Dynex Power Inc.

Report for the quarter ended September 30th 2004

powerful ideas at work

Quarterly Report

LETTER FROM THE PRESIDENT – THIRD QUARTER 2004

Dear Shareholder,

The third quarter and the early part of the fourth quarter have seen many changes at Dynex. Michael LeGoff, who founded the Company in 1996 and who had led it since then, stepped down as President and Chief Executive Officer of the Company at the start of November. He remains a director of the Company but is no longer involved in the day-to-day operations in Lincoln.

The Board has asked me to take on the roles of President and Chief Executive and I have accepted their offer with pleasure. I joined the company in 1976 at the Lincoln power semiconductor business unit of what was then AEI Semiconductors Ltd., a GEC plc group company. I have held a series of engineering and general management positions including, most recently, that of Chief Technology Officer.

My appointment has coincided with a number of other changes in the senior management team. Nick Mallinson, VP Sales & Marketing, Trevor Marsh, VP Manufacturing, Jane Quibell, Logistics Manager and Trevor Boulding, HR Manager have all decided to find new opportunities outside the Company. They have given many years' service to the Company and its predecessors. We shall miss them as colleagues and friends, and wish them well in their new careers. Bob Lockwood and Bill McGhie remain as part of the senior management team and Mark Kempton joins us. We congratulate Mark on his appointment.

It is disappointing that in my first letter to our shareholders I have to report that performance in the third quarter was below expectations. Revenue in July had been reasonable. However, the shortage of working capital referred to in the second quarter report and delays in forecast orders meant that August and September revenues were well below expectation and we lost money. More importantly, the proceeds from the private placement completed in early August proved to be insufficient, under the circumstances of the revenue delays experienced by the Company, to ease the supply chain problems in time for September shipments. September revenues were thus affected and further losses incurred. As a result, we are reporting a loss for the third quarter of $1.4 million.

What is the management team doing to address these problems and to lay the foundations for a return to profitability? The answer is many things. Additional finance has been raised from the directors and some of our major shareholders in Canada and the Company has accepted an offer from the UK subsidiary of a major, international bank who will replace the Royal Bank of Scotland. The new lender will provide a larger, more flexible facility than we enjoyed with the Royal Bank of Scotland. The new facility and the shareholders' and Directors' loans ease the liquidity shortage that currently inhibits the business. We hope to be able to report further progress on these two initiatives shortly. They are vital building blocks in our recovery plan.

Internally, we have undertaken a major cost reduction exercise to enable us to be profitable at the lower levels of revenue that we are currently experiencing. Forty employees are no longer with the Company. A large portion of the cost of thirty-five redundancies have been funded by DTI by a three-year, interest free loan. In addition, the Company has implemented other cost saving initiatives undertaken to reduce our annual operating costs by $3.9million. In the short term, senior management has reduced its salaries by 20% for three months, indirect employees have agreed to short-time working for three months, the IGBT wafer fabrication unit is closed for three months to allow it to be downsized, pension contributions have been suspended, and the directors fees cancelled for six months. We have also restructured the management to provide a greater focus on the profitability of the major product lines. Mark Kempton now leads our Power Bipolar Discretes product line, Bill McGhie leads our Power Electronic Assemblies business line and I will lead the Power Modules business line. Each of us has gross profit responsibility for our area: our objectives are to achieve profitability through both tight control of the product line costs and revenue growth in our profitable sectors.

These changes and the arrangements of the new financial facilities will not be implemented quickly enough for revenue to meet expectations in the fourth quarter. The results however, will be improved by the cost savings initiatives.

Much work has already been completed on the recovery of Dynex, but the full recovery will not be achieved overnight. The new structure is in place, some of the cost saving initiatives have been completed, others are still on-going. But there is much detailed work to be completed including the refinancing. Our customers remain loyal and our suppliers supportive, but it will take time to get the business operating efficiently again. We are looking to eliminate the loss in the fourth quarter, albeit on flat revenues, and are forecasting a small increase in revenue next year. The focus on our cost saving activities is to ensure that our costs are reduced sufficiently to enable us to be profitable in 2005 at the forecast level of revenue.

I want you to understand that there is much going on to overcome the problems encountered in the past months. The new management team is far from happy with the performance of the business and we do not expect you to be either. We see that there is much to be done, to recover our profitability, improve customer satisfaction, and rebuild our reputation as a reliable supplier of high power semiconductors. But we hope that you will support the new management team in its efforts to build a better and more secure future for the business, its employees and its shareholders. I look forward to updating you on our progress at the end of the year.

Yours truly,

PDTaylor

Dr Paul Taylor
President & Chief Executive Officer.

MANAGEMENT DISCUSSION & ANALYSIS

The following discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements and Notes of the Company for the quarter ended September 30th, 2004.

This quarterly report may contain certain forward-looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Group's business and results of operation. By nature, these risks and uncertainties could cause actual results to differ materially from those indicated. Such factors include, without limitation, the various factors set forth in the Management Discussion & Analysis of this report as discussed in public disclosure documents filed with Canadian regulatory authorities.

Overview

In July and August the Company raised some $2.5 million gross of costs through a private placement of shares. The money raised was intended to alleviate the liquidity shortage referred to in the 2004 Second Quarter Report. Unfortunately, the Company's operating performance in July and August was below expectations. Therefore, the new funds were insufficient to enable us to operate efficiently and orders that we had expected to deliver in those months were delayed by certain customers. These orders have not gone away, but delivery is now unlikely to take place before the first quarter of next year. This shortfall in revenue meant we were unable to recover fully from the shortage of liquidity. As a consequence we have again encountered problems in the supply chain, which has meant customer orders that we did have could not be delivered on time adversely affecting revenue in September. Obtaining adequate working capital has therefore remained our major challenge.

Change in Accounting Policy

With affect from January 1, 2004, the Canadian Institute of Chartered Accountants requires the Company to account for the fair value of all stock options issued since January 1, 2002. The Company has done this in respect of the options issued in April 2003, which were the only options issued since January 2002 that had not previously been accounted for on the fair value method. Management does not consider that the impact of the change in accounting policy is material to the Company.

Revenue

Revenue for the third quarter of 2004 was $6.3 million up by $0.9 million or 17% against the second quarter, although the result was $0.8 million or 11% below the corresponding quarter of last year. The third quarter of last year had been particularly strong as a result of a large assembly order. As already mentioned, orders expected in the quarter have been delayed. In addition, the shortage of liquidity meant that we could not complete certain customer orders on time in July and August and some short-term market opportunities were again lost. There was a significant backlog in deliveries at the end of the quarter. Had we had the liquidity to exploit these opportunities, revenue would have been increased significantly.

Gross Margin

The improvement in revenue compared to the preceding quarter meant that we were able to record a positive gross margin of $279,000 compared to a negative gross margin of $296,000 in the second quarter. Welcome though this improvement was, it still represents a $561,000 or 67% reduction from the gross margin earned in the corresponding quarter of last year. As before, the product sold in the quarter continued to deliver a good contribution over variable cost, but the volume achieved was insufficient to cover the high fixed manufacturing cost inherent in running semiconductor fabrication plants.

Expenses

Total overhead expenditure of $1.6 million was $125,000 or 7% lower than in the preceding quarter with significant savings in General & Administration and Sales & Marketing costs offset by small increases in Research & Development and Interest Expense. Compared to the corresponding quarter of last year, Expenses have been reduced by $686,000 or 30% with significant savings achieved in all areas. These reductions are a direct result of robust management action and a determination to ensure that our costs are brought into line with the revenues being generated as soon as possible. More work is being done to reduce these costs further for the future.

Interest & Other Income

Interest and other income of $55,000 was not significantly different from the $65,000 reported in the second quarter. The figure of $130,000 reported in the corresponding quarter of last year included a one-off income of $80,000 related to space sublet to the new owners of the microwave sensors business until such time as they were able to relocate this activity to new premises. The main constituent of Other Income in the third quarter, the preceding quarter and the corresponding quarter of last year (excluding the one-off item already referred to) was the release of deferred revenue that had arisen at the time of the sale and leaseback of the premises in Lincoln, England. Such releases of deferred revenue will continue for the next thirteen years.

Foreign Exchange Loss

The foreign exchange loss of $199,000 reversed the $4,000 gain in the preceding quarter and was four times the size of the loss recorded in the corresponding quarter of last year of $48,000. The loss arose primarily on the intercompany loan from the Company to Dynex Semiconductor Limited, the UK operating business. The intercompany loan had been used to channel the new equity raised by the Company to the UK business. It is intended to convert this loan into additional equity in the UK business during the fourth quarter, thus eliminating further large foreign exchange gains or losses.

Income Taxes

In view of the losses in the quarter, neither the Company nor any of its subsidiaries will be paying any taxes in relation to the third quarter results. There was no tax payable in the previous quarter or in the corresponding quarter of last year. However, during the third quarter, the UK operating company finalised its tax return for 2001, which resulted in the payment of a small, unaccrued tax liability of $2,000.

Net Loss

The net loss was $1.4 million both before and after discontinued operations. It was $0.5 million or 25% lower than the loss in the second quarter. It was $100,000 or 8% higher than the loss before discontinued operations in the corresponding quarter of last year. The corresponding quarter of last year had a profit after discontinued operations of $3.1 million but this figure included a $4.0 million profit on the disposal of the microwave sensors business.

Segmental Analysis

Revenue for Power Units of $4.7 million was $0.1 million or 2% higher than the previous quarter and some $0.6 million or14% higher than in the corresponding quarter of last year.

Despite the delay in Power Assembly orders, revenue of $1.4 million was $835,000 or 149% higher than the preceding quarter. However, because of the delay in the new large order, it remained $1.2 million or 46% below the corresponding quarter of last year.

Revenue from Integrated Circuits of $176,000 was down $27,000 or 13% from the previous quarter. Revenue was down $207,000 or 54% from the corresponding quarter of last year.

Seasonality

Management does not regard the business as seasonal. Significant changes in quarterly revenues in power devices in the past have reflected internal operating conditions. In addition, in the case of power assemblies and integrated circuits, small numbers of large contracts drive both these segments. The delivery of a large contract in a particular quarter can cause revenue to fluctuate significantly, giving the appearance of seasonality.

Liquidity & Capital Resources

A small strengthening of Sterling saw a positive translation adjustment of $44,000.

In addition to the net proceeds of $2.3 million from the private placement already referred to above, the Company issued $90,000 of shares to the independent directors for their services in 2003 and $37,400 of shares under a small private placement.

As a result of the transactions and the results for the quarter, Shareholders' Equity have risen from $293,000 at the end of the second quarter to $1.3 million at the end of the third quarter

The losses arose as a result of poor sales in the quarter, which arose from the delays in customer orders and from an inability to complete orders on time due to the shortage of liquidity. However, the small increase in revenue over the second quarter was reflected in a rise in accounts receivable of $209,000 and a reduction in stock of $319,000. Despite the liquidity shortage, accounts payable were reduced by $1 million since the end of the last quarter, but the figure still remains $1.6 million higher than at the end of 2003.

Selected Financial Information

Selected quarterly financial information (taken from the unaudited quarterly reports) and annual information (taken from the annual reports) are presented below. All amounts are stated in thousands of dollars except for earnings per share figures (EPS), which are stated in cents per share. The figures for long-term liabilities do not include deferred revenues, as these are not a liability of the Company.

	2004 Q3	2004 Q2	2004 Q1	2003 Q4	2003 Q3	2003 Q2	2003 Q1	2002 Q4	2003 FY	2002 FY	2001 FY
Revenue	6,266	5,363	6,714	6,903	7,077	5,261	4,348	7,133	23,563	30,581	37,000
Continuing operations:											
Net (loss)	(1,438)	(1,924)	(576)	(548)	(1,335)	(2,813)	(2,826)	(805)	(7,477)	(2,531)	(13,719)
Basic EPS	(0.06)	(0.09)	(0.03)	(0.02)	(0.07)	(0.14)	(0.18)	(0.04)	(0.38)	(0.14)	(0.98)
Diluted EPS	(0.06)	(0.09)	(0.03)	(0.02)	(0.07)	(0.14)	(0.18)	(0.04)	(0.38)	(0.14)	(0.98)
Total operations:											
Net earnings/(loss)	(1,438)	(1,924)	(576)	(650)	3,076	(1,762)	(2,751)	625	(2,087)	448	(7,300)
Basic EPS	(0.06)	(0.09)	(0.03)	(0.04)	0.15	(0.09)	(0.15)	0.04	(0.11)	0.03	(0.52)
Diluted EPS	(0.06)	(0.09)	(0.03)	(0.04)	0.15	(0.09)	(0.15)	0.03	(0.11)	0.02	(0.52)
Total assets	14,916	15,004	16,680	14,862	15,116	16,363	17,581	24,391	14,862	24,391	28,347
Long term liabilities	0	4	9	13	18	22	433	3,006	13	3,006	4,563
Cash Dividends paid	0	0	0	0	0	0	0	0	0	0	0

The decline in revenue over the last three years reflects the closure of various business lines, such as macrochip, and a recession in the demand for high power semiconductors. The quarterly revenue figures show a fall in revenue in Q1 of 2003 as a result of a severe liquidity shortage, followed by a steady recovery in revenue and a reduction in the loss from continuing operations. A tight liquidity situation in the second quarter of 2004 and delays to some major orders reversed that trend. The third quarter has seen the start of a recovery but results in the third quarter were also hampered by the continuing shortage of liquidity and further delays in major orders.

Changes in the loss from continuing operations follow the changes in revenues but also show the impact of long term cost reduction initiatives. Results from total operations differ significantly from results from continuing operations in Q4 of 2002 and Q2 of 2003 due to very high volumes and good results in those quarters from the microwave sensors business. The difference in Q3 of 2003 between the results from continuing operations and the result from total operations reflects the profit on the sale of the microwave sensors business.

The large reduction in total assets between Q4 of 2002 and Q1 of 2003 is a result of the sale and leaseback of the site in Lincoln, England. A significant amount of the proceeds from this transaction was used to reduce the long-term debt of the Company.

Risk Management

The level of world-wide demand for power semiconductors is one of the key drivers of the Company's financial performance. Demand has been recovering for the past two years. Recent power blackouts in both North America and Europe have provided vivid evidence of the need for significant investment in power generation, transmission and distribution. Such investment would benefit the Company and management has already seen the first stages of recovery in demand from such investment. Management expects the recovery to continue and probably accelerate over the next few years. Therefore, Management believes that the continuation of the investment in a properly capitalized Dynex will yield good financial results over time.

As disclosed in the Financial Statements, the Company had three major customers who each accounted for 10% or more of revenue in the quarter. Relationships with all three customers remain good.

Although the Company buys some materials in North America, continental Europe and the Far East, the bulk of its costs are incurred in Sterling. However, it sells into world markets with many sales denominated in Euros and US dollars. As a consequence, the Company's results are affected by changes in exchange rates between these currencies. Management monitors these exposures but does not undertaking hedging of these exposures. The need to undertake such hedging is reviewed from time to time.

The Company's sole operating unit is in Lincoln, England and so the majority of its assets, liabilities, revenues, expenses and cash flows take place and are recorded in Sterling. These values have to be translated to Dollars for inclusion in the consolidated financial statements of the Company. Movements in the Dollar-Sterling exchange rate directly affect such values. The Company does not hedge such exposures.

The availability of cash to finance the working capital needs of the business has been the source of problems in the past. The need to obtain sufficient working capital to enable the business to operate efficiently remains a major task of management

Related Party Transactions

The Directors agreed to waive their fees for six months from the end of August 2004. As at September 30th, 2004 a total of $60,833 was payable to directors in respect of their fees for the first eight months of the year. The directors' fees are recorded at negotiated amounts.

The Company has two loans from a director totalling $449,236 which bear interest at 8.5% per annum compounded monthly and which are repayable in December 2004. The Company has a third loan from a director for $229,0000 which bears interest at 9.5% per annum compounded monthly and is repayable in three equal instalments in February, March and April 2005.

On March 31st 2004, the Company settled a legal dispute to which a director of the company was due to contribute $53,607. That amount was outstanding at 30 June 2004 but was repaid during the quarter.

Business Development

Management is forecasting similar levels of revenue in the fourth quarter to that reported in the third quarter. Growth of around 15% is forecast in 2005, which is more modest than in previous forecasts. Greater emphasis is being placed by management on reducing costs to enable the Company to be profitable at these lower turnover levels rather than chasing growth to justify a higher level of costs.

Subsequent Events

On October 26th 2004, the Company announced a major restructuring and cost reduction initiative designed to save the Company $380,000 in 2004 and not less than $3.9 million in 2005. Work continues to identify further savings.

On November 3rd 2004, Michael LeGoff resigned as President and Chief Executive Officer of the Company. Dr Paul Taylor, who has worked for the business for 28 years, most recently as Chief Technical Officer, took over as Chief Executive.

Bob Lockwood.

Director and Chief Financial Office

Consolidated Financial Statements of

DYNEX POWER INC.

Quarter Ended September 30th, 2004

DYNEX POWER INC.
Consolidated Balance Sheet
Quarter Ended September 30th, 2004

		Sept 30th 2004 (unaudited)		Dec 31st 2003 (audited)
CURRENT ASSETS				
Cash and cash equivalents	$	350,935	$	661,208
Accounts receivable		3,987,922		4,833,140
Inventories (Note 3)		9,176,047		7,888,166
Prepaid expenses and deposits		684,677		639,729
		14,199,581		14,022,243
CAPITAL ASSETS (Note 4)		716,031		840,231
	$	14,915,612	$	14,862,474
CURRENT LIABILITIES				
Accounts payable and accrued liabilities	$	7,325,813	$	5,698,044
Due to director (Note 5)		678,236		500,000
Short-term loan (Note 6)		3,234,174		3,458,309
Current portion of long-term debt (Note 7)		17,640		17,640
Current portion of deferred revenue (Note 8)		177,109		178,911
		11,432,972		9,852,904
CONTINGENCIES (Note 18)		-		-
LONG-TERM DEBT (Note 7)		-		13,230
LONG TERM DEFERRED REVENUE (Note 8)		2,213,858		2,370,566
		13,646,830		12,236,700
SHAREHOLDERS' EQUITY				
Share Capital (Note 9)		12,345,049		9,950,035
Deficit		(10,592,350)		(6,654,380)
Cumulative translation adjustment		(483,917)		(669,881)
		1,268,782		2,625,774
	$	14,915,612	$	14,862,474

DYNEX POWER INC.
Consolidated Statement of Profit and Loss (Unaudited)
Quarter Ended September 30th, 2004

	3 months Sept 30th 2004	3 months Sept 30th 2003	YTD Sept 30th 2004	YTD Sept 30th 2003
Revenue	$ **6,265,881**	$ 7,077,278	$ **18,343,087**	$ 16,660,225
Cost of sales	**5,986,473**	6,236,862	**17,087,211**	16,641,548
Gross margin	**279,408**	840,416	**1,255,876**	18,677
Expenses				
General and administration	**752,664**	1,063,837	**2,465,522**	3,403,023
Sales and marketing	**408,118**	416,141	**1,284,123**	1,197,817
Research and development	**346,354**	546,111	**1,174,734**	1,488,207
Interest expense	**63,764**	231,320	**187,187**	536,801
	1,570,900	2,257,409	**5,111,566**	6,625,848
Loss before undernoted items	**(1,291,492)**	(1,416,993)	**(3,855,690)**	(6,607,171)
Other income (expenses)				
Interest and other income	**54,581**	130,248	**170,609**	190,436
Foreign exchange loss	**(198,595)**	(48,067)	**(250,566)**	(929,020)
	(144,014)	82,181	**(79,957)**	(738,584)
(Provision for) recovery of income taxes (Note 10)				
Current	**(2,323)**	-	**(2,323)**	(3,535)
Future	**-**	-	**-**	420,190
	(2,323)	-	**(2,323)**	416,655
NET LOSS FROM CONTINUING OPERATIONS	**(1,437,829)**	(1,334,812)	**(3,937,970)**	(6,929,100)
NET EARNINGS FROM DISCONTINUED OPERATIONS (Note 11)	**-**	437,177	**-**	1,518,686
PROFIT ON DISPOSAL OF DISCONTINUED OPERATIONS	**-**	3,973,776	**-**	3,973,776
NET (LOSS) EARNINGS	**(1,437,829)**	3,076,141	**(3,937,970)**	(1,436,638)
DEFICIT, BEGINNING OF PERIOD	**(9,154,521)**	(9,080,639)	**(6,654,380)**	(4,567,860)
DEFICIT, END OF PERIOD	$ **(10,592,350)**	$ (6,004,498)	$ **(10,592,350)**	$ (6,004,498)
(Loss) per share from continuing operations				
Basic	**($0.06)**	($0.07)	**($0.18)**	($0.36)
Diluted	**($0.06)**	($0.07)	**($0.18)**	($0.36)
(Loss) earnings per share				
Basic	**($0.06)**	$0.15	**($0.18)**	($0.07)
Diluted	**($0.06)**	$0.15	**($0.18)**	($0.07)
Weighted average number of shares				
Basic	**25,238,185**	20,225,396	**22,238,163**	19,515,563
Diluted	**25,238,185**	20,540,365	**22,381,163**	19,515,563

DYNEX POWER INC.
Consolidated Statement of Cash Flow (Unaudited)
Quarter Ended September 30th, 2004

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
OPERATIONS				
Net (loss) earnings	**$ (1,437,829)**	$ 3,076,141	**$ (3,937,970)**	$ (1,436,638)
Items not affecting cash				
Amortization	**64,415**	88,787	**217,070**	268,796
Gain on disposal of capital assets	**(45,881)**	(46,225)	**(150,937)**	(112,185)
Gain on business disposals	**-**	(3,973,776)	**-**	(3,973,776)
Future income taxes	**-**	-	**-**	(420,190)
Amortization of deferred finance charges	**-**	185,000	**-**	231,000
Shares and options issued for services	**90,000**	-	**104,281**	90,000
Changes in non-cash operating working capital (Note 14)	**(1,253,723)**	(1,625,607)	**1,167,374**	(2,605,198)
	(2,583,018)	(2,295,680)	**(2,600,182)**	(7,958,191)
FINANCING				
Shares issued for cash	**2,280,233**	10,000	**2,290,733**	74,000
Decrease in due from director	**53,607**	-	**-**	-
Increase in due to shareholder	**-**	28,171	**-**	28,171
(Decrease) increase in loans from a director	**(50,764)**	(225,000)	**193,784**	500,000
Increase (decrease) in short term debt	**401,090**	(1,751,176)	**(220,144)**	(3,925,339)
(Decrease) in long-term debt	**(4,410)**	(4,410)	**(13,230)**	(2,410,467)
	2,679,756	(1,942,415)	**2,251,143**	(5,733,635)
INVESTMENTS				
Proceeds on disposal of capital assets	**-**	1,914	**11,152**	8,440,228
Purchase of capital assets	**(11,992)**	(14,853)	**(95,171)**	(48,065)
Proceeds from business diposals	**-**	4,536,717	**-**	4,536,717
	(11,992)	4,523,778	**(84,019)**	12,928,880
NET INCREASE (DECREASE) IN CASH POSITION	**84,746**	285,683	**(433,058)**	(762,946)
Effect of foreign currency translation on cash flow	**131,122**	10,332	**122,785**	723,577
Cash, beginning of period	**135,067**	791,651	**661,208**	1,127,035
CASH, END OF PERIOD	**$ 350,935**	$ 1,087,666	**$ 350,935**	$ 1,087,666
Supplementary Information:				
Interest paid	**$ 63,764**	$ 231,320	**$ 187,187**	$ 393,543
Income taxes paid during year	**$ 2,323**	-	**$ 2,323**	-

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
Quarter Ended September 30th, 2004

1. DESCRIPTION OF BUSINESS

The Corporation is engaged in the design and manufacture of industrial power equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting policies

The consolidated financial statements presented here are prepared using the same accounting policies as were used last year, details of which are set out in the Annual Report for 2003 and are in accordance with Canadian generally accepted accounting principles.

Currency of reporting

All figures are in Canadian dollars except as otherwise stated.

Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, Dynex Semiconductor Limited and Dynex SARL, in accordance with Canadian generally accepted accounting principles.

Use of accounting estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Corporation's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from the estimates made by management.

Cash and cash equivalents

Cash and cash equivalents include investments that have terms of three months or less at the time of acquisition. Cash equivalents consist primarily of term deposits. The carrying amounts of cash and cash equivalents are stated at cost plus accrued interest, which approximates their fair market value.

Inventories

Raw materials and work in process are valued at the lower of cost and replacement cost, and finished goods at the lower of cost and net realizable value. Raw materials are valued at standard cost that accurately reflects their purchase cost. Work in process and finished goods are valued at the standard cost of direct material and labour plus allocated overheads. Inventory is fully provided for if raw materials have not moved in six months and if work in progress or finished goods have not moved in three months.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital assets

Capital assets are recorded at cost. Amortization is calculated using the straight-line method over the anticipated useful lives of the assets as follows:

Equipment	3-8 years

Deferred revenue

The gain on the sale and leaseback of the land and buildings (note 8) is being amortized over the 15 year minimum term of the resulting lease.

Revenue recognition

The Corporation recognizes product revenues from sales to end-customers and to its distributors at the time of shipment provided that all significant contractual obligations, including customer acceptance, have been satisfied and collection is reasonably assured. Any potential for warranty claims is provided for at the time of sale, based on warranty terms and prior claims experience.

Foreign currency translation

The Corporation considers its wholly owned subsidiaries, Dynex Semiconductor Limited and Dynex SARL, to be self-sustaining subsidiaries and the accounts in foreign currency are translated into Canadian dollars using the current rate method of foreign currency translation. Under this method, assets and liabilities are translated at the exchange rate in effect as of the balance sheet date and income and expense items are translated at the average exchange rate for the period. Net unrealized exchange adjustments arising on translation of foreign currency are included in shareholders' equity as cumulative translation adjustment.

Research and development costs

Research costs are expensed as incurred. Expenditures for research and development equipment are capitalized. Development costs are expensed as incurred.

Income taxes

The Corporation and its subsidiaries account for income taxes using the liability method. Under this method, current income taxes are recognized for estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefits of tax losses available to be carried forward to future years if these are more likely than not to be realized.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-based compensation

The Corporation follows the CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments" which establishes standards for the recognition, measurement and disclosure of stock-based compensation. Effective January 1, 2004, these recommendations require that the Corporation account for its stock-based compensation for awards and modification subsequent to January 1, 2002 based on the fair-value method. The CICA Handbook Section 3870 requires that this change in accounting policy be implemented retroactively, however the Corporation did not have any significant stock-based compensation related to grants to employees and previously accounted for its grants to non-employees using the fair-value based method. As a result, there was no impact on the financial statements of prior periods. Any consideration paid by employees on the exercise of stock options is recorded as share capital.

Sale of Sensors business

The Corporation sold its Sensors business for cash on August 22nd, 2003. Consequently, the net earnings of the Sensors business for the period to September 30th, 2003 are reported separately after the results of the continuing operations.

3. INVENTORIES

	Sept 30th, 2004	Dec 31st, 2003
Raw materials	**$ 2,074,740**	$ 2,172,189
Work in progress	**6,018,137**	4,654,172
Finished goods	**1,083,170**	1,061,805
	$ 9,176,047	$ 7,888,166

Inventory is stated net of a provision of $10,152,062 (Dec 31st, 2003 - $11,091,929) for obsolescence.

4. CAPITAL ASSETS

	Sept 30th, 2004			Dec 31st, 2003
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Equipment	**$ 2,136,125**	**$ 1,420,094**	**$ 716,031**	$ 840,231
	$ 2,136,125	**$ 1,420,094**	**$ 716,031**	$ 840,231

5. DUE TO DIRECTOR

The Corporation has two loans payable to a director of the Corporation totalling $449,236 (Dec 31st, 2003 – $500,000) which bear interest at 8.5% per annum compounded monthly and are repayable in December 2004.

The Corporation has a third loan payable to a director of the Corporation of $229,000 (Dec 31st, 2003 - $nil) which bears interest at 9.5% per annum compounded monthly and is repayable in three equal instalments in February, March and April 2005.

6. SHORT-TERM LOAN

The Corporation has a short term loan of $3,234,174 (Dec 31st, 2003 - $3,458,309) secured by a first charge on all capital assets, inventory, cash and cash equivalents and accounts receivable. The loan is repayable on demand.

7. LONG-TERM DEBT

	Sept 30th, 2004	Dec 31st, 2003
Loan payable in monthly instalments of $1,470 to September, 2005 bearing interest at 13.7% and secured under a general security agreement.	**17,640**	30,870
	17,640	30,870
Current portion	**17,640**	17,640
	$ -	$ 13,230

Principal payments

Principal payments required in each of the next two fiscal years are:

2004	**4,410**
2005	**13,230**
	$ 17,640

8. DEFERRED REVENUE

On March 25th, 2003 the Corporation's subsidiary entered into a sale and leaseback of its Lincoln, England land and buildings. The gain realized on the sale has been deferred. Amortization of this gain, amounting to $45,881, is included in other income for the quarter ended September 30th, 2004 (Sept 30th, 2003 - $44,312).

9. SHARE CAPITAL

Authorized:
An unlimited number of common shares
An unlimited number of preferred shares issuable in series

Issued:
The Corporation's issued and outstanding share capital is as follows:

		Sept 30th, 2004	Dec 31st, 2003
Common shares	- amount	**$ 12,345,049**	$ 9,950,035
	- number	**26,579,725**	20,708,729

The Corporation has no issued and outstanding preferred shares.

Common share transactions

On July 16th, 2004 the Corporation issued 4,637,145 shares on the first closing of a private placement offer. Each share issued had one half warrant attached. Each full warrant entitles the holder to subscribe for one new share at an issue price of $0.60 at any time from the date of issue to July 15th, 2006. The issue price for each share plus attached half warrant was $0.45.

On July 16th, 2004 the Corporation issued 363,715 warrants to McFarlane Gordon as part of their compensation for arranging the private placement. Each warrant entitles McFarlane Gordon to subscribe for one new share at an issue price of $0.60 at any time from the date of issue to July 15th, 2006.

On August 9th, 2004 the Corporation issued 215,640 shares to the independent directors for their services in 2003. Of the total 81,000 were issued under the Independent Directors' Share Plan at a price of $0.28 per share. The remaining 134,640 were issued at $0.50 per share.

On August 9th, 2004 the Corporation issued 74,800 shares for cash to the Chairman, David Banks at $0.50 per share.

On August 15th, 2004 the Corporation issued 918,411 shares on the second and final closing of the private placement offer. Each share issued had one half warrant attached. Each full warrant entitles the holder to subscribe for one new share at an issue price of $0.60 at any time from the date of issue to August 14th, 2006. The issue price for each share plus attached half warrant was $0.45.

On August 15th, 2004 the Corporation issued 91,841 warrants to McFarlane Gordon as part of their compensation for arranging the private placement. Each warrant entitles McFarlane Gordon to subscribe for one new share at an issue price of $0.60 at any time from the date of issue to August 14th, 2006.

9. SHARE CAPITAL (Continued)

Stock option plan

A total of 2,650,000 (Dec 31st, 2003 - 2,650,000) of the common shares of the Corporation outstanding from time to time are reserved for the issuance of stock options pursuant to the Corporation's stock option plan. Generally, options granted under the plan vest evenly over a three-year period commencing one year from the date of grant and expire five years from the date of the grant. Options are not assignable. The movements in stock options are summarized below:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31st, 2002	1,641,000	$ 1.02
Granted	160,000	$ 0.34
Exercised	(50,000)	$ 0.20
Cancelled	(47,500)	$ 1.78
Outstanding at December 31st, 2003	1,703,500	$ 0.93
Granted	-	$ -
Exercised	(25,000)	$ 0.30
Cancelled	(203,000)	$ 0.30
Outstanding at September 30th, 2004	**1,475,500**	**$ 1.03**

The weighted average remaining life of the outstanding options is 1 year and 10 months. At September 30th, 2004 there are 1,242,167 options exercisable with a weighted average exercise price of $1.15 and a weighted average remaining life of 1 year and 8 months.

At September 30th, 2004 the following stock options are outstanding:

	Number of Options	Exercise Price	Grant Date	Expiry Date
Officers	130,000	$ 0.60	January 19, 2000	January 18, 2005
	81,000	$ 2.00	January 1, 2001	December 31, 2005
	150,000	$ 0.23	April 28, 2003	April 27, 2008
Directors who are not officers	75,000	$ 1.59	June 6, 2001	June 5, 2006
	400,000	$ 0.50	January 1, 2002	December 31, 2006
All other employees	250,000	$ 0.60	January 19, 2000	January 18, 2005
	389,500	$ 2.00	January 1, 2001	December 31, 2006
Total outstanding	1,475,500	$ 1.03		

10. INCOME TAXES

The following are components of the income tax expense (recovery) for the periods:

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
Current	**$ 2,323**	$ -	**$ 2,323**	$ 3,535
Future	**-**	-	**-**	(420,190)
	$ 2,323	$ -	**$ 2,323**	$ (416,655)

The provision for income taxes reported differs from the amount computed by applying the Canadian statutory rate to earnings before income taxes for the following reasons:

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
(Loss) before income taxes	**$ (1,435,506)**	$ (3,076,141)	**$ (3,935,647)**	$ (1,853,493)
Expected tax (recovery)	**(525,395)**	(1,125,868)	**(1,440,447)**	(678,345)
Increase (decrease) resulting from:				
Unrecorded benefit of tax loss	**525,295**	1,125,868	**1,440,447**	261,650
Foreign tax differential	**2,323**	-	**-**	-
Reported income tax expense (recovery)	**$ 2,323**	$ -	**$ 2,323**	$ (416,655)

The Canadian statutory tax rate of 36.1% (Sept 30th, 2003 - 36.6%) is comprised of Federal income tax at approximately 22.1% (Sept 30th, 2003 – 24.1%) and Provincial income tax at approximately 14% (Sept 30th, 2003 – 12.5%). The United Kingdom statutory rate is 30% (Sept 30th, 2003 – 30%)

As at September 30th, 2004 the Corporation has undeducted research and development expenditures of approximately $43,000 which are available without expiry to reduce future years' Canadian Federal and Provincial taxable income.

10. INCOME TAXES (Continued)

As at September 30th, 2004 the Corporation also has Canadian tax loss carry forwards available to reduce future years' income for tax purposes. These loss carry forwards expire as follows:

Year of expiry	Provincial	Federal
2004	**$ 160,000**	**$ 160,000**
2005	**2,000**	**2,000**
2006	**521,000**	**521,000**
2007	**424,000**	**424,000**
2008	**421,000**	**421,000**
2010	**304,000**	**304,000**

As at September 30th, 2004 the Corporation has United Kingdom tax loss carry forward of approximately $5,643,000 available to reduce future years' income for tax purposes. These tax loss carry forwards have no expiry date.

The potential future income tax benefits related to the above items have not been recorded in the financial statements.

11. NET EARNINGS FROM DISCONTINUED OPERATIONS

The following are the revenue, gross margin and net earnings figures for the discontinued operatons:

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
Revenue	**$ -**	$ 795,396	**$ -**	$ 4,189,831
Gross Margin	**-**	540,933	**-**	1,791,432
Net Earnings before and after tax	**$ -**	$ 437,177	**$ -**	$ 1,518,687

12. (LOSS) EARNINGS PER SHARE

At September 30th, 2004 the number of shares that could potentially dilute basic earnings per share in future but which were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive was 4,475,501 (Sept 30th, 2003 - 1,592,666).

13. COMMITMENTS

Minimum operating lease commitments over the next three years are as follows:

2004	**$**	**209,424**
2005		**731,984**
2006		**628,535**
	$	**1,569,943**

14. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
Accounts receivable	**$ (460,605)**	$ 432,536	**$ 875,720**	$ 2,073,041
Inventories	**(284,147)**	211,481	**(1,443,450)**	(1,276,852)
Prepaid expenses and deposits	**(3,182)**	(36,006)	**(53,183)**	(215,152)
Accounts payable and accrued liabilities	**(505,789)**	(2,233,618)	**1,788,287**	(3,186,235)
	$ (1,253,723)	$ (1,625,607)	**$ 1,167,374**	$ (2,605,198)

15. ECONOMIC SIGNIFICANCE

For the quarter ended September 30th, 2004 the Corporation had one customer that accounted for approximately 17% of revenue, one customer that accounted for approximately 15% of revenue and one customer that accounted for approximately 10% of revenue. (Sept 30th, 2003 – one customer accounting for approximately 26% of revenue).

16. FINANCIAL INSTRUMENTS

There is financial risk to the Corporation's earnings that arises from fluctuations in foreign exchange rates, and the degree of volatility of these rates. The Corporation has not used derivative instruments to hedge its exposure to foreign currency risk. The exposure to foreign currency risk is primarily limited to that of the United States Dollar, the United Kingdom Pound and the Euro.

In addition, the Corporation is exposed to credit risk from customers. The Corporation's business is mostly with large corporations and governments. The Corporation has credit evaluation, approval and monitoring processes intended to mitigate potential credit risk.

The carrying amounts for cash and cash equivalents, accounts receivable, amounts due from shareholders, accounts payable, and short-term loan approximate fair market value because of the short maturity of these instruments.

The fair value of long-term debt is determined by discounting future cash flows using rates that reflect those that the Corporation could currently obtain, on the market, for loans with similar terms, conditions and maturities. The carrying value amount of all financial instruments was similar to fair values.

17. BUSINESS SEGMENT INFORMATION

Business area

The business operates in three distinct customer areas - power devices (the design and manufacture of power semiconductors), power assemblies (the design and assembly of power devices into stacks) and integrated circuits. The customers serviced by these business areas require different marketing strategies but the product manufacturing is supported by common infrastructure at the Corporation's Lincoln, UK facility. As at September 30th, 2004 the Corporation does not segregate assets or other balance sheet accounts by business area nor does the Corporation measure operating profits by these areas. The Corporation evaluates performance and allocates resources based on revenue by business area.

17. BUSINESS SEGMENT INFORMATION (Continued)

Geographic area

The destination of sale (the location of the customer) of revenues and the location of tangible assets determine the geographic areas.

	3 months Sept 30th 2004	3 months Sept 30th 2003	**YTD Sept 30th 2004**	YTD Sept 30th 2003
Revenue:				
Business segment				
Power units	**$ 4,694,988**	$ 4,118,534	**$ 14,150,171**	$ 10,735,322
Power assemblies	**1,395,295**	2,576,306	**2,958,367**	4,607,513
Integrated Circuits	**175,598**	382,438	**1,234,549**	1,317,391
	$ 6,265,881	$ 7,077,278	**$ 18,343,087**	$ 16,660,226
Geographic area				
Europe	**$ 4,099,081**	$ 5,310,573	**$ 11,570,279**	$ 11,674,768
North America	**1,180,279**	1,282,272	**3,918,990**	3,286,196
Far East and other	**986,521**	484,433	**2,853,818**	1,699,262
	$ 6,265,881	$ 7,077,278	**$ 18,343,087**	$ 16,660,226

Capital assets

	Sept 30th, 2004	Dec 31st, 2003
Geographic area		
Europe	**$ 715,078**	$ 839,278
North America	**953**	953
	$ 716,031	$ 840,231

18. CONTINGENCIES

An action against the Corporation has been commenced in the Italian courts by a former supplier, for US$198,000 plus interest, claiming breach of contract. The Corporation believes that it may have to make a payment in order to settle this claim and has accrued the estimated amount of this liability: however, the ultimate liability may exceed the amount accrued.

18. CONTINGENCIES (Continued)

An action against the Corporation was commenced by a former consultant of the Corporation in the Ontario Superior Court of Justice on February 4th, 2002 for payment of $321,000 in respect of claimed outstanding payments. The Corporation has defended this action and believes there is a reasonable prospect of a settlement of this matter that will not have a material adverse effect on the operating results and financial condition of the Corporation. However, the outcome is not determinable at this time.

19. PENSION PLAN

The Corporation incurred expenses of $118,956 (Sept 30th, 2003 - $137,786) with respect to a defined contribution pension plan in place at Dynex Semiconductor Limited. The Corporation instigated a six-month suspension of contributions into this plan, commencing November 2001. The Corporation's stated intention is to reimburse the contribution shortfall after the six-month period, based on its financial position. At September 30th, 2004 $395,643 (Dec 31st, 2003 - $426,257) is included in accrued liabilities.

20. RELATED PARTY TRANSACTIONS

The Corporation incurred expenses of $15,833 (Sept 30th, 2003 - $22,500) with respect to fees payable to directors. As at September 30th, 2004 $60,833 is payable to directors (Dec 31st, 2003 - $90,000). The directors' fees are recorded at the negotiated amounts.

The Corporation has three loans from a director. Details of these loans are set out in Note 5.

21. SUBSEQUENT EVENTS

Subsequent to the completion of the third quarter, but prior to the release of the third quarter results, the Corporation initiated a restructuring plan involving the redundancy or termination of contracts of 40 employees, a 20% cut in salary and short time working week for indirect employees for three months and the temporary closure and downsizing of the IGBT fabrication plant. As part of the changes the structure of the UK operating company is being changed to segregate more clearly the three product groups of bipolar power discretes, power modules and power electronic assemblies.

On November 3rd, 2004 Michael LeGoff resigned as President and Chief Executive Officer. He was succeeded in these roles by Dr. Paul Taylor. He remains a director of the Corporation.

CORPORATE INFORMATION

Board of Directors

David F. Banks
Chairman

Bob Lockwood
Director, VP Finance & CFO

Debbie Weinstein *†
Director & Company Secretary

Richard Bertrand *
Director

Richard Carl †
Director

Michael A. LeGoff
Director

Daniel Owen
Director

Keith Ralls *†
Director

* Members of Audit Committee
† Members of Compensation Committee.

Senior Officers, VPs & Senior Managers

Dr. Paul D. Taylor
President, CEO & Power Modules Business Manager

Bob Lockwood
VP Finance & CFO

Mark Kempton
Bi Polar Discrete Business Manager

Bill McGhie
Power Electronic Assemblies Business Manager

Stock Exchange Listing
Toronto Ventures Exchange
Symbol: DNX

Auditors
Canada – Deloitte & Touche LLP
UK – Deloitte & Touche LLP

Legal Counsel
LaBarge Weinstein LLP, Ottawa, Ontario

Transfer Agent
Computershare Trust Company of Canada

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powerful ideas at work