

As at December 31, 2003, the company has approximately \$888,000 of research and development expenditures available for unlimited carry-forward, \$4,324,000 of undeducted expenditures for tax purposes related primarily to share issue costs and property, plant and equipment, and \$86,000 of investment tax credits, expiring 2008 to 2010, all of which may be used to reduce future Canadian income taxes otherwise payable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

The company has accumulated losses of approximately \$4,427,000 for income tax purposes which may be deducted in the calculation of taxable income in future years. The losses expire as follows:

	\$
2004	115,000
2005	312,000
2006	43,000
2007	466,000
2008	1,036,000
2009	1,145,000
2010	1,310,000
	<u>4,427,000</u>

As at December 31, 2003, the company's future tax assets and liabilities were as follows:

	2003	2002
	\$	\$
Property, plant and equipment	78,000	792
Financing costs	272,000	261,096
Research and development expense carry-forwards	372,000	499,212
Non-capital loss carry-forwards	1,577,000	951,276
Total future tax assets	2,299,000	1,712,376
Valuation allowance	(2,299,000)	(1,712,376)
Total future tax assets	<u>-</u>	<u>-</u>

No income tax benefits related to the future tax assets have been recognized in the accounts as their realization does not meet the requirements of "more likely than not" under the liability method of tax allocation.

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expense (recovery), using a 37.62% (2002 - 39.62%) statutory tax rate, at December 31 is:

	2003	2002
	\$	\$
Income tax recovery at statutory rates	(441,774)	(428,306)
Change in valuation allowance	586,624	408,681
Share issue costs	(209,321)	(115,676)
Difference between current and future tax rates	45,980	68,495
Non-deductible expenses and other	18,491	66,806
	<u>-</u>	<u>-</u>

13 Financial instruments

Fair value of financial instruments

The company's financial instruments include cash, short-term investments, trade receivables, receivable from joint venture partner, government grant receivable, sales tax receivable and other, and accounts payable and accrued liabilities. Given the short-term nature of these items, the fair values of these financial instruments approximate their carrying values.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 and 2002

Credit risk exposure

The company's exposure to credit risk is as indicated by the carrying value of its receivables. The company mitigates this risk by reviewing and monitoring these balances.

Interest rate exposure

The Series A debentures bear interest at a fixed rate. Management considers that no events have occurred subsequent to the issuance of these debentures that would indicate that the fair value differs substantially from the carrying value.

14 Commitments

The company is committed to minimum annual lease payments for office premises and equipment as follows:

	\$
2004	83,000
2005	77,000
2006	50,000

The company is committed to spend an additional amount of approximately \$900,000 to complete the Bisbee plant.

15 Segmented information

The company currently has one operating segment (see note 1). Geographic disclosures are as follows:

	2003	2002
	\$	\$
Revenue		
Canada	49,000	-
U.S.	10,169	-
Other	30,070	-
	<u>89,239</u>	<u>-</u>
Property, plant and equipment		
Canada	2,032,844	516,182
U.S.	1,228,960	-
	<u>3,261,804</u>	<u>516,182</u>

16 Subsequent event

Debt financing agreement

Early in 2004, the company finalized a financing agreement for a \$800,000 demand non-revolving loan. Proceeds from the loan will be used to refinance the Raglan plant.

The first advance of \$200,000 was received on February 23, 2004. The second advance of \$600,000 is receivable when the Raglan plant commences operations and meets certain performance criteria. Interest will be charged, at the company's option, at the prime rate plus 1.5% or at the bank's fixed cost of funds plus 3%.

As security for the loan, the company has provided a fixed first charge over all its property in Quebec and a general security interest in all personal property of the company. The company has also assigned the monthly fixed fee payments from Falconbridge as security for the monthly repayment to the Lender.

CORPORATE INFORMATION

Directors

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Senior Vice President
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Vancouver, B.C.

Kelvin P.M. Dushnisky
Vice President, Regulatory Affairs
Barrick Gold Corporation
Toronto, Ontario

Anthony T. Kana
Financial Services Consultant
Vancouver, B.C.

Clement A. Pelletier
President & CEO
Rescan Environmental Services Ltd.
Vancouver, B.C.

Ian W. Telfer
Chairman & CEO
Wheaton River Minerals Ltd.
Vancouver, B.C.

Kenneth F. Williamson
Independent Consultant
Dwight, Ontario

Officers and Management

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John C. York
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