

PROCYON



Message to shareholders,

November 19, 2002

We are pleased to submit this report, for our third quarter ended September 30, 2002. The quarter was highlighted by the achievement of a major milestone for the Company, namely the commencement of human clinical trials with our lead cancer product PCK3145 for the treatment of late stage prostate cancer. Significant developments also occurred with our diagnostic/prognostic test for determining the occurrence and aggressivity of prostate cancer. During the quarter we concluded our license option agreement with Chiron, leading to a mutual arrangement not to extend it. Much progress was also made in the filing of new patent applications, finalising the protocols for clinical Phase IIb trials for Fibrostat[®], our product for treatment of hypertrophic scars, and optimizing for the production of clinical grade (GMP) ANsA, our monoclonal antibody for treatment of a variety of cancers.

Procyon's synthetic peptide PCK3145 enters the clinic

During the third quarter, the Company was pleased to have its first internally developed cancer drug candidate, PCK3145, enter human clinical Phase IIa trials in the UK. The trials are being led by Professor Robert Hawkins, an eminent medical oncologist, at the Christie Cancer Research Centre in Manchester. A total of 22 patients with late stage hormone resistant prostate cancer are in the process of being enrolled. Evaluation criteria include safety to escalating doses as well as tumor response and a monitoring of a variety of tumor markers. Clinical data are expected within nine to twelve months.

Procyon and Chiron mutually agree to terminate license option

In January 2002, we announced the signing of a six month license option agreement with Chiron Corporation of California, for our PSP⁹⁴ technology. This agreement was extended for three months in July. Chiron's primary interest was in assessing the viability of using the recombinant PSP⁹⁴ in their own proprietary system. Procyon had made a decision two years ago not to pursue the recombinant PSP⁹⁴ for clinical trials, in favour of PCK3145. After a rigorous evaluation done by Chiron, Procyon and an independent researcher, Chiron determined that, although efficacy was shown in animal models, the recombinant PSP⁹⁴ did not meet their criteria for an anticancer drug within their system. Procyon's clinical program with PCK3145 continues as planned, with the human Phase IIa clinical trials program. We are also pursuing licensing discussions with companies that have expressed an interest in the peptide technology.

Continued progress on all technologies

During the third quarter, the Company continued to make progress on the finalising of the protocols for the Phase IIb clinical trials with Fibrostat[®], in collaboration with Biovail Corporation, our licensing partner for North America, as well as members of the Medical Advisory Panel for the project. The trial is expected to commence in the first half of 2003. Our lead monoclonal antibody candidate c2C5 has been undergoing optimization for GMP grade production at Goodwin Biotechnology Inc., Florida. This will enable the Company to complete the pre-clinical studies leading to an IND for commencing human clinical trials next year. During the quarter, the Company strengthened its intellectual property portfolio by filing a patent application relating to the effect of PSP⁹⁴ for treatment of cancer related hypercalcemia. We are also very pleased to report the development of a proprietary diagnostic/prognostic assay for PSP⁹⁴ measurements in blood, and have retained the services of a commercial diagnostics company to establish a fully validated test for large scale clinical evaluations of both retrospective and prospective serum samples.

Procyon was also pleased to note during the quarter the progress made by our licensing partner, IMI of Toronto, in the clinical trials for the rectal mucous-based colorectal cancer screening technology. Plans are on track to file for regulatory approval in the U.S. in 2003, and discussions are underway with potential marketing partners for commercialization of the product. Under our licensing agreement, Procyon shares the revenues with IMI, including a double-digit royalty on sales of any of the mucous-based colorectal cancer screening technology.

Signed: "Hans J. Mäder"
Chairman, President & CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read in conjunction with the Company's unaudited consolidated financial statements and related notes included herein, together with our audited consolidated financial statements for the year ended December 31, 2001 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles.

RESULTS OF OPERATIONS

Quarter ended September 30, 2002 compared with the Quarter ended September 30, 2001

The Company incurred a net loss of \$1,480,239 or \$0.03 per common share during the third quarter of 2002, compared with a net loss of \$2,668,013 or \$0.06 per common share for the corresponding quarter last year.

Revenues for the current quarter were \$126,748, compared with \$95,368 in the third quarter last year. The increased revenues resulted from an increase in interest income due to the higher level of cash and short-term investments compared to the third quarter of 2001, together with license revenue generated in the current quarter.

Research and development expenses amounted to \$1,143,673 in the third quarter of 2002, compared with \$2,156,602 in the same quarter last year, a decrease of 47%. The level of spending in the current quarter continued to be temporarily lower than in the third quarter of 2001. Clinical studies for the PSP⁹⁴ technology commenced during the third quarter of 2002 and the production of antibodies for the ANsA technology is expected to begin in the fourth quarter. Research and development spending is projected to increase materially in the fourth quarter of 2002. Tax credits increased to \$248,677 in the current quarter from \$229,000 in the same quarter last year. This was primarily due to the receipt of tax credits for prior years, following an audit by the tax authorities, which were in excess of amounts recorded. This more than offset a reduction in the amount of tax credits recorded in the current quarter compared to the third quarter of 2001 as a result of the lower expenses. Research and development expenses represented 62% of total expenses before tax credits in the current quarter, compared with 72% in the corresponding quarter last year.

General and administrative expenses decreased to \$590,657 in the third quarter of 2002, from the total of \$721,814 for the same quarter last year. The lower expenses primarily reflected the high level of spending in the third quarter of 2001 for investor relations and professional fees.

Amortization expense increased to \$121,334 from \$113,965 in the third quarter of 2001. The increase resulted primarily from the amortization on the continuing investment on intellectual property.

Nine Months ended September 30, 2002 compared with the Nine Months ended September 30, 2001

A net loss of \$4,714,424 or \$0.10 per common share was incurred in the first nine months of 2002, compared with a net loss of \$7,173,135 or \$0.16 per common share in the same period last year.

Revenues earned during the first nine months of 2002 declined to \$288,165 from the amount of \$430,230 earned in the same period last year. The reduction was the result of a decrease in interest income due to the decline in interest rates compared with the first nine months of 2001, partially offset by license revenue earned in the current period.

Research and development expenses amounted to \$3,418,196 in the first nine months of 2002, compared with \$5,516,679 in the corresponding period last year, a decrease of 38%. The higher spending during the first nine months of 2001 reflected the accelerated pace at which the Company was moving its products through the various phases of clinical trials during that period. Tax credits increased to \$617,677 in the current period from \$545,000 in the first nine months of 2001 due to the receipt of tax credits for prior years following an audit by the tax authorities. Research and development expenses comprised 61% of total expenses before tax credits for the first nine months of 2002, compared with 68% in the same period last year.

General and administrative expenses for the nine months ended September 30, 2002 amounted to \$1,839,604, a reduction of 20% from the amount of \$2,312,905 in the same period in 2001. The reduced expenses were primarily for professional fees, employee compensation and investor relations.

Amortization expense in the first nine months of 2002 amounted to \$362,466, compared with \$318,781 in the corresponding period last year. The increase reflected primarily the amortization on the additional investment on intellectual property during the past year.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents and short-term investments at September 30, 2002 amounted to \$12,957,766 compared with \$5,566,152 at December 31, 2001. The increase of \$7,391,614 resulted primarily from two major events. Cash proceeds of \$10,001,520 were realized on May 10, 2002 from the issue of Units, each comprised of one common share and one-half of a common share purchase warrant, before cash expenses of \$1,082,731 related to the transaction. An additional \$4,000,000 was generated from the issue of First Preferred Shares, Series 1 on January 4, 2002 in connection with the licensing agreement granting the United States marketing rights for FIBROSTAT[®] to Biovail Corporation. These amounts were supplemented by proceeds of \$510,860 from the issue of common shares during the period, primarily resulting from the exercise of stock options. A total of \$5,854,162 of the cash and short-term investments was utilized to finance operating activities for the nine months ended September 30, 2002, including an increase of \$1,592,204 in non-cash working capital. Expenditures on intellectual property and equipment during the first nine months of 2002 totalled \$183,873.

The cash and short-term investments on hand are expected to be sufficient to support the Company's activities for more than 18 months.

In addition to the above, the Company received an amount of \$1.5 million in October 2002 for research and development tax credits related to the year 2001.

Safe Harbour Statement

Certain matters discussed in this management's discussion and analysis of financial condition and results of operations are, by their nature, forward-looking. For a number of reasons, actual results could differ materially.

PROCYON BIOPHARMA INC.
CONSOLIDATED BALANCE SHEETS

As at	September 30, 2002 (unaudited) \$	December 31, 2001 (audited) \$
ASSETS		
Current assets		
Cash and cash equivalents	10,485,516	540,934
Short-term investments	2,472,250	5,025,218
Accounts receivable	225,211	324,922
Investment tax credits recoverable	1,735,000	1,806,064
Prepaid expenses	76,348	33,263
	14,994,325	7,730,401
Property, plant and equipment	480,822	494,103
Intellectual property	4,680,606	4,845,918
Investments	53,001	53,001
	20,208,754	13,123,423
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	334,309	1,994,153
Deferred revenue	57,900	117,950
	392,209	2,112,103
Convertible debenture	50,000	50,000
Preferred shares (note 3)	4,000,000	-
	4,442,209	2,162,103
Shareholders' equity (note 3)		
Share capital	41,971,932	33,498,087
Other paid-in capital	1,538,588	862,000
Warrants	952,903	233,687
Equity component of convertible debenture	612,500	612,500
Deficit	(29,309,378)	(24,244,954)
	15,766,545	10,961,320
	20,208,754	13,123,423

See accompanying notes

PROCYON BIOPHARMA INC.
CONSOLIDATED STATEMENTS OF
OPERATIONS AND DEFICIT
(unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2002	2001	2002	2001
	\$	\$	\$	\$
REVENUES				
License revenue	20,017	-	60,050	-
Interest and other income	106,731	95,368	228,115	430,230
	126,748	95,368	288,165	430,230
EXPENSES				
Research and development	1,143,673	2,156,602	3,418,196	5,516,679
Research and development tax credit	(248,677)	(229,000)	(617,677)	(545,000)
General and administrative	590,657	721,814	1,839,604	2,312,905
Amortization of property, plant and equipment	20,566	21,139	60,418	61,750
Amortization of intangibles	100,768	92,826	302,048	257,031
	1,606,987	2,763,381	5,002,589	7,603,365
Net loss	(1,480,239)	(2,668,013)	(4,714,424)	(7,173,135)
Adjustment to terms of outstanding warrants (note 3)	-	-	(350,000)	-
Deficit, beginning of period	(27,829,139)	(19,397,913)	(24,244,954)	(14,892,791)
Deficit, end of period	(29,309,378)	(22,065,926)	(29,309,378)	(22,065,926)
Basic and diluted loss per share	(0.03)	(0.06)	(0.10)	(0.16)
Weighted average number of common shares outstanding	52,259,036	44,769,025	48,943,336	44,115,827

See accompanying notes

PROCYON BIOPHARMA INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2002	2001	2002	2001
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss	(1,480,239)	(2,668,013)	(4,714,424)	(7,173,135)
Add non-cash items				
Amortization	121,334	113,965	362,466	318,781
Services paid by issuance of stock options (note 3)	-	-	90,000	77,000
	(1,358,905)	(2,554,048)	(4,261,958)	(6,777,354)
Net change in non-cash working capital balances related to operations	(441,483)	(311,079)	(1,592,204)	(552,911)
Cash flows related to operating activities	(1,800,388)	(2,865,127)	(5,854,162)	(7,330,265)
INVESTING ACTIVITIES				
Acquisition of intellectual property	(83,732)	(93,322)	(136,736)	(258,298)
Acquisition of property, plant and equipment	(23,220)	(15,316)	(47,137)	(86,184)
Purchase of short-term investments	(2,472,250)	(1,953,849)	(7,935,065)	(1,953,849)
Maturities of short-term investments	5,462,815	-	10,488,033	11,912,880
Cash flows related to investing activities	2,883,613	(2,062,487)	2,369,095	9,614,549
FINANCING ACTIVITIES				
Issuance of units	-	-	10,001,520	-
Unit issue expenses	(146,634)	-	(1,082,731)	-
Issuance of common shares	-	12,000	510,860	1,180,288
Share issue expenses	-	(19,158)	-	(40,350)
Issuance of preferred shares	-	-	4,000,000	-
Issuance of convertible debenture	-	43,750	-	362,500
Cash flows related to financing activities	(146,634)	36,592	13,429,649	1,502,438
Net change in cash and cash equivalents	936,591	(4,891,022)	9,944,582	3,786,722
Cash and cash equivalents, beginning of period	9,548,925	10,828,034	540,934	2,150,290
Cash and cash equivalents, end of period	10,485,516	5,937,012	10,485,516	5,937,012
Supplemental cash flow information				
Cash paid during the period for interest	-	-	-	-

See accompanying notes

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2002

(unaudited)

1. Basis of presentation

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods of application as the most recent annual financial statements, except for the changes in accounting policies described in note 2. The interim financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the most recent annual financial statements as at and for the year ended December 31, 2001.

2. Changes in accounting policies

(i) Intangible assets

Effective January 1, 2002, the Company prospectively adopted the new recommendations published by the Canadian Institute of Chartered Accountants relating to the method of valuation and the presentation and disclosure requirements for intangible assets. The new recommendations require recognized intangible assets to be amortized over their useful life to an enterprise, unless the life is determined to be indefinite. When an intangible asset is determined to have an indefinite useful life, it is not amortized until its life is determined to be no longer indefinite. The amortization method and estimate of the useful life of an intangible asset is reviewed annually. Intangible assets that are subject to amortization are tested for impairment by comparing the net carrying amount with the net recoverable amount whereas for intangible assets not subject to amortization, the net carrying amount is compared to the asset's fair value. The impact of the adoption of the new recommendations will not result in any change to the recognized intangible assets of the Company because its intangible assets are not considered to have an indefinite life. However, the Company will have additional disclosure requirements relating to its intangible assets.

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2002

(unaudited)

(ii) Stock-based compensation and other stock-based payments

Effective January 1, 2002, the Company also adopted the new CICA recommendations relating to stock-based compensation and other stock-based payments. As permitted, the Company has applied this change prospectively for new awards granted on or after January 1, 2002. The Company has chosen to recognize no compensation when stock options are granted to employees and directors under stock option plans at the prevailing market price and with no cash settlement features. However, direct awards of stock to employees and stock and stock option awards granted to non-employees are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of direct awards of stock is determined based on the quoted market price of the Company's stock and the fair value of stock options is determined using the Black-Scholes Option Pricing Model. In periods prior to January 1, 2002, the Company recognized no compensation when stock or stock options were issued to employees. Pro forma information regarding net income is required to be disclosed as if the Company had accounted for its employee stock options granted after December 31, 2001 under the fair value method. The fair value of these options is estimated at the date of grant using a Black-Scholes Option Pricing Model with assumptions for the weighted-average risk-free interest rates, dividend yields, weighted-average expected volatility of the market price of the Company's common shares and a weighted-average expected life of the options in years. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting periods on a straight-line basis.

3. Share capital

Common shares

The Company is authorized to issue an unlimited number of common shares. As at September 30, 2002, 52,411,708 common shares recorded at \$41,971,932 were issued and outstanding (45,114,008 common shares recorded at \$33,498,087 at December 31, 2001). On May 10, 2002, the Company issued 6,897,600 Units at \$1.45 each for total cash proceeds of \$10,001,520, before cash issue expenses of \$1,082,731. Each Unit consisted of one common share and one-half common share purchase warrant. Each whole common share purchase warrant entitles the holder to purchase one additional common share for \$1.75 up to November 10, 2003. Also, during the nine months ended September 30, 2002 a total of 400,100 common shares were issued for cash consideration of \$410,860 on exercise of stock options and a \$100,000 shareholder loan was repaid.

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2002

(unaudited)

Preferred shares

The Company is authorized to issue an unlimited number of non-voting First Preferred Shares and Second Preferred Shares, each without par value.

On January 4, 2002, the Company issued 4,000,000 First Preferred Shares, Series 1 for total consideration of \$4,000,000. From January 1, 2004 to December 31, 2006, the holder of these shares may elect (i) to convert them into common shares at two times the market price on the date of conversion, or (ii) to require Procyon to redeem them for cash, in which case Procyon must redeem the shares if it has received sufficient cash to do so, pursuant to a licensing agreement with the holder, and, if not, Procyon may convert such shares into common shares at the market price at the date of conversion. If no election is made prior to December 31, 2006, Procyon may redeem the shares on or prior to January 30, 2007 for cash or convert them into common shares at the market price on the date of conversion. Since these shares are retractable, they have been included with liabilities on the balance sheet.

Stock option plan

On June 5, 2002, the maximum number of common shares to be issued pursuant to the Company's stock option plan was increased to 4,545,900. As at September 30, 2002, 3,976,332 stock options were outstanding compared to 3,958,932 as at December 31, 2001. During the nine months ended September 30, 2002, 502,500 options were granted, 400,100 options were exercised and 85,000 options were forfeited. The Company applies the intrinsic value based method of accounting for stock-based compensation awards granted to employees. Accordingly, no compensation cost has been recognized for stock options granted to employees and directors. Had compensation cost been determined based on the fair value of options as of the date of grant and amortized over the vesting period of the options, the Company's net loss and loss per common share would have been amended as follows:

		Three months ended September 30, 2002	Nine months ended September 30, 2002
Net loss	As reported	\$(1,480,239)	\$(4,714,424)
	Pro forma	(1,490,084)	(4,726,535)
Earnings per share Basic and diluted	As reported	\$(0.03)	\$(0.10)
	Pro forma	(0.03)	(0.10)

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2002

(unaudited)

Warrants

As at September 30, 2002, there were 8,919,425 common shares reserved for issuance upon the exercise of warrants, compared to 5,470,625 at December 31, 2001. The increase of 3,448,800 resulted from the issue of 6,897,600 Units discussed under "Common shares" above, each of which included one-half of a common share purchase warrant. On April 5, 2002, the Company amended the terms of the common share purchase warrants issued on July 31, 2000 to lower the exercise price to \$2.62 per common share from \$3.93 per common share and to extend the time up to which the warrants may be exercised until April 10, 2003. As a result of these amendments, other paid-in capital was increased by \$350,000, with an offsetting charge to the deficit.

Other paid-in capital

As at September 30, 2002, other paid-in capital amounted to \$1,538,588, compared to \$862,000 at December 31, 2001. On April 5, 2002, the terms of the common share purchase warrants issued on July 31, 2000 were amended, resulting in an increase of \$350,000 in other paid-in capital. The fair value of the broker warrants associated with the issue of Units on May 10, 2002 amounted to \$236,588, while the fair value of stock options granted to a consultant on June 17, 2002 was \$90,000.

4. Comparative figures

Certain comparative figures have been reclassified to conform to the presentation in the current period.

5. Subsequent events

On October 18, 2002, the Company and Chiron Corporation mutually agreed not to extend the license option agreement on the Company's Prostate Secretory Protein (PSP⁹⁴) technology for the treatment of prostate cancer. As a result, the Company is no longer committed to an exclusive option and can out-license the technology to another party.