



Dear friends and shareholders:

August 10, 2005

We are pleased to submit this report on the results for the second quarter ended June 30, 2005. While the development of our existing programs, PCK3145 and PPL-100 progresses, the second quarter of 2005 marked the successful completion of the acquisition of Bioxalis Medica Inc., a Montreal-based biopharmaceutical company committed to the discovery and development of targeted liposomes for cancer treatment. This acquisition was accompanied by a concurrent financing of \$3.5 million and brings into Procyon's oncology pipeline a very innovative and promising anti-cancer technology, TVT-Dox.

ONCOLOGY UPDATE

TVT-Dox - An asset to Procyon's oncology pipeline

TVT-Dox is a Tumor Vasculature Targeting technology that can be used to treat cancer patients by selectively destroying blood vessels that feed the tumor and are involved in metastases but not in normal tissues. Research to date has shown TVT-Dox to be a very potent anti-tumor agent, with seven-out-of-seven positive results in animal models and six-out-of-six positive results with human tumor biopsies. Preclinical studies are to be initiated with the intent to file an Investigational New Drug (IND) application within the next 12 months.

PCK3145 - As effective when administrated once a week

During the second quarter of 2005, we were pleased to report the first results of an amendment/continuation to the UK Phase IIa study for our therapeutic peptide PCK3145 for the treatment of advanced metastatic prostate cancer. This amendment/continuation was conducted in order to evaluate the feasibility of a less frequent dosing regime than the three times per week used in the original study. The first results were very positive in this regard, as they showed PCK3145 to be as effective when administrated once a week. This is a tremendous step forward, as it implies the need for less frequent visits by patients to the hospital and offers a more acceptable administration option to these patients for the future.

Our efforts and progress in cancer development were recognized this quarter when we received the 2005 Frost & Sullivan Award for excellence in technology in the field of emerging cancer therapies.

Colopath[®]/ColorectAlert[™] - Nearing commercialization

Procyon's licensing partner, IMI International Medical Innovations Inc., announced that members of the U.S. National Cancer Institute's Early Detection Research Network's (EDRN) and the Great Lakes-New England Clinical Epidemiology Center Consortium will include ColorectAlert[™] in a major colorectal cancer clinical trial. This 600-patient study is expected to support ColorectAlert[™]'s effectiveness as a tool for the early detection of colorectal cancer. This event is a significant step forward in the continued development of Colopath[®]/ColorectAlert[™]. In 2001, Procyon licensed out to IMI the worldwide rights to Colopath[®], its colorectal cancer rectal mucus-based test. The terms of the agreement include upfront and milestone payments as well as a royalty on sales of any rectal mucus-based screen test for colorectal cancer.

VIROLOGY UPDATE

Presentation of PPL-100 at two major HIV conferences

During the second quarter of 2005, Procyon presented the first pharmacokinetics results obtained with PPL-100, our phosphorylated pro-drug of its protease inhibitor, PL-100 at the 6th International Workshop on Clinical Pharmacology of HIV Therapy and the XIV International HIV Drug Resistance Workshop, both held in Quebec City. Work continues towards the development of PPL-100 as a once daily drug that does not require ritonavir boosting.

CORPORATE UPDATE

The second quarter of 2005 saw a very successful Procyon Oncology and HIV symposium that was held in New York City and at which Procyon's PCK3145 and PPL-100 programs were presented to members of the United States financial and investment community. I would like to take this opportunity to thank also our external collaborators Dr. Howard Scher, Dr. Richard Béliveau and Dr. Mark Wainberg for their participation and contribution to this event.

In line with the new guidelines for effective corporate governance both in Canada and the United States, I stepped down as Chairman of the Board and my recommendation to have Dr. Max Link take my place was unanimously accepted by the Directors. Dr. Link, a non-management director of Procyon since 1999, will have the responsibility to oversee that the Board discharges its responsibilities.

In conclusion, Procyon again successfully integrated another very promising company and technology with a concurrent financing. Procyon continues to strive to become an even more prominent player in the Canadian biotechnology industry, building value through the growth and diversification of its product pipeline.

The second quarter of 2005 closed with our AGM, at which I was pleased to be able to meet many of you in person. I thank you for your continued support.

A handwritten signature in black ink, appearing to read 'H. J. Mäder', written in a cursive style.

Hans J. Mäder
President & Chief Executive Officer

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, 2004 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts shown are stated in Canadian dollars. This review was prepared by management from information available to July 29, 2005. Additional information relating to the Company, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

On June 29, 2005 the Company acquired 100% of the outstanding shares of Bioxalis Medica Inc. ("Bioxalis") for a purchase price, including acquisition expenses of \$3,580,500. In a concurrent transaction, a total of \$3,500,000, before cash expenses estimated at \$316,000, was obtained from the sale, by a private placement, of unsecured convertible debentures maturing on June 29, 2010. The debentures are convertible into common shares of Procyon at \$0.45 per share and pay interest at 7% in cash or common shares, at the Company's option. Purchasers of the debentures also received warrants to purchase 3,888,889 common shares of Procyon at \$0.50 per share to June 29, 2010.

FORWARD LOOKING STATEMENTS

Some of the statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements. These statements relate to future events or to Procyon's future financial performance and involve known and unknown risks, uncertainties and other factors that may cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

OVERVIEW

Procyon Biopharma Inc. is a publicly-traded Canadian biotechnology company actively engaged in the discovery and development of innovative products in the fields of oncology and infectious diseases. The Company brings its technologies from the laboratory to the clinical trials and licenses them to larger pharmaceutical partners for further development and commercialization. Procyon receives from licensee partners upfront and milestone payments, as well as royalty revenues upon commercialization.

Procyon's products and technologies are steadily advancing from research through development, preclinical and clinical studies. As a result, Procyon is developing a balanced pipeline of both mid- and late-stage products. The lead oncology candidate, PCK3145, is a non-toxic therapeutic agent for the treatment of advanced metastatic prostate cancer that will soon commence Phase IIb clinical trials. The virology candidate, PPL-100, is a next-generation protease inhibitor for the treatment of drug-resistant HIV/AIDS for which the preclinical stages of development are nearing completion prior to filing an Investigational New Drug (IND/CTA) submission during the second half of 2005. Procyon's product portfolio also comprises PL-2500, an integrase inhibitor that addresses a novel mechanism of action for the treatment of HIV/AIDS. Through the acquisition of Bioxalis, the Company acquired TVT-Dox, a tumor vascular targeting technology for the treatment of solid tumors for which an IND is expected within 12 months. The Company also has two out-licensed diagnostic candidates: PSP94 immunoassays, a reliable, quick-and-easy test kit to detect and monitor prostate cancer licensed out to Medicorp Inc. and Colopath[®], a simple screening and monitoring test for colorectal cancer licensed out to IMI International Medical Innovations Inc.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. The reported amounts and note disclosures in the consolidated financial statements are determined using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action. Actual results, however, may differ from the estimates used in the consolidated financial statements and such differences could be material. Details of our critical

accounting estimates were reported in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2004 and these continue to apply for the quarter ended June 30, 2005.

RESULTS OF OPERATIONS

Quarter ended June 30, 2005 compared with the Quarter ended June 30, 2004

The Company incurred a net loss of \$3,218,901 or \$0.04 per common share for the second quarter of 2005, compared with a net loss of \$4,689,259 or \$0.06 per common share for the same quarter last year.

The Company has incurred substantial losses since its inception, due primarily to its expenditures for research and development activities. It expects to incur further losses during the next several years resulting from the continuation of its clinical trials and pre-clinical development activities.

Revenues

Revenues for the second quarter of 2005 were \$88,661, compared with \$101,801 in the corresponding quarter last year. The lower revenues resulted from a decrease in interest income, due to the reduced level of cash and short-term investments on hand, partially offset by an increase in interest rates in the current quarter compared to the second quarter of 2004.

Procyon has not generated any significant revenues from product sales since 1997. Throughout these years, revenues have been earned primarily from research and development tax credits and from interest on available cash balances. We expect to continue to receive such revenues during the next several years, as well as licensing or collaborative research revenues as our products are out-licensed or partnered.

Research and Development Expenses

Research and development expenses amounted to \$2,164,532 in the second quarter of 2005, compared with \$3,688,384 in the same quarter last year. The corporate restructuring plan successfully implemented in January 2005 resulted in the refocusing of the Company's research spending and generated cost savings. These were only partially offset by increased expenditures on PPL-100. Tax credits decreased to \$246,000 in the current quarter from \$402,000 in the corresponding quarter last year, due to the lower level of expenses in the current quarter. Research and development expenses represented 64% of total expenses before tax credits and write-down of intellectual property in the current quarter, compared with 71% in the corresponding quarter last year.

Our research and development expenses consist primarily of salaries and related personnel costs, fees paid to external service providers, laboratory supplies and costs for leasing of facilities and equipment. In the second quarter of 2005, fees paid to external service providers were primarily related to pre-clinical costs for PPL-100 and PCK3145 clinical trial costs.

We expect our research and development expenses to continue to be significant during the next few years as we continue our clinical trials for our more advanced products, while continuing to advance our other research programs. However, we are unable to estimate the specific timing and future costs of our research programs.

General and Administrative Expenses

General and administrative expenses amounted to \$828,231 in the second quarter of 2005, a decrease of \$330,450 or 29% from the total of \$1,158,681 for the second quarter last year. A decrease in non-cash expenses resulting from stock options and lower consulting fees were the principal reasons for the reduction in expenses.

Other Expenses

Amortization expense decreased to \$211,369 from \$267,054 in the second quarter of 2004. The decrease resulted primarily from the write-off in December 2004 of the carrying value of the Anti-Nucleosome Antibodies (ANsA) technology.

The interest expense on the Biolevier loan increased to \$174,330 from \$87,529 in the same quarter last year. The increase was due to the additional interest resulting from the drawdown of an additional \$4,000,000 under the loan facility in December 2004. The interest on the Biolevier loan is being capitalized and added to the outstanding balance of the loan.

On January 18, 2005, the Company announced the preliminary results of its North American Phase IIb clinical trial for Fibrostat[®], which did not meet expected results. Although Fibrostat[®] was safe and well tolerated, the primary endpoint of efficacy was not reached. As a consequence, the Company had to reevaluate the future of this program and has now decided to discontinue any further development. Consequently, the carrying value of the related intellectual property amounting to \$179,698 was written off in the current quarter.

Six Months ended June 30, 2005 compared with the Six Months ended June 30, 2004

A net loss of \$6,294,104 or \$0.07 per common share was incurred during the six months ended June 30, 2005, compared with a net loss of \$7,728,534 or \$0.10 per common share for the six months ended June 30, 2004.

Revenues of \$174,736 were earned in the first half of 2005, compared with \$165,480 in the same period last year. The increase was primarily the result of higher interest income due to improved average interest rates.

Research and development expenses for the six months ended June 30, 2005 were \$4,307,649, compared with \$5,935,017 in the corresponding period last year. The corporate restructuring plan successfully implemented in January 2005 resulted in the refocusing of the Company's research spending and generated cost savings, which more than offset the increased expenditures on PPL-100. Tax credits decreased to \$576,000 in the first half of 2005, from \$695,000 in the same period last year, reflecting the lower level of research and development expenses. Research and development expenses represented 64% of total expenses before tax credits, restructuring charges and write-down of intellectual property in the current period, compared with 69% in the corresponding period last year.

General and administrative expenses amounted to \$1,622,061 in the first half of 2005, a decrease of \$338,920 or 17% from the total of \$1,960,981 for the corresponding period last year. The reduction was primarily due to lower non-cash compensation relating to stock options and a decrease in consulting fees.

Amortization expense decreased to \$421,596 from \$533,238 in the same period last year. The reduction resulted primarily from the write-off in December 2004 of the carrying value of the Anti-Nucleosome Antibodies (ANsA) technology.

Interest on the Biolevier loan increased to \$343,686 from \$180,063 in the first half of 2004. The increased interest resulted from the drawdown of an additional \$4,000,000 under the loan facility in December 2004.

On January 26, 2005, the Company announced that it had implemented a corporate restructuring plan. The costs associated with the restructuring amounted to \$172,279.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations and its acquisitions of technology and capital assets primarily through private placements and public issues of common shares, scientific research investment tax credits, interest income and amounts received under licensing agreements for certain of its products. In addition, a loan agreement entered into in December 2002 expanded the Company's financing base by providing it with a loan facility of \$10 million obtained under the Biolevier program of the Government of Quebec, from which an amount of \$9 million has been drawn to-date, leaving an amount of \$1 million available for future use.

Cash and cash equivalents and short-term investments totaled \$13,130,243 at June 30, 2005, compared with \$15,720,424 at December 31, 2004. The decrease of \$2,590,181 resulted from the utilization of \$6,018,915 to finance operating activities for the first half of 2005, including an increase of \$923,848 in non-cash working capital. In addition, a net amount of \$123,021 was used in the period for additional property, plant and equipment and intellectual property. In addition, expenses of \$20,000 were incurred in connection with the acquisition of Bioxalis on June 29, 2005 on a share exchange basis, while the concurrent convertible debenture financing generated \$3,500,000, before cash expenses, which are estimated at \$316,000, of which \$38,481 was paid during the first half of 2005. An additional amount of \$5,575 was paid for debt financing costs relating to the second drawdown on the Biolevier facility. Cash of \$253,311 was obtained with the acquisition, with \$137,500 being used to pay down a Bioxalis loan. The remaining balance of \$137,500 on the loan was repaid in July 2005.

The Biolevier loan does not adversely impact the Company's liquidity at this time, as no capital or interest is repayable prior to November 19, 2006.

Including the balance of \$1 million still available from the Biolevier loan facility referred to above and the 2004 investment tax credits expected to be received in the fourth quarter of 2005, the Company has approximately \$15 million to support its future activities. Management believes that these funds will be sufficient to support the Company's ongoing activities for at least the next 16 months.

SIGNIFICANT PROJECTS

Each of our product candidates, which were discussed in the Overview section, will have to complete the necessary phases of clinical trials and obtain regulatory approval before they can generate significant revenues. The costs to complete these clinical trials and to obtain regulatory approval are significant and the costs associated with this process are expected to continue to be significant over the next several years. These costs are expected to be borne to some extent by various corporate partners under research collaboration and licensing agreements.

SEGMENTED INFORMATION

The Company operates in only one segment, which is the sector related to the development and commercialization of diagnostic and therapeutic drugs. All revenues were earned in Canada, most operations are carried out in Canada and all assets are located in Canada.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

A summary of the Company's contractual obligations as at December 31, 2004 was disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2004. The amount of these contractual obligations increased during the quarter ended June 30, 2005 as a result of the Bioxalis acquisition and concurrent financing. The contractual obligations from these transactions are as follows:

(in thousands of dollars)	Payments due by period				Total
	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	
Convertible debentures			1,992	Note 1	1,992
Obligations under licensing agreement	215	322	54	Note 2	591

Notes:

1. The amount of \$1,992,000 represents the liability component of the \$3,500,000 convertible debenture financing.
2. Payments totaling approximately \$1 million related to the TVT-Dox technology obtained through the Bioxalis acquisition are contingent upon the achievement of certain milestones, commencing only when the technology reaches Phase II clinical trials. These are not included above. Also, a minimum annual royalty of approximately \$27,000 per year has been included for 5 years only.

Other than in the normal course of business, the Company has not entered into any other off-balance sheet arrangements during the quarter ended June 30, 2005 and does not expect to enter into any in the near future. There were no commitments for capital expenditures as at June 30, 2005

RELATED PARTY TRANSACTIONS

There has been no material change during the quarter ended June 30, 2005.

PROPOSED TRANSACTIONS

The Company continually reviews opportunities for mergers and acquisitions that could increase shareholder value. At the present time, the Company has not entered into any signed definitive agreements involving the acquisition or disposition by the Company of assets or businesses.

CHANGES IN ACCOUNTING POLICIES

Accounting guideline 15 – Consolidation of variable interest entities came into effect for annual and interim periods beginning on or after November 1, 2004. Management is of the opinion that this new accounting guideline had no effect on the Company's results for the quarter ended June 30, 2005.

FINANCIAL INSTRUMENTS

The Company does not use currency or other hedging instruments.

OUTSTANDING SHARE DATA

As of July 29, 2005 there are 4,000,000 First Preferred Shares, Series 1 outstanding, unchanged from December 31, 2004. The number of common shares outstanding as of July 29, 2005 is 94,153,899, an increase of 9,000,000 from December 31, 2004, resulting from the acquisition of Bioxalis . The number of stock options outstanding at July 29, 2005 is 4,388,707, a decrease of 540,654 from December 31, 2004. In addition, 18,654,743 warrants are outstanding on July 29, 2005, compared to 16,924,315 at December 31, 2004. The increase resulted from the issue on June 29, 2005 of 1,000,000 warrants for the acquisition of shares of Bioxalis and 3,988,889 warrants related to the concurrent financing, including 100,000 broker warrants, partly offset by the expiry without value on April 17, 2005 of 3,258,461 warrants issued through a private placement on April 17, 2003.

RISKS AND UNCERTAINTIES

The Company's activities involve a number of risks and uncertainties that are generally experienced by the biotechnology industry. The future viability of Procyon depends upon its ability to successfully develop its technologies and products, to enter into licensing agreements and to obtain the regulatory approvals necessary to allow the products to be marketed.

The Company can make no assurance that its products will be developed successfully or receive regulatory approval. The new products of the Company are currently in the research and development stages. The Company can make no assurance that its research and development programs will result in commercially viable products. To achieve profitable operation, the Company, alone or with others, must successfully develop and market its products. To obtain regulatory approvals for the products being developed, clinical trials must demonstrate efficacy and that the products are safe for human use. Unsatisfactory results obtained from a particular study relating to a program may cause the Company or its collaborators to abandon its commitment to that program. The Company can make no assurance that any future animal or human test will yield favourable results.

The Company can make no assurance that products based on its technology, if approved for marketing, will achieve market acceptance. The degree of market acceptance will depend on the efficacy and safety of the product candidates, their potential advantage over alternative products and treatment method. The lack of such market acceptance would have a material adverse effect on the Company's business and financial condition.

To develop its technologies, the Company requires significant investment of financial resources. Consequently, the ability of the Company to obtain the cash needed to finance its operations is fundamental to its future success and therefore constitutes a business risk.

With regard to the concentration of credit risk, investment tax credits recoverable are due from the Québec government. The cash and cash equivalents are comprised of cash held with a Canadian chartered bank and a discount note and bankers' acceptances of four major banks. The short-term investments are held in a discount note and a banker's acceptance.

Certain matters discussed in this report are, by their nature, forward-looking and are subject to risks and other factors that are wholly or partially beyond the control of the Company's management. Consequently, actual results could differ materially.

PROCYON BIOPHARMA INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

As at

	June 30,	December 31,
	2005	2004
	\$	\$
ASSETS		
Current assets		
Cash and cash equivalents	9,660,238	319,382
Short-term investments	3,470,005	15,401,042
Accounts receivable	255,636	271,973
Investment tax credits recoverable	1,697,921	685,000
Prepaid expenses	193,674	110,320
	15,277,474	16,787,717
Property, plant and equipment	727,816	808,504
Intellectual property	8,377,264	5,180,795
Deferred financing fees	1,052,615	909,500
	25,435,169	23,686,516
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	1,581,843	1,066,787
Loan payable	137,500	-
	1,719,343	1,066,787
Biolevier loan facility	9,761,079	9,417,393
Convertible debentures [note 4]	2,041,500	50,000
Preferred shares	4,000,000	4,000,000
	17,521,922	14,534,180
Shareholders' equity [note 5]		
Share capital	64,881,900	61,461,900
Warrants	2,955,360	2,904,038
Contributed surplus	4,657,548	3,995,794
Equity component of convertible debentures	1,926,939	1,005,000
Deficit	(66,508,500)	(60,214,396)
	7,913,247	9,152,336
	25,435,169	23,686,516

Commitments and guarantees [note 6]

See accompanying notes

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
	\$	\$	\$	\$
REVENUES				
License revenue	-	-	-	9,617
Interest and other income	88,661	101,801	174,736	155,863
	88,661	101,801	174,736	165,480
EXPENSES				
Research and development	2,164,532	3,688,384	4,307,649	5,935,017
Research and development tax credit	(246,000)	(402,000)	(576,000)	(695,000)
Net research and development	1,918,532	3,286,384	3,731,649	5,240,017
General and administrative	828,231	1,158,681	1,622,061	1,960,981
Amortization of property, plant and equipment	61,161	77,252	122,133	153,782
Amortization of intellectual property	124,575	173,210	248,196	346,271
Amortization of deferred financing fees	25,633	16,592	51,267	33,185
Interest on Biolevier loan	174,330	87,529	343,686	180,063
Restructuring charges	-	-	172,279	-
Financial charges	2,662	1,338	4,092	2,729
Foreign exchange gains	(7,260)	(9,926)	(6,221)	(23,014)
	3,127,864	4,791,060	6,289,142	7,894,014
Loss before write-down of intellectual property	(3,039,203)	(4,689,259)	(6,114,406)	(7,728,534)
Write-down of carrying value of intellectual property [note 2]	179,698	-	179,698	-
Net loss	(3,218,901)	(4,689,259)	(6,294,104)	(7,728,534)
Deficit, beginning of period	(63,289,599)	(45,230,615)	(60,214,396)	(42,191,340)
Deficit, end of period	(66,508,500)	(49,919,874)	(66,508,500)	(49,919,874)
Basic and diluted loss per share	(0.04)	(0.06)	(0.07)	(0.10)
Weighted average number of common shares outstanding	85,275,365	83,462,700	85,126,878	75,381,744

See accompanying notes

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss	(3,218,901)	(4,689,259)	(6,294,104)	(7,728,534)
Add non-cash items				
Amortization of property, plant and equipment	61,161	77,252	122,133	153,782
Amortization of intellectual property	124,575	173,210	248,196	346,271
Amortization of deferred financing fees	25,633	16,592	51,267	33,185
Write-down of carrying value of intellectual property [note 2]	179,698	-	179,698	-
Write-down of investments	-	-	-	7,001
Loan interest capitalized	174,330	87,529	343,686	180,063
Non-cash license revenues	-	-	-	(4,417)
Services paid by issuance of stock options [note 5]	142,666	300,690	254,057	361,609
	(2,510,838)	(4,033,986)	(5,095,067)	(6,651,040)
Net change in non-cash balances relating to operations	(146,964)	(352,570)	(923,848)	(1,136,273)
Cash flows related to operating activities	(2,657,802)	(4,386,556)	(6,018,915)	(7,787,313)
INVESTING ACTIVITIES				
Acquisition of intellectual property	(41,697)	(5,281)	(123,541)	(8,243)
Acquisition of property, plant and equipment	(5,960)	(39,096)	(10,633)	(63,515)
Proceeds on disposal of property, plant and equipment	11,153	-	11,153	-
Cash and cash equivalents obtained on acquisition of business	253,311	-	253,311	-
Business acquisition expenses	(20,000)	-	(20,000)	-
Purchase of short-term investments	(3,470,005)	(4,400,000)	(3,470,005)	(4,400,000)
Maturities of short-term investments	9,657,568	5,938,210	15,401,042	9,440,494
Cash flows related to investing activities	6,384,370	1,493,833	12,041,327	4,968,736
FINANCING ACTIVITIES				
Issuance of units	-	17,250,000	-	17,250,000
Unit issue expenses	-	(1,593,154)	-	(1,593,154)
Issuance of common shares	-	-	-	83,310
Debt financing costs	(38,481)	-	(44,056)	-
Repayment of debt assumed in an acquisition	(137,500)	(1,206)	(137,500)	(3,824)
Issuance of convertible debentures [note 4]	3,500,000	330,000	3,500,000	330,000
Cash flows related to financing activities	3,324,019	15,985,640	3,318,444	16,066,332
Net increase in cash and cash equivalents	7,050,587	13,092,917	9,340,856	13,247,755
Cash and cash equivalents, beginning of period	2,609,651	631,511	319,382	476,673
Cash and cash equivalents, end of period	9,660,238	13,724,428	9,660,238	13,724,428
Supplemental cash flow information				
Cash paid during the period for interest	347	56	347	2,837

See accompanying notes

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(unaudited)

1. Basis of presentation

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to interim financial statements and follow the same accounting policies and methods of application as the most recent annual financial statements. 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, 2004.

2. Corporate Restructuring

On January 18, 2005, the Company announced the preliminary results of its North American Phase IIb clinical trial for Fibrostat[®], which did not meet expected results. Shortly after, on January 26, 2005, the Company announced that it had implemented a corporate restructuring plan aimed at shifting its focus from an early-stage research company to a late-stage drug development company. The restructuring resulted in the closure of three of the Company's research laboratories and the termination of 14 of its 42 employees, mainly in research and administrative support functions. The costs associated with the restructuring amounted to \$172,279. The Company decided, following a review of alternatives, to discontinue further development of Fibrostat[®]. Consequently, the carrying value of the related intellectual property amounting to \$179,698 was written off effective June 30, 2005.

3. Business acquisition

Effective June 29, 2005, the Company acquired 100% of the outstanding shares of Bioxalis Medica Inc. ("Bioxalis"), a Montreal-based biopharmaceutical company committed to the discovery and development of targeted liposomes for cancer treatment in exchange for 9,000,000 common shares of Procyon valued at \$3,420,000, based on the closing share price on June 28, 2005, and warrants to purchase an additional 1,000,000 common shares, plus estimated acquisition costs of \$160,500. The warrants will vest only upon the filing of an IND for TVT-Dox, the lead product of Bioxalis, on or before March 15, 2007 and will be exercisable within 24 months of such filing at the average price of the Company's common shares on the Toronto Stock Exchange for the five trading days preceding their vesting date. As a result, the value of this contingent consideration is not readily determinable and has not been included as part of the consideration. The impact of these warrants on the consideration, if any, will be recorded when their value can be determined. The acquisition has been accounted for using the purchase method at fair value. The results of operations of Bioxalis have been consolidated with the accounts of the Company since the date of acquisition.

The allocation of the purchase price is as follows:

	\$
Cash and cash equivalents	253,311
Accounts receivable	57,916
Investment tax credits recoverable	436,921
Property, plant and equipment	41,965
Intellectual property	3,500,822
Total assets acquired	4,290,935
Accounts payable and accrued liabilities	435,435
Loan payable	275,000
Total liabilities assumed	710,435
Net assets acquired	3,580,500
Consideration represented by:	
Cash and accrued liabilities	160,500
Share capital [note 5]	3,420,000
	3,580,500

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Of the assets acquired, \$3,500,822 was assigned to purchased patents and intellectual property. This intellectual property is being amortized over a fifteen-year period.

The loan payable of \$275,000 above was collateralized by investment tax credits recoverable. An amount of \$137,500 was repaid on June 29, 2005, immediately following the closing of the acquisition of Bioxalis and the balance was repaid on July 8, 2005.

4. Convertible debentures

On June 29, 2005, concurrent to the acquisition of Bioxalis, the Company completed a \$3,500,000 financing by way of a private placement of convertible debentures maturing on June 29, 2010. The \$1,000 nominal value unsecured debentures bear interest at an annual rate of 7%, payable semi-annually in cash or common shares at Procyon's option, and are convertible, in whole or in part, into common shares of Procyon at a price of \$0.45 per share. Purchasers of the convertible debentures also received warrants to purchase 50% of the number of common shares that would be issued if the debentures were fully converted. Each full warrant is exercisable at a price of \$0.50 per share at any time to June 29, 2010. In the event of a change in control of in excess of 60% of the voting securities of the Company, as defined in the agreement, the holders of the debentures may elect, within 30 days of receipt of notice of change in control, to redeem in cash, including accrued interest, at a redemption price equal to 110% of the principal amount of the debentures.

Of the total amount of the financing, \$1,991,500 is included in liabilities, \$1,018,500 is recorded as the equity component of the convertible debenture and \$490,000 is estimated to be the value of the warrants, determined using the Black-Scholes option pricing model with a volatility of 70%, a risk-free interest rate of 3.3%, a dividend yield of nil and an expected life of five years. The liability component will be accreted over time by a charge to the statement of operations for imputed interest and at maturity will be equal to the face value of the debentures. In addition to a cash commission paid on a portion of the financing and other issue costs totaling \$316,349, the Company granted to the underwriter warrants to purchase 66,667 common shares at \$0.45 per share and 33,333 common shares at \$0.50 per share, all of which are exercisable at any time to June 29, 2007. These compensation warrants have a fair value estimated at \$15,475, determined using the Black-Scholes option pricing model with a volatility of 84%, a risk-free interest rate of 2.9%, a dividend yield of nil and an expected life of two years.

5. Share capital

Common shares

The Company is authorized to issue an unlimited number of common shares.

	Number of shares	Stated capital
		\$
Balance as at December 31, 2004	85,153,899	61,461,900
Issued in exchange for shares of Bioxalis	9,000,000	3,420,000
Balance as at June 30, 2005	94,153,899	64,881,900

On June 29, 2005, the Company issued 9,000,000 common shares in exchange for 100% of the outstanding shares of Bioxalis and warrants to purchase an additional 1,000,000 common shares.

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Stock option plan

On June 30, 2005, the Company's stock option plan was amended to provide that the maximum number of common shares to be issued upon the exercise of options granted under the Plan will be equal to 10% of the number of issued and outstanding common shares at the time of grant. As at June 30, 2005, there were 4,406,207 stock options outstanding, compared to 4,929,361 at December 31, 2004.

	Six months ended June 30,		2004	
	2005	Weighted Average Exercise price	Number	Weighted Average Exercise price
	Number	\$		\$
Options outstanding January 1	4,929,361	0.83	3,638,500	1.25
Granted	345,000	0.42	1,723,750	0.99
Forfeited	(478,154)	0.90	(245,000)	1.86
Expired	(390,000)	1.17	-	-
Exercised	-	-	(90,500)	0.92
Options outstanding June 30	4,406,207	0.76	5,026,750	1.14
Exercisable	2,951,193	0.75	3,605,501	1.25

All options were granted with an exercise price equal to the market price of the Company's shares at the date of grant. Compensation expense of \$190,123 has been recognized in the first half of 2005 for stock options granted to employees and directors and an additional amount of \$63,934 has been expensed for options granted to consultants. The expense was based on the fair value of the options at the date of grant determined using the Black-Scholes option pricing model with a volatility factor of from 67% to 88%, a risk-free interest rate of from 3% to 4%, a dividend yield of nil and an expected life of up to five years.

Effective January 1, 2003, the Company began prospectively recording compensation expense for awards granted to employees. In 2002, the fair value of options granted to employees was not expensed. Had compensation expense for 2002 been determined based on the fair value of options as of the date of grant using the Black-Scholes option pricing model, with a volatility factor of 63%, a risk-free interest rate of 4%, a dividend yield of nil and a weighted-average expected life of the options of three years, and had the fair value been amortized over the vesting period of the options, the Company's net loss and loss per common share in 2004 would have been as follows:

	Three months	Six months
	ended June 30	ended June 30
	2004	2004
	\$	\$
Net loss – as reported	(4,689,259)	(7,728,534)
Net loss – pro forma	(4,702,011)	(7,756,304)
Loss per share – basic and diluted		
As reported	(0.06)	(0.10)
Pro forma	(0.06)	(0.10)

All options granted in 2002 would have been fully vested by December 31, 2004. Consequently, results for periods after 2004 would not be affected.

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Warrants

	Number	\$
Balance as at December 31, 2004	16,924,315	2,904,038
Issued in connection with Bioxalis acquisition	1,000,000	-
Issued in connection with convertible debenture issue (note 4)	3,888,889	490,000
Issuance costs	-	(46,456)
Broker warrants for convertible debenture issue (note 4)	100,000	-
Expired warrants – Private placement April 17, 2003	(3,258,461)	(392,222)
<u>Balance as at June 30, 2005</u>	<u>18,654,743</u>	<u>2,955,360</u>

In total, 2,575,845 warrants have not yet vested and will vest only upon the achievement of certain milestones.

Contributed surplus

	\$
Balance as at December 31, 2004	3,995,794
Compensation warrants issued	15,475
Warrants expired	392,222
Options issued to consultants	63,934
Options granted to employees and directors	190,123
<u>Balance as at June 30, 2005</u>	<u>4,657,548</u>

The fair value of options granted to employees and directors since January 1, 2003 is being recorded as an expense over their vesting period, with a corresponding credit to Contributed Surplus.

6. Commitments and guarantees

The Company is committed under a licensing agreement undertaken by Bioxalis for payments totaling approximately \$1 million that are contingent upon achieving certain milestones, commencing only when the technology reaches Phase II clinical trials, as well as other payments of approximately \$360,000 for research work and a minimum annual royalty of approximately \$27,000 per year.

7. Comparative figures

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

