



PROCYON BIOPHARMA INC.

04 ANNUAL REPORT

CANCER AND
HIV/AIDS
THERAPEUTICS
NEXT STAGE • LATE STAGE

2004 milestones

PCK3145 THERAPEUTIC PEPTIDE

- ▶ Completed PCK3145 phase IIa trial and disclosed results at the 2004 American Society of Clinical Oncology (ASCO) meeting
- ▶ Published anti-metastatic proof-of-concept data in *Cancer Research*
- ▶ Reported new data on the mode-of-action as an anti-metastatic agent
- ▶ Filed an Investigational New Drug (IND) application for Phase IIb clinical studies to be spearheaded by Memorial Sloan Kettering Cancer Center

PPL-100 PROTEASE INHIBITOR

- ▶ Received a ninth US patent on compounds with HIV protease inhibitory activity
- ▶ Presented PPL-100's unique resistance profile at the XIIIth International HIV Drug Resistance Workshop in Spain
- ▶ Developed a pro-drug with better solubility and bioavailability

FIBROSTAT®

- ▶ Completed Fibrostat® phase IIb multi-center trial and disclosed results shortly following year-end
- ▶ Presented new data on mode-of-action at three major dermatology meetings

OTHER

- ▶ Developed and tested three assays for PSP94 tumor marker

CORPORATE

- ▶ Closed a \$17.25 million financing
- ▶ Obtained research coverage from Loewen, Ondaatje, McCutcheon (LOM) and National Bank Financial (NBF)
- ▶ Received two prestigious awards at 2004 Genesis Ceremony
- ▶ Presented at more than 10 major healthcare conferences

2005 milestones

PCK3145 THERAPEUTIC PEPTIDE

- ▶ Elucidation of mode-of-action with receptor identification
- ▶ Completion of pilot study for dose administration regimen
- ▶ Initiation of Phase IIb multi-center clinical trial

PPL-100 PROTEASE INHIBITOR

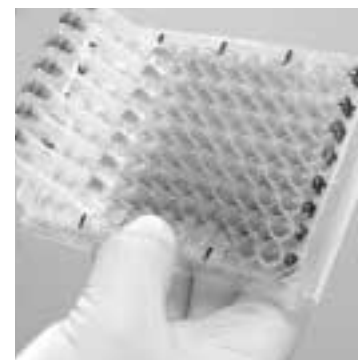
- ▶ Disclosure of resistance and pharmacokinetic profiles
- ▶ Filing of IND/CTA followed by initiation of Phase I clinical trial

FIBROSTAT®

- ▶ Assessment of different options to potentially study the prevention of excessive scarring as well as other therapeutic indications

OTHER

- ▶ Licensing-out of PSP94-based test kits for prostate cancer



Dear friends and shareholders:

It is with great pleasure that I report on Procyon's achievements and activities for the fiscal year 2004. This past year has allowed us to grow on all fronts while advancing our main products to new stages of development.

Fiscal 2004 was also marked by the attainment of major corporate as well as scientific milestones in our two areas of expertise, oncology and HIV/AIDS. Needless to say, these achievements have strengthened our Company and we shall soon reap the benefits of our hard work.

As is often the case with R&D-based companies, we experienced a set-back following year-end with one of our products, Fibrostat®. Nonetheless, the Company needed to face this situation responsibly in order to maximize shareholder value in the short to medium term and we therefore decided to implement a corporate restructuring plan aimed at shifting our focus from an early-stage research company to a late-stage drug development company. Consequently, we will now direct most of our efforts at conducting clinical trials with our lead drug candidates, namely: PCK3145, for advanced metastatic prostate cancer, and PPL-100, a pro-drug of our protease inhibitor, PL-100, for drug-resistant HIV/AIDS; while assessing new therapeutic indications for Fibrostat®.

PCK3145 • SUCCESSFUL COMPLETION OF PCK3145 PHASE IIa TRIAL

We were proud to report the final positive results from our Phase IIa clinical trial with PCK3145 at the 2004 American Society of Clinical Oncology (ASCO) Meeting held last June in New Orleans. The final Phase IIa results confirm the safety, tolerability and the preliminary efficacy of PCK3145 at all dose levels tested. At the time of completion of the study, seven patients had stable disease and one patient showed a partial response after two cycles of treatment.

The most dramatic and unexpected results were shown in the plasma levels of matrix metalloproteinase-9 (MMP-9), a gelatinase B enzyme involved in extracellular matrix degradation and tumor invasion (metastasis). A normalization of the levels was observed in all patients with elevated MMP-9 levels at baseline, while no significant change was observed after the first cycle in patients with normal baseline MMP-9 levels. Research to date suggests that PCK3145 shows a potential dual effect by restoring normal cell growth through inducing apoptosis and inhibiting the metastatic process through regulating MMP-9 levels.

This new and very promising finding was further confirmed by our external collaborators who achieved tremendous progress in determining the dual mode-of-action of PCK3145. First, Procyon along with McGill University collaborators under the supervision of Dr. Shafaat Rabbani published in *Cancer Research* preclinical findings that demonstrate the efficacy of PCK3145 in reducing tumor volume and delaying the development of skeletal metastases in an animal model of prostate cancer. Second, recent work on the mode-of-action of PCK3145 under the supervision of Dr. Richard Béliveau, of the Hôpital Sainte-Justine and Université du Québec à Montréal, indicates that PCK3145 interferes in a "hit-and-run" manner with Vascular Endothelial Growth Factor (VEGF) signaling pathway which is critical to angiogenesis and subsequent metastasis. As primary tumors cannot expand without a blood supply to provide nutrients, the inhibition of angiogenesis, i.e. the formation of new blood vessels, could lead to the reduction of tumor growth and metastasis. These findings suggest utility in treating other cancer types where MMP-9 levels are also altered.

Finally, in December we filed an Investigational New Drug application (IND) with the United States Food and Drug Administration (FDA) in order to initiate a pilot trial followed by a North American Phase IIb clinical trial. Both studies will be conducted under the supervision of principal investigators Susan F. Slovin, M.D., Ph.D., and Howard I. Scher, M.D., at the Memorial Sloan-Kettering Cancer Center in New York. The primary objective of the randomized pilot trial is to confirm an optimal dosing frequency, since our "hit-and-run" mode-of-action suggests that the drug could be administered once-weekly. We expect to complete the pilot trial during the third quarter of 2005 and thereafter initiate a North American Phase IIb trial to assess the efficacy of PCK3145 and its effect on tumor invasion and metastasis.

The final Phase IIa results confirm the safety, tolerability and the preliminary efficacy of PCK3145 at all dose levels tested.

PPL-100 • EN ROUTE TO THE CLINIC

PPL-100 is a pro-drug of the protease inhibitor, PL-100, for drug-resistant HIV/AIDS that we acquired with Pharmacor in April 2003. PPL-100 has a unique resistance profile which we were pleased to present at the prestigious XIIIth International HIV Drug Resistance Workshop in Spain, in June. To date, PPL-100 has shown in vitro antiviral activity superior to currently-marketed protease inhibitors when tested against 63 HIV strains that have shown resistance to six available protease inhibitors as well as two other compounds currently in clinical studies by pharmaceutical companies. This indicates the potential for good activity against existing protease inhibitor-resistant viruses in treatment-experienced patients or in those patients newly-infected with similar resistant strains.

An ideal HIV protease inhibitor drug candidate needs to show a broad cross-resistance profile, minimal or no toxicity, good oral bioavailability, ease of synthesis and have excellent patent protection. Bioavailability remains a challenge for the protease inhibitor class. During Fiscal 2004, we achieved significant progress in developing PPL-100, a pro-drug of PL-100. PPL-100 is much more soluble as well as more bioavailable than PL-100. This pro-drug of PL-100 presents the same favorable resistance profile as the original molecule acquired from Pharmacor. However, the higher solubility and bioavailability of the pro-drug would reduce the pill burden of the candidate drug, a desired attribute for protease inhibitors. HIV/AIDS patients are treated with drug cocktails with high pill burden, often leading to patient compliance problems. The higher bioavailability and other properties of PPL-100 could potentially lead to use of a lower concentration of ritonavir as a boosting agent, which is an important characteristic of protease inhibitors favored by physicians.

We are currently conducting pharmacokinetic studies on PPL-100 and other preclinical work on this compound is nearing completion. We expect to bring the candidate to the clinic in the second half of 2005.

During the year, we also received a ninth US patent covering a series of novel small molecules that demonstrate inhibitory activity against the HIV aspartyl protease and the whole virus in cell cultures. As new protease inhibitors are constantly needed due to the resistance issue in HIV/AIDS, Procyon's objective is to build a significant library of compounds in order to develop additional protease inhibitors in the near future.

FIBROSTAT® • DEVELOPMENT ON HOLD

As reported in January 2005, the results of the Phase IIb trial with Fibrostat® indicated that although Fibrostat® was safe and well tolerated, the primary endpoint of efficacy was not reached. The North American placebo-controlled, double-blind, randomized Phase IIb clinical trial with Fibrostat® was conducted throughout the year 2004 and results were announced shortly following year-end.

During the later stages of the study, we discovered through research conducted by our academic collaborators that a major mode-of-action of Fibrostat® was to block the formation of excessive collagen cross linking. It is this excess that leads to the rope-like aspect so typical of hypertrophic scarring. If the cross linking can be prevented at an early-stage, the development of hypertrophic scars could be reduced, or perhaps entirely prevented.

Procyon along with its North American partner, Biovail Corporation, will assess the different future options to potentially study the prevention aspect of the drug candidate as well as its therapeutic effect in other undisclosed indications.

NEXT STAGE • LATE-STAGE

Following large-scale production challenges with the lead candidate c2C5 derived from the Anti-Nucleosome Antibodies (ANsA) technology, the Company completed both an intensive internal review and an external due diligence to determine whether the products resulting from the ANsA platform justify continued preclinical and clinical development. The conclusion of the due diligence was a recommendation to pursue the program. However, before doing so, it was recommended to establish further proof-of-concept and also verify the reproducibility of the preclinical data already available. Subsequent validation of critical preclinical in vitro and in vivo experiments performed under GLP and GMP conditions unfortunately showed little to no evidence of anticancer activity. As a result in January 2005, Procyon made the decision to discontinue any further activities pertaining to the ANsA program.

In order to provide sufficient funds for our ongoing and upcoming clinical trials, we closed during the second quarter of 2004 a 15,000,000 Units offering at a price of \$1.00 per Unit. The exercise in full of the underwriters' over-allotment option brought the total gross proceeds of the financing to \$17,250,000. The offering was made through a syndicate of underwriters led by Dundee Securities Corporation that included Canaccord Capital Corporation, Loewen, Ondaatje, McCutcheon Limited and Research Capital Corporation.

This financing, along with our recent restructuring, will allow us to deliver our anticipated milestones for 2005, which include the elucidation of PCK3145's complete mode-of-action and receptor identification and the confirmation of its dosing regimen, followed shortly by the main Phase IIb trial; the disclosure of PPL-100 pharmacokinetic and resistance profiles and the initiation of its Phase I trial; and the out-licensing of our PSP94-based test kits for prostate cancer.

Finally, I wish to welcome Jinzi J. Wu, Ph.D., our new Vice-President, Preclinical and Basic Research and Judith Cohn, MD, Ph.D., our new Vice-President, Clinical Research and Regulatory Affairs. I have always believed that one of Procyon's strongest assets has been having a dynamic team that combines solid experience from the pharmaceutical and biotechnology sectors. This was confirmed at the 2004 Genesis Ceremony where Procyon received two prestigious awards. The Company collected the "Entrepreneurship - Biotechnology-Biopharmaceutical" award, a tribute from the Fonds de Solidarité de la FTQ, while I was personally honored with the "Brio" award, a tribute from the Royal Bank of Canada.

I wish to thank our distinguished Board of Directors, shareholders, employees and friends for your support and confidence.

Best regards,

(Signed) Hans J. Mäder

Hans J. Mäder

I have always believed that one of Procyon's strongest assets has been having a dynamic team that combines solid experience from the pharmaceutical and biotechnology sectors. This was confirmed at the 2004 Genesis Ceremony where Procyon received two prestigious awards.

PCK3145 THERAPEUTIC PEPTIDE

INDICATION	Advanced metastatic prostate cancer
DEVELOPMENT STATUS	Clinical Pilot study underway to be followed by Phase IIb in US and Canada
PATENTS	World granted for protein applications World pending for peptide and analogues
US PATIENT POPULATION*	Prevalence: ~ 2,000,000 Incidence: 230,000 Deaths: 30,000
POTENTIAL WORLDWIDE REVENUES TO PARTNER	CA\$ 1.6 billion annually Procyon to receive a royalty on this figure
PARTNER	Discussions ongoing

*American Cancer Society, Cancer Facts and Figures, 2004

Mode-of-action

PCK3145 is a synthetic 15-mer peptide that is derived from the natural sequence of amino acids of the prostate secretory protein (PSP94). PSP94 is one of three predominant proteins found in human seminal fluid along with prostate specific antigen (PSA) and prostatic acid phosphatase (PAP). Research to date shows that PCK3145 appears to have a dual mode-of-action by reducing tumor size through apoptosis and preventing and reducing the metastatic process through the regulation of Matrix Metalloproteinase-9 (MMP-9) levels. Recent studies conducted on PCK3145 show that the drug candidate interferes with Vascular Endothelial Growth Factor (VEGF) signaling pathway which is critical to angiogenesis and subsequent metastasis.

Progress

In 2004, Procyon reported the final positive results from a multiple ascending dose, open-label, Phase IIa with PCK3145. The study included 4 cohorts of 4 patients with Metastatic Hormone-Refractory Prostate Cancer; each to receive respectively 5, 20, 40 and 80 mg/m², of the drug intravenously, 3 times a week for 4 weeks followed by a 7-day observation period. The trial was conducted at the Christie Hospital NHS Trust, Manchester, UK, under the supervision of Principal Investigator Professor Robert Hawkins.

Final Phase IIa results confirm the safety, tolerability and the preliminary efficacy of PCK3145 at all dose levels tested. At the time of the completion of the study, seven patients had stable disease and one patient showed a partial response after two cycles of treatment. Preliminary efficacy was also shown, while a substantial reduction in levels of MMP-9, a gelatinase B enzyme involved in extracellular matrix degradation and tumor invasion (metastasis), was observed in all patients with elevated MMP-9 levels at baseline. No significant change was observed after the first cycle in patients with normal baseline MMP-9 levels. The pharmacokinetic analysis showed that the half-life of the peptide drug ranged from 1.2 to 2.7 hours.

In light of these results, Procyon in collaboration with Dr. Shafaat Rabbani, Professor, Department of Medicine, Physiology and Oncology, McGill University conducted further preclinical work which showed that treatment with PCK3145 resulted in a significant dose-dependent decrease in tumor volume. At the same time, bone histomorphometry indicated that following intracardial inoculation of tumor cells, treatment with the drug at 100 ug/kg/day resulted in a marked decrease (<50%) in tumor/bone volume ratio after ten days of treatment. This proof-of-concept study was published in the August issue of *Cancer Research*. Finally, in collaboration with Dr. Richard Béliveau, Director, Laboratory of Molecular Medicine, Hôpital Sainte-Justine and Université du Québec à Montréal, Procyon discovered that PCK3145 interferes with Vascular Endothelial Growth Factor (VEGF) signaling pathway which is critical to angiogenesis and subsequent metastasis.

In December, the Company filed an Investigational New Drug application (IND) with the United States Food and Drug Administration (FDA) in order to initiate a pilot trial followed by a North American Phase IIb clinical trial, with PCK3145.

Both studies will be conducted under the supervision of principal investigators Susan F. Slovin, M.D., Ph.D., and Howard I. Scher, M.D., at the Memorial Sloan-Kettering Cancer Center in New York. The primary objective of the randomized pilot trial is to confirm an optimal dosing frequency for PCK3145 which can reduce and normalize MMP-9 levels in asymptomatic patients with castrate metastatic prostate cancer and the Company expects to complete the pilot trial during the third quarter of 2005. The objective of the North American Phase IIb trial will be to assess the efficacy of PCK3145 and its effects on tumor invasion and metastasis.



Judith Cohn, Ph.D., M.D.
Vice-President,
Clinical Research and Regulatory Affairs

PPL-100 PROTEASE INHIBITOR

INDICATION	HIV/AIDS
DEVELOPMENT STATUS	IND submission in Q3 2005
PATENTS	US granted and World pending
US PATIENT POPULATION*	Prevalence: ~ 1,000,000 Incidence: 44,000 Deaths: 16,000
POTENTIAL WORLDWIDE REVENUES TO PARTNER	CA\$ 870 million annually Procyon to receive a royalty on this figure
PARTNER	Discussions ongoing

*WHO/UNAIDS, AIDS Epidemic Update, 2004

Mode-of-action

PPL-100 is Procyon's lead protease inhibitor which shows potent anti-protease and antiviral activity against wild-type HIV-1 and has a favorable cross-resistance profile as compared to currently-marketed protease inhibitors, namely: amprenavir (APV), atazanavir (ATV), indinavir (IDV), lopinavir (LPV), nelfinavir (NFV), and saquinavir (SQV). This indicates the potential for good activity against existing protease inhibitor-resistant viruses in treatment-experienced patients or in those patients newly-infected with similar resistant strains.

Progress

In 2004, Procyon's scientists developed a pro-drug of PL-100 now known as PPL-100. This new pro-drug is much more soluble and is more bioavailable than the original PL-100 while it presents the same favorable resistance and potential toxicity profiles as PL-100. However, higher solubility and bioavailability of the drug will reduce the pill burden of the candidate drug, a desired attribute of protease inhibitors. HIV/AIDS patients are treated with drug cocktails with high pill burden which often lead to patient compliance problems. Pharmacokinetic studies on PPL-100 are currently ongoing.

In June 2004, Procyon was invited to present the favorable resistance profile of PPL-100 at the XIIIth International HIV Drug Resistance Workshop, in Spain. The presentation described its unique resistance profile as assessed by *in vitro* susceptibility testing with a reporter-gene based phenotypic assay in comparison with currently-marketed protease inhibitors. The tests were conducted independently by ViroLogics Inc. of California.

On average, PPL-100 showed better cross-resistance profile than the approved protease inhibitors tested. To date, PPL-100 has been tested against 63 HIV resistant strains. The selected viral strains were challenged with PPL-100 and its back-up compound, PL-337, as well as the commercially available protease inhibitors, amprenavir, indinavir, lopinavir, nelfinavir, saquinavir, and the recently available atazanavir. In addition, the viral strains selected for the study also contained important resistant mutations for two other compounds currently in clinical studies by pharmaceutical companies. Many of these strains were found to be susceptible to both PPL-100 and PL-337. Both median and mean fold-change in EC50 for PPL-100 were significantly lower than the marketed protease inhibitors tested.

Professor Mark A. Wainberg, Ph.D., Chair of Procyon's Virology Scientific Advisory Board and Director, McGill University AIDS Center; has also made important contributions to the study of the antiviral activity and resistance profile of PPL-100, which is scheduled to enter Phase I studies in healthy subjects in the second half of 2005.

Finally, Procyon was granted a ninth US patent covering a series of novel small molecules that demonstrate inhibitory activity against the HIV aspartyl protease and the whole virus in cell cultures. As new protease inhibitors are constantly needed due to the resistance issue in HIV/AIDS, Procyon's objective is to build a significant library of compounds in order to develop additional protease inhibitors in the near future.



Chandra J. Panchal, M.Sc., Ph.D.
Senior Executive Vice-President,
New Technologies



Jinzi J. Wu, Ph.D.
Vice-President,
Preclinical and Basic Research

OTHER PROMISING VIROLOGY CANDIDATE

PL-2500 Integrase inhibitor

As more people develop resistance to protease inhibitors, nucleoside reverse transcriptase inhibitors and non-nucleoside reverse transcriptase inhibitors, other therapeutic options become indispensable. The integrase enzyme is a complex protein that inserts HIV genetic material into the human DNA. This process is necessary for viral infectivity and replication. If the insertion of pro-viral DNA into the host genome is prevented by an integrase inhibitor, then the virus cannot replicate. Procyon's anti-integrase program is based on a family of molecules containing hydroxyphenyl derivatives, aromatic derivatives and pyridoxal phosphate derivatives which have shown activity in enzymatic assays on HIV replication in cell culture.

PL-2500, a pyridoxal-5-phosphate derivative, has emerged as a lead compound that shows high activity against the integrase enzyme and HIV in cell culture. Screening tests have further shown PL-2500 to inhibit integrase activity as well as HIV reproduction in cells without overt cellular toxicity. This program is currently on hold, but activities for a PL-2500 derived product are expected to be reinitiated once PPL-100 is in the clinic and additional basic research resources become available.

OUT-LICENSED ONCOLOGY CANDIDATES

PSP94-based test kits for prostate cancer

There is a continued need to identify new and more reliable diagnostic and prognostic markers for prostate cancer that are more accurate than the existing tests. Procyon has developed new simple blood tests that specifically measure the free PSP94 and the total PSP94 as well as the PSP94 binding protein. The determination of the ratio of these forms and the binding protein is believed to have utility for the diagnosis, prognosis and monitoring of prostate cancer. Procyon's PSP94-based test kits were shown to differentiate between patients with prostate cancer and patients with benign conditions among patients who underwent a prostate biopsy as well as to identify patients suffering from a more aggressive disease.

Following year-end, Procyon entered into a licensing and distribution agreement with Medicorp Inc. granting the latter the exclusive worldwide rights to manufacture and commercialize PSP94-based test kits for research purposes as well as the rights to sub-license for clinical diagnostic applications. Under the terms of the agreement, Procyon and Medicorp will share the revenues generated from the sales of these test kits. Additionally, there will also be a sharing of revenues from upfront, milestone and/or royalty payments from sub-licenses in clinical diagnostic applications. Medicorp will cover all future costs associated with the further development, manufacturing and commercialization of these test kits. Medicorp expects to begin to market the test kits for research purposes in Canada and the United States during the second quarter of 2005. It also plans to start marketing the kits via distributors in Europe and Japan during the fourth quarter of 2005.

Colopath®/ColorectAlert™ for colorectal cancer

Early detection is a key to reducing mortality from colorectal cancer. Colopath®/ColorectAlert™ is a highly sensitive and minimally invasive screening and monitoring test for colorectal cancer. Colopath® screens for a phospholipid analyte (plasmalogen) in rectal mucus of individuals with colorectal pathology, whereas ColorectAlert™ screens for the T-antigen, a complex sugar in rectal mucus. The Colopath®/ColorectAlert™ test involves the application of a rectal mucus sample to a test strip and a positive/negative result is based on a Schiff's aldehyde reaction.

Procyon has entered into a licensing agreement with IMI International Medical Innovations Inc. granting IMI the worldwide exclusive license to develop, market and distribute an optimal colorectal cancer screening technology arising from both Colopath® and ColorectAlert™ in exchange for upfront and milestones payments as well as a royalty on revenues of any rectal mucus-based diagnostic test for colorectal cancer. Further clinical studies to evaluate the applicability of Colopath®/ColorectAlert™ to low-risk population are planned in preparation for an application with the FDA within the next 12 to 24 months.



Daniel C. Böck, Ph.D.
Vice-President,
Business Development and Licensing

The following discussion and analysis should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2004 and the related notes therein, 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 as at February 18, 2005. Additional information relating to the Company, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

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 AND OUTLOOK FOR 2005

Procyon Biopharma Inc. is a publicly-traded Canadian biotechnology company actively engaged in the development of innovative therapeutics in the fields of oncology and HIV/AIDS. The Company leverages its strengths in clinical research and development, bringing products through mid- to late-stage clinical trials and then evaluating the best options for further development, such as partnerships and licensing. Procyon's pipeline includes: PCK3145, a non-toxic peptide for advanced metastatic prostate cancer; PPL-100, a protease inhibitor for drug-resistant HIV/AIDS; and Fibrostat[®], a topical cream for the management of hypertrophic scars and other potential indications. The Company is also developing a medical device, PSP94 immunoassays, a reliable, quick-and-easy test kit to detect and monitor prostate cancer, and has out-licensed Colopath[®], a simple screening and monitoring test for colorectal cancer; to IMI International Medical Innovations Inc.

PCK3145 Therapeutic peptide

In June 2004, Procyon reported the final positive results from its Phase IIa clinical trial with PCK3145 at the 2004 American Society of Clinical Oncology (ASCO) Meeting. These results confirm the safety, tolerability and the preliminary efficacy of PCK3145 at all dose levels tested. The most significant and unexpected results were shown in the normalization of plasma levels of matrix metalloproteinase-9 (MMP-9), a gelatinase B enzyme involved in extracellular matrix degradation and tumor invasion (metastasis). This suggests that PCK3145 shows a potential dual effect by restoring normal cell growth through inducing apoptosis and inhibiting the metastatic process through regulating MMP-9 levels.

In light of these findings, Procyon and its external collaborators achieved significant progress in determining the dual mode-of-action of PCK3145. First, Procyon demonstrated the efficacy of PCK3145 in reducing tumor volume and delaying the development of skeletal metastases in an animal model of prostate cancer. Second, the Company showed that PCK3145 interferes in a "hit-and-run" manner with Vascular Endothelial Growth Factor (VEGF) signaling pathway which is critical to angiogenesis and subsequent metastasis. In December 2004, Procyon filed an Investigational New Drug application (IND) with the United States Food and Drug Administration (FDA) in order to initiate in early 2005 a pilot trial followed by a North American Phase IIb clinical trial in the United States and Canada.

PPL-100 Protease inhibitor

During 2004, the Company also achieved significant progress with the preclinical development of PPL-100, a pro-drug of the HIV protease inhibitor, PL-100. This more soluble as well as more bioavailable version of PL-100 should reduce the pill burden of the candidate drug, a desired attribute for protease inhibitors, as HIV/AIDS patients often face compliance problems. To date, PPL-100 has shown in vitro antiviral activity superior to currently-marketed protease inhibitors when tested against 63 HIV strains that have shown resistance to six available protease inhibitors as well as two other protease inhibitors currently in clinical studies by pharmaceutical companies. This indicates the potential for good activity against existing protease inhibitor-resistant viruses in treatment-experienced patients or in those patients newly-infected with similar resistant strains. The Company is currently completing preclinical work and expects to file an Investigational New Drug (IND/CTA) submission during the second half of 2005 in order to commence a human clinical Phase I trial shortly thereafter.

Fibrostat[®]

Following year-end, Procyon announced that its Phase IIb trial with Fibrostat[®] did not reach its efficacy endpoint. During the later stages of the North American placebo-controlled, double-blind, randomized Phase IIb clinical trial, Procyon discovered through research conducted by its academic collaborators that a major mode-of-action of Fibrostat[®] was to block the formation of excessive collagen cross linking. It is this excess that leads to the rope-like aspect so typical of hypertrophic scarring. If the cross linking can be prevented at an early-stage, the development of hypertrophic scars could be reduced, or perhaps entirely prevented.

Procyon is currently assessing different options to potentially study the prevention aspect of the drug candidate as well as its therapeutic effect in other undisclosed indications.



Monique Létourneau, M.Sc., CFA
Executive Vice-President,
Finance and Chief Financial Officer

Restructuring

Following the announcement of the disappointing Fibrostat® results, the Company has undertaken to substantially reduce its anticipated burn-rate to approximately \$850,000 per month for the fiscal year 2005. The corporate restructuring plan aims at shifting its focus from an early-stage research company to a late-stage drug development company. It has resulted in the closing down of three of its five basic research laboratories as well as the immediate termination of 14 of its 42 employees, mainly in the basic research and administrative support functions, and the cancellation of 2004 bonus payments to employees. Consequently, all efforts in 2005 are aimed at progressing through the clinic its lead drug candidates, PCK3145 and PPL-100, as well as assessing the potential utility of Fibrostat® in other indications.

Financing

On the financial front, during the second quarter of 2004 Procyon closed a 17,250,000 Units offering at a price of \$1.00 per Unit, for total gross proceeds of \$17,250,000. Each Unit consisted of one common share and one-half common share purchase warrant. Each purchase warrant entitles the holder to purchase one additional common share at \$1.25 up to April 7, 2006. In addition, in December 2004 an additional drawdown of \$4,000,000 was made on the loan facility of \$10,000,000 obtained in December 2002 under the Biolevier program of the Government of Québec. An initial drawdown of \$5,000,000 was made in 2003, leaving a balance of \$1,000,000 currently available on the facility.

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 our ongoing clinical trials and preclinical development activities.

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 the more critical estimates used are as follows:

Research and development expenses

The Company incurred research and development expenditures that are eligible for investment tax credits. The investment tax credits, which are recorded as a reduction of research and development expenses, amounted to \$1,157,869 in 2004 (2003 - \$1,332,062) and are based on management's estimates of amounts that will be recovered. However, these amounts are subject to audit by taxation authorities. Management considers that the amounts recorded have been conservatively estimated.

Impairment of long-lived assets


When the carrying value of a long-lived asset is less than its net recoverable value as determined on an undiscounted basis, an impairment loss is recognized. The impairment loss is recognized to the extent that the asset's fair value measured on a discounted expected cash flow basis over its life is below its carrying value. Management must estimate the cash flows that can be derived from the Company's long-lived assets to assess impairment. Based on management's evaluation of the net recoverable value of its long-lived assets, no impairment losses were recognized in 2003. However, as discussed under "Results of Operations" below, a write-down of \$1,625,915 was taken in 2004 on the carrying value of the Company's Anti-Nucleosome Antibodies (ANsA) technology, following a decision to discontinue research activities on that technology.

Stock-based compensation

The Company also makes accounting estimates of the fair value of stock options granted to employees, directors and consultants and of warrants issued to purchase common shares of the Company. Management is required to make estimates of volatility, expected life and dividend yield. As at December 31, 2004, a total of 4,929,361 stock options were outstanding, of which 2,797,440 were exercisable at that date. Also, 16,924,315 common shares were reserved for issuance on the exercise of warrants. The warrants, net of issue costs, were recorded at \$2,904,038.

Valuation allowance for future tax assets

A valuation allowance has been recorded on future tax assets primarily related to operating losses and research and development expense carry forwards. We have assumed that the related tax benefits are not likely to be realized, based on the Company's historical results and estimated future taxable income and tax planning strategies. The implementation of tax planning strategies or the generation of future taxable income could result in the recognition of some portion or all of these carry forwards as soon as the Company has a history of net income, which could result in a material increase in the results of operations through the recovery of future income taxes.



Richard La Rue, L.L.L., D.D.N.
Vice-President,
Legal Affairs, Human Resources and Corporate Secretary

RESULTS OF OPERATIONS

Year ended December 31, 2004 compared with the year ended December 31, 2003

The net loss for the year ended December 31, 2004 amounted to \$18,023,056 or \$0.23 per common share, compared with a net loss of \$10,719,002 or \$0.17 per common share for the year ended December 31, 2003. The increase in the net loss was primarily due to increased spending on research and development, including the full-year effect of the acquisition of Pharmacor Inc. on April 17, 2003, together with the write-down of \$1.6 million in the carrying value of intellectual property resulting from the Company's decision to discontinue research activities related to its ANSA technology.

Revenues

Revenues for 2004 were \$334,473, compared with \$303,976 in 2003. The higher level of revenues in 2004 reflected the increase in interest income generated in 2004 as a result of higher average levels of cash, which more than offset the effect of lower interest rates. License revenue earned was lower in 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 interest on available cash balances. We expect to continue to receive such revenues during the next several years, as well as licensing revenues to be earned as our products advance through clinical development.

Research and development expenses

Gross research and development expenses for 2004 amounted to \$12,709,113, compared with \$8,060,427 in 2003. The increase of \$4,648,686 or 58% over 2003 reflected the high level of spending in the year, including increases of \$2.2 million on Fibrostat®, with the Phase IIb North American clinical trial initiated in June 2003 ongoing through 2004, \$1.7 million on PPL-100 preclinical activities, and \$0.7 million for PCK3145, for which a Phase IIa clinical trial was completed in June 2004. Research and development tax credits were lower in 2004 at \$1,157,869, compared with \$1,332,062 in 2003. The full-year effect of a reduction in Québec research and development tax credits effective June 12, 2003 was a factor in the reduction, as was the lower proportion of Québec-based research spending. Research and development expenses represented 71% of total expenses before tax credits and the write-down of carrying value of intellectual property, compared with 65% in 2003.

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 2004, fees paid to external service providers were primarily related to the Phase IIb clinical trial for Fibrostat®, the Phase IIa trial for PCK3145 and preclinical costs for PPL-100.

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 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 for 2004 were \$3,776,224, an increase of \$411,522 or 12% over the total of \$3,364,702 in 2003. The increase resulted from a non-cash expense of \$0.6 million relating to the fair value of stock options granted to employees and directors.

Amortization expense

Amortization expense amounted to \$1,118,378 in 2004, compared with \$895,721 in 2003. The increase reflected primarily the full-year effect of the added amortization from the Pharmacor acquisition, together with the amortization of deferred financing fees relating to the Biolevier loan.

Write-down of intellectual property

A write-down of \$1,625,915 was recorded in 2004 as a result of the Company's decision to discontinue research activities related to its ANSA technology. Although the Company intends to either dispose of or out-license the technology, the proceeds to be obtained cannot be estimated at this time. Consequently, the net book value of the technology at December 31, 2004 has been written off.

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. 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 Québec. As at December 31, 2004, \$9 million has been drawn against this facility.



Brian L. Davies, CA
Director, Finance and Controller

The net loss during the past eight quarters has fluctuated primarily in line with the level of research and development expenses during each of those quarters. The first quarter of 2003 immediately preceded the acquisition by the Company of Pharmacor Inc. in April 2003 and expenses were consequently lower than in subsequent periods. In the second quarter of 2004, research and development expenses were higher due primarily to the expenses associated with the clinical trial with Fibrostat[®], while in the fourth quarter of 2004 the increased loss resulted primarily from higher research and development expenses related to the PCK3145 Phase IIa clinical trial and to preclinical work on PPL-100, our protease inhibitor for the treatment of drug-resistant HIV/AIDS, together with the \$1.6 million write-down of the carrying value of the Company's ANsA technology.

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

A summary of the Company's contractual obligations as at December 31, 2004 is as follows:

(in thousands of dollars)	Payments due by period				Total
	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	
Operating leases	183	149	152	51	535
Biolevier loan facility	–	①	①	①	9,417
Convertible debenture	–	-	-	50	50
Preferred shares	②	②	②	②	4,000
Royalty obligations	10	20	20	③	50
Obligations under consulting agreements ④	91	137	-	-	228
Total	284	306	172	101	14,280

Notes:

- ① Under the terms of the Biolevier loan agreement, the loan is for a 10-year term from the date of the first disbursement, November 19, 2003, and bears interest at the Canadian prime rate plus 3%, which can be converted to a fixed rate after the final loan disbursement. No capital or interest is repayable prior to November 19, 2006. Thereafter, interest is payable monthly, with annual capital repayments equal to 25% of the Company's annual operating cash flows, if any. Since Procyon is not yet generating operating cash flows, this is not expected to occur until an out-licensing deal is consummated. Consequently, the timing of repayments cannot be determined.
- ② From January 1, 2004 to December 31, 2006, the holder of the preferred shares may elect (i) to convert them into common shares at two times the market price at the date of conversion, or (ii) to require the Company to redeem them for cash, in which case the Company must redeem the shares if it has received sufficient cash to do so, pursuant to a licensing agreement with the holder; and, if not, the Company may convert such shares at the market price at the date of conversion. As at December 31, 2004, the conditions required for a cost redemption were not met. If no election is made prior to December 31, 2006, the Company 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. Consequently, the Company cannot determine whether any repayment will be made and, if so, the timing thereof.
- ③ The amount of \$10,000 per year represents a minimum annual royalty payable under an in-licensing agreement for Fibrostat[®]. If the Company receives royalty revenues, the annual amount payable will increase, depending upon the amount of such future royalty revenues.
- ④ The Company is committed to a consulting agreement that has a remaining term of 30 months. The amounts shown above reflect this obligation. Almost all of the Company's purchase obligations are for major contracts undertaken in the normal course of business that relate primarily to ongoing clinical trials for PCK3145 and Fibrostat[®] and for preclinical studies for PPL-100. Such contracts can be terminated by the Company, subject to notice of termination of up to three months. In the event of termination by the Company, it will generally be liable for costs incurred up to the effective date of termination, including in certain cases expenses required to be incurred to complete activities associated with termination of the project.

There were no commitments for capital expenditures as at December 31, 2004.

OFF-BALANCE SHEET ARRANGEMENTS

Except for the operating leases and royalty and purchase obligations disclosed above under "Contractual Obligations", the Company has not entered into any off-balance sheet arrangements and does not expect to enter into any, other than in the normal course of business, in the near future.

RELATED PARTY TRANSACTIONS

Under an employee share purchase loan program implemented in 2000, key employees were permitted to participate in the 2000 Special Warrant Offering through share purchase loans. Loans were limited to a maximum of \$100,000 to any one individual and related, for each loan, to the purchase of 38,168 special warrants at \$2.62 each. These loans are non-interest bearing and are collateralized by the underlying common shares. As at December 31, 2004, two of these loans totaling \$200,000 were outstanding to officers and directors and the underlying shares had a market value of approximately \$62,600. The loans are due on April 11, 2013, can be repaid at any time and must be repaid in full when the market price of the common shares reaches \$2.65 for ten consecutive trading days, or upon termination of the borrowers' employment with the Company, subject to certain conditions.

PROPOSED TRANSACTIONS

At the present time, we do not anticipate any significant transactions involving the acquisition or disposition by the Company of assets or businesses.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies adopted by the Company during the year ended December 31, 2004.

Accounting Guideline 15 – Consolidation of variable interest entities applies to annual and interim periods beginning on or after November 1, 2004. We do not believe we are involved with any VIEs, but are currently evaluating the situation.

FINANCIAL INSTRUMENTS

The Company does not use currency or other hedging instruments.

OUTSTANDING SHARE DATA

As of February 18, 2005 there are 4,000,000 First Preferred Shares, Series I outstanding, unchanged from December 31, 2004. The number of common shares outstanding as of February 18, 2005 is 85,153,899, also unchanged from December 31, 2004. The number of stock options outstanding at February 18, 2005 is 4,979,361, an increase of 50,000 from December 31, 2004. In addition, 16,924,315 warrants are outstanding on February 18, 2005, unchanged from December 31, 2004.

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 held with one Canadian chartered bank. The short-term investments are held in high quality commercial paper of major corporations and a banker's acceptance, together with a floating rate note of a government agency.

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.

MANAGEMENT'S REPORT

To the shareholders of Procyon Biopharma Inc.

Management is responsible for the integrity, objectivity and reliability of the accompanying consolidated financial statements and for ensuring that all information in the annual report is consistent with these financial statements. This responsibility includes selecting appropriate accounting policies and making estimates and other judgments consistent with Canadian generally accepted accounting principles.

Management has established and maintains control processes that provide reasonable assurance that the financial records are complete and accurate, that all financial transactions are properly authorized, that assets are safeguarded and that the Company and its subsidiaries comply with all reporting requirements.

The Company's Board of Directors is responsible for overseeing management's performance of its financial reporting responsibilities. The Board delegates this responsibility to the Audit Committee. The Audit Committee, whose members are not affiliated with the Company, is appointed by the Board to review the financial statements in detail with management and to report to the directors prior to their approval of the consolidated financial statements for publication.

Ernst & Young have been appointed as the Company's auditors to report to the shareholders regarding their audit of the consolidated financial statements.

(Signed) Hans J. Mäder

Hans J. Mäder
Chairman, President and Chief Executive Officer

(Signed) Monique Létourneau

Monique Létourneau
Executive Vice-President, Finance and Chief Financial Officer
March 1, 2005.

AUDITORS' REPORT

To the Shareholders of Procyon Biopharma Inc.

We have audited the consolidated balance sheets of Procyon Biopharma Inc. as at December 31, 2004 and 2003 and the consolidated statements of operations and deficit and cash flows for the years ended December 31, 2004 and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) Ernst & Young LLP

Montréal, Canada,
February 10, 2005.

Chartered Accountants

As at December 31

2004

2003

\$

\$

ASSETS [note 8]**Current assets**

Cash and cash equivalents	319,382	476,673
Short-term investments [note 4]	15,401,042	9,440,494
Accounts receivable	271,973	213,946
Investment tax credits recoverable [note 15]	685,000	1,047,500
Prepaid expenses	110,320	155,093
	16,787,717	11,333,706
Property, plant and equipment [note 5]	808,504	1,034,677
Intellectual property [note 6]	5,180,795	7,305,837
Long-term investments [note 7]	—	7,001
Deferred financing costs [note 8]	909,500	663,686
	23,686,516	20,344,907

LIABILITIES AND SHAREHOLDERS' EQUITY**Current liabilities**

Accounts payable and accrued liabilities	1,066,787	1,582,775
Deferred revenue	—	9,617
	1,066,787	1,592,392
Biolevier loan facility [note 8]	9,417,393	5,043,223
Convertible debenture [note 9]	50,000	50,000
Preferred shares [note 11]	4,000,000	4,000,000
	14,534,180	10,685,615

Shareholders' equity [note 11]

Share capital	61,461,900	47,874,176
Warrants	2,904,038	751,292
Contributed surplus	3,995,794	2,550,164
Equity component of convertible debenture [note 9]	1,005,000	675,000
Deficit	(60,214,396)	(42,191,340)
	9,152,336	9,659,292
	23,686,516	20,344,907

Commitments and guarantees [note 12]

See accompanying notes

On behalf of the Board:

(Signed)
Hans J. Mäder(Signed)
Iain MacInnesHans J. Mäder
DirectorIain MacInnes
Director

Years ended December 31	2004	2003
	\$	\$
REVENUES		
Licence revenue	9,617	28,267
Interest and other income	324,856	275,709
	334,473	303,976
EXPENSES		
Research and development	12,709,113	8,060,427
Research and development tax credits [note 15]	(1,157,869)	(1,332,062)
Net research and development	11,551,244	6,728,365
General and administrative	3,776,224	3,364,702
Amortization of property, plant and equipment	318,018	262,468
Amortization of intellectual property	698,383	624,957
Amortization of deferred financing fees	101,977	8,296
Interest on Biolevier loan facility	374,170	43,223
Financial charges	4,261	23,340
Foreign exchange gains	(92,663)	(32,373)
	16,731,614	11,022,978
Loss before write-down of intellectual property	(16,397,141)	(10,719,002)
Write-down of carrying value of intellectual property [note 6]	1,625,915	—
Net loss for the year	(18,023,056)	(10,719,002)
Deficit, beginning of year	(42,191,340)	(31,472,338)
Deficit, end of year	(60,214,396)	(42,191,340)
Basic and diluted loss per share [note 11]	(0.23)	(0.17)
Weighted average number of common shares outstanding	80,016,090	62,882,510

See accompanying notes

Consolidated Statements of Cash Flows

Years ended December 31

2004

2003

\$

\$

OPERATING ACTIVITIES

Net loss for the year	(18,023,056)	(10,719,002)
Items not affecting cash		
Amortization of property, plant and equipment	318,018	262,468
Amortization of intellectual property	698,383	624,957
Amortization of deferred financing fees	101,977	8,296
Write-down of carrying value of intellectual property	1,625,915	—
Write-down of investment	7,001	46,000
Loan interest capitalized	374,170	43,223
Non-cash license revenues	(4,417)	(17,666)
Services paid by issuance of stock options	909,588	97,962
	(13,992,421)	(9,653,762)
Net change in non-cash balances relating to operations [note 16]	(167,735)	(133,382)
Cash flows related to operating activities	(14,160,156)	(9,787,144)

INVESTING ACTIVITIES

Acquisition of intellectual property	(199,256)	(188,364)
Acquisition of property, plant and equipment	(91,845)	(163,304)
Cash and cash equivalents obtained on acquisition of business	—	159,832
Business acquisition expenses	—	(236,254)
Maturities of short-term investments	9,440,494	18,316,970
Purchase of short-term investments	(15,401,042)	(15,390,394)
Cash flows related to investing activities	(6,251,649)	2,498,486

FINANCING ACTIVITIES

Issuance of convertible debenture	330,000	—
Issue of units	17,250,000	3,530,000
Unit issue expenses	(1,618,214)	(317,711)
Issue of common shares	296,935	40,163
Issuance of long-term debt	4,000,000	5,000,000
Repayment of long-term debt assumed in an acquisition	(4,207)	(138,993)
Repayment of bank indebtedness assumed in an acquisition	—	(624,280)
Debt financing costs	—	(102,856)
Cash flows related to financing activities	20,254,514	7,386,323
Net increase (decrease) in cash and cash equivalents	(157,291)	97,665
Cash and cash equivalents, beginning of year	476,673	379,008
Cash and cash equivalents, end of year	319,382	476,673

Supplemental cash flow information

Cash paid during the year for:		
Interest	2,873	17,918

See accompanying notes

1. DESCRIPTION OF BUSINESS

Procyon Biopharma Inc. [the "Company"] is a biopharmaceutical company engaged in the development and commercialization of diagnostics and therapeutic drugs. It was incorporated under the laws of the Province of Ontario in 1986 and was continued under the *Canada Business Corporations Act* in 2001.

To date, the Company has financed its cash requirements primarily from equity issuances, investment tax credits, government grants and loans, license revenues and interest income. The success of the Company is dependent on bringing its technologies to market, obtaining the necessary regulatory approvals and achieving future profitable operations. It may be necessary for the Company to raise additional funds for the continuing development and marketing of its technologies.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the following accounting policies:

Basis of consolidation

The consolidated financial statements include the accounts of the Company, those of its wholly-owned US subsidiary, Oncologic Biopharmaceuticals Corporation ["Oncologic"], which was purchased on September 30, 1997 and those of its wholly-owned Canadian subsidiary, Pharmacor Inc., since its acquisition on April 17, 2003. After the close of business on December 31, 2003, Pharmacor Inc.'s operations were wound up and all of its assets and liabilities were transferred into the Company, and is in the process of being dissolved. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of 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 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 these consolidated financial statements and such differences could be material.

Cash and cash equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments with an original maturity of less than three months that are readily convertible to known amounts of cash and that are subject to an insignificant risk of change in value.

Short-term and long-term investments

Short-term investments are recorded at the lower of cost and fair market value determined on a portfolio basis. Long-term investments are recorded at cost and are written down to their fair market value when a decline in value is other than temporary.

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of investment tax credits. Amortization is provided on a basis and at rates assigned to amortize the cost of the assets over their estimated useful lives. The annual rates of amortization are as follows:

Laboratory equipment	30% declining balance
Office equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold improvements	20% straight-line basis

Intellectual property

Purchased patents and intellectual property consists of patents, licenses, and scientific knowledge relating to products under development purchased by the Company. Patent costs include legal fees to obtain patents and patent application fees.

Patent costs and purchased patents and intellectual property are amortized on a straight-line basis over 15 years.

Impairment of long-lived assets

On a periodic basis, management reviews the carrying value of property, plant and equipment and intellectual property and considers whether there have been events or changes in circumstances that indicate that the carrying value may not be recoverable. The review is based on the assessment of technological changes, the Company's intended use and the projected estimated net undiscounted cash flows expected to be generated from the underlying assets together with its residual value (net recoverable value). If such assets are considered impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds its fair value generally determined on a discounted expected cash flow basis. Any impairment results in a write-down of the assets and a charge to income during the year.

Revenue recognition

Sales revenue is recognized when the product is delivered to customers, title has passed and collection is reasonably assured. Contract research revenue is recognized as services are performed and collection is reasonably assured. License revenue is recognized over the term of the related license. Interest income is recognized when it is earned.

Government assistance

Government assistance received in the form of grants and investment tax credits for qualifying research and development activities are applied as a reduction of the cost of the related property, plant and equipment or as a reduction of the applicable research and development expenses.

Research and development

Research costs are charged against income as incurred. Development costs are charged against income in the period of expenditure unless a development project meets the criteria specified under generally accepted accounting principles for deferral and amortization. The Company has not deferred any such development costs to date.

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**Income taxes**

The Company follows the liability method of accounting for income taxes according to which future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

Stock-based compensation

The Company has a stock-based compensation plan, which is described in note 11. The Company applies the fair value based method to expense all stock options awarded since January 1, 2003. Options issued to employees, officers and directors are recognized as an expense over the vesting period. Options issued to consultants are recognized as an expense at the earlier of the vesting date or over the period over which the services are performed using the Black-Scholes option pricing model. Any consideration paid by employees, officers and directors on exercise of stock options or purchase of stock is credited to share capital.

Prior to January 1, 2003, no compensation expense was recognized for this plan when stock or stock options were issued to employees, officers and directors.

Earnings per share

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated using the treasury stock method, giving effect to the exercise of all dilutive securities. The treasury stock method assumes that proceeds from the exercise of options are used to purchase common shares at the average market price during the period. Shares issued in connection with share purchase loans are excluded from the calculation of basic earnings per share but are included for purposes of calculating diluted earnings per share when the effect is dilutive.

Foreign currency translation

The consolidated financial statements are denominated in Canadian dollars. The operations of the US subsidiary are considered to be integrated with the Company and as such the temporal method is used whereby the monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year-end exchange rates and non-monetary assets and liabilities are translated at the exchange rates prevailing when the assets were acquired or liabilities were incurred. Revenue and expenses are translated at the average rate of exchange for the period. Gains and losses on translation of foreign currencies are included in the consolidated statement of operations in the current period.

Financing costs

Financing costs related to the issuance of debt are deferred and amortized over the term of the related debt using the effective yield method.

Financial instruments

Certain classes of preferred shares provide the holder with a retraction right, which may result in the Company being required to redeem the shares. Consequently, these preferred shares are presented as a liability in the balance sheet and carried at amortized value.

3. BUSINESS ACQUISITION

Effective April 17, 2003, the Company acquired 100% of the outstanding shares of Pharmacor Inc., a Montreal-based biopharmaceutical company committed to the discovery and development of innovative therapeutic agents for the treatment of HIV/AIDS, in exchange for 6,999,996 common shares of Procyon valued at \$2,800,000, based on the closing share price on April 17, 2003, plus acquisition costs of \$243,697. The acquisition has been accounted for using the purchase method at fair value. The results of operations of Pharmacor 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	159,832
Accounts receivable	69,753
Investment tax credits recoverable	1,018,664
Prepaid expenses	42,038
Property, plant and equipment	669,782
Intellectual property	3,020,603
Total assets acquired	4,980,672
Bank indebtedness	624,280
Accounts payable and accrued liabilities	1,173,702
Long-term debt	138,993
Total liabilities assumed	1,936,975
Net assets acquired	3,043,697
Consideration represented by:	
Cash	236,254
Share capital [note 11]	2,800,000
Fair value of warrants issued [note 11]	7,443
	3,043,697

Of the assets acquired, \$3,020,603 was assigned to purchased patents and intellectual property. This intellectual property is being amortized over a fifteen-year period.

3. BUSINESS ACQUISITION [Cont'd]

The bank indebtedness of \$624,280 above was collateralized by the investment tax credits recoverable. In July 2003, the investment tax credits were received and the bank indebtedness was repaid in full. The investment tax credits received are subject to audit by the taxation authorities. In addition, the long-term debt was repaid during 2003.

One of the Company's directors represented a shareholder, Société en commandite T²C²/Bio in both the Company (less than 5%) and Pharmacor (less than 10%). The acquisition by the Company of the shares of Pharmacor held by the shareholder represented less than 1% of the market capitalization of the Company. The director did not participate in and was not in attendance during any discussions or decisions relating to the acquisition of Pharmacor's shares.

4. SHORT-TERM INVESTMENTS

	2004	2003
	\$	\$
Commercial paper and government backed bonds and a banker's acceptance, earning interest at rates ranging from 2.10% to 2.65% [2003 – 2.50% to 2.85%] and maturing on various dates from January to June 2005 [2003 – January to June 2004]	15,401,042	9,440,494
	15,401,042	9,440,494

5. PROPERTY, PLANT AND EQUIPMENT

	Cost	Accumulated amortization	Net carrying value
	\$	\$	\$
As at December 31, 2004			
Laboratory equipment	1,686,682	1,179,312	507,370
Office equipment	277,358	138,381	138,977
Computer equipment	492,350	349,993	142,357
Leasehold improvements	105,866	86,066	19,800
	2,562,256	1,753,752	808,504
As at December 31, 2003			
Laboratory equipment	1,682,829	962,813	720,016
Office equipment	262,348	105,564	156,784
Computer equipment	438,718	300,529	138,189
Leasehold improvements	86,516	66,828	19,688
	2,470,411	1,435,734	1,034,677

6. INTELLECTUAL PROPERTY

	Cost	Accumulated amortization	Net carrying value
	\$	\$	\$
As at December 31, 2004			
Patent costs	1,558,837	534,695	1,024,142
Purchased patents and intellectual property	5,163,885	1,007,232	4,156,653
	6,722,722	1,541,927	5,180,795
As at December 31, 2003			
Patent costs	1,923,025	525,273	1,397,752
Purchased patents and intellectual property	7,720,064	1,811,979	5,908,085
	9,643,089	2,337,252	7,305,837

The Company has discontinued research activities related to the Company's Anti-Nucleosome Antibodies (ANsA) technology and as a result expected future cash flows did not support the carrying value of the underlying intellectual property. The net carrying value of \$1,625,915 consisting of patents costs of \$407,202 and purchased patents and intellectual property of \$1,218,713 at December 31, 2004 were written off.

7. LONG-TERM INVESTMENTS

Under the terms of a license agreement entered into in March 2001 with IMI International Medical Innovations Inc. ["IMI"], a public company, the Company received cash and a warrant, expiring on March 19, 2004, to purchase 75,000 common shares of IMI exercisable at \$4.50 per share. Management estimated the fair value of this warrant at that time, using the Black-Scholes option pricing model, with a volatility factor of 45% and a risk-free interest rate of 5%, to be approximately \$53,000. The revenue was recognized over a 36-month period, representing the term of the warrant. On June 30, 2003, the carrying value of the warrant was written down to \$7,001, management's estimate of its fair value at that date, determined using the Black-Scholes option pricing model with a volatility factor of 47% and a risk-free interest rate of 3%. The warrant expired on March 19, 2004 and the remaining carrying value of \$7,001 was written off at that time.

8. BIOLEVIER LOAN FACILITY

In December 2002, the Company signed a loan agreement with Investissement Québec (IQ) under the Biolevier program for a \$10,000,000 loan facility. As at December 31, 2004, the Company has drawn \$9,000,000 on this facility. Interest thereon to December 31, 2004 at the Canadian prime rate plus 3% amounted to \$417,393 and has been capitalized as part of the loan facility.

The remainder of the facility is available for up to three years from the date of the first disbursement, November 19, 2003, to finance research and development programs, working capital and acquisitions of intellectual property or businesses. To draw down on the remainder of the facility the Company must have first disbursed funds towards qualified expenditures. To December 31, 2004, the Company has made sufficient qualified expenditures to allow them to draw down the remaining facility.

The significant terms and conditions of the loan agreement are as follows:

- i. The repayment term of the loan is ten years from the date of the first disbursement on November 19, 2003.
- ii. No capital or interest is repayable for the first three years after the initial disbursement. Interest is due on a monthly basis thereafter, with annual capital repayments equal to 25% of the Company's annual operating cash flows, if any.
- iii. Interest is at the average Canadian prime rate plus 3% [7.25% at December 31, 2004, [2003 – 7.5%]] and can be converted to a fixed rate after the final loan disbursement.
- iv. The loan is collateralized by a first ranking \$15,000,000 charge on all current and future assets including intellectual property of the Company and its subsidiaries. However, upon request by the Company, and subject to certain conditions, IQ will release the charge against any specific intellectual property for which the Company is in the process of entering into a licensing, marketing or operating agreement.

In addition, on February 6, 2003 the Company provided IQ with warrants to purchase 1,503,759 common shares at an exercise price of \$0.56 per share, expiring 5 years from the date of their issuance. The term of these warrants will automatically expire one year after loan repayment if repaid from operating cash flows, or two years after loan repayment in all other cases. Should the Toronto Stock Exchange permit the extension of the term of these warrants past 5 years, the life of the warrants could be extended up to 10 years. The number of warrants that may be exercised will be reduced in proportion to the amount loaned should the Company borrow less than \$7,500,000, to a minimum of 751,880 warrants.

A total of 751,880 warrants vested on November 19, 2003, the date of the first disbursement of \$5,000,000. The remaining 751,879 warrants vested on December 20, 2004, when an additional \$4,000,000 was drawn. The fair value of these warrants on the vesting date, using the Black-Scholes option pricing model with a volatility factor of 62%, a risk-free interest rate of 4%, a dividend yield of nil and an expected life of 5 years amounted to \$347,791 [2003 – \$392,952]. These amounts are recorded as deferred financing costs, as are the costs associated with this facility in the amount of \$279,030, and both are being amortized to expense over the term of the loan using the effective yield method.

9. CONVERTIBLE DEBENTURE

On February 1, 2000, the Company entered into a Canadian licensing agreement with a biopharmaceutical company [the "Holder"] whereby the Holder will advance funds to the Company upon the achievement of specific scientific and regulatory milestones related to Fibrostat®. The funds will be advanced up to a maximum of \$1,500,000, in the form of a non-interest bearing debenture, convertible into common shares, which matures on December 31, 2049. The Holder of the debenture has a right to convert the debenture into common shares at prices ranging from 125 % to 150% of the market price of the common shares at the date regulatory approval of Fibrostat® is obtained. As at December 31, 2004, the Company has received \$1,055,000, including \$330,000 advanced in 2004. Of this total amount, \$50,000 is included in liabilities and \$1,005,000 is recorded as the equity component of the convertible debenture. 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 debenture.

10. INCOME TAXES

The income tax reported differs from the amount of the tax computed by applying statutory income tax rates to the loss before taxes. The reasons for the differences and the related tax effects are as follows:

	2004 %	2003 %
Combined statutory federal and provincial rates	31.02	33.05
Increase (decrease) in taxes recoverable resulting from:		
Non-deductible expenses and other differences	(1.71)	(0.60)
Unrecognized tax benefits of operating losses	(29.88)	(33.77)
Tax credits not taxable in Québec	0.57	1.32

10. INCOME TAXES [Cont'd]

The tax effects of temporary differences and net operating losses that give rise to future income tax assets and liabilities are as follows:

	2004	2003
	\$	\$
Future income tax liability		
Carrying values of intellectual property in excess of tax basis	658,000	1,331,000
Carrying values of property, plant and equipment in excess of tax basis	—	36,000
Others	27,000	60,000
Total future income tax liability	685,000	1,427,000
Future income tax assets		
Net operating losses carried forward – USA	645,000	647,000
Net operating losses carried forward – Canada	9,571,000	7,754,000
Research and development expenditures	9,717,000	6,996,000
Carrying values of property, plant and equipment below tax basis	72,000	—
Carrying values of intellectual property below tax basis	87,000	—
Financing fees and share issue costs	643,000	420,000
Total future income tax assets	20,735,000	15,817,000
Valuation allowance	20,050,000	14,390,000
Net future income tax assets	685,000	1,427,000
Net future income taxes	—	—

[i] The Company has accumulated loss carry-forwards for Federal and Québec purposes, which are available to reduce future taxable income. The tax benefit of \$685,000, representing \$2,208,000 of these losses has been recognized in these financial statements as a net future income tax asset. These loss carry-forwards expire as follows:

	Federal	Québec
	\$	\$
2005	2,130,000	2,130,000
2006	3,134,000	3,134,000
2007	2,227,000	2,204,000
2008	6,276,000	6,105,000
2009	4,678,000	4,594,000
2010	5,526,000	5,409,000
2011	6,998,000	6,998,000
	30,969,000	30,574,000

[ii] The Company has accumulated net operating loss carry-forwards in the US of \$1,483,000. The tax benefit of these losses has not been recognized in these financial statements.

[iii] The Company has approximately \$28,680,000 of research and development expenditures available for Federal tax purposes and \$37,649,000 for Québec tax purposes that are available, to reduce taxable income in future years and have an unlimited carryforward period, the tax benefit of which has not been reflected in these financial statements.

11. CAPITAL STOCK**Authorized***Common Shares*

An unlimited number of common shares.

First Preferred Shares

An unlimited number of non-voting First Preferred Shares without par value, shall be issuable in series and the Board of Directors of the Company shall have the right, to fix the number of, and to determine the rights and conditions attaching to these shares.

Second Preferred Shares

An unlimited number of non-voting Second Preferred Shares without par value, shall in all respects be subject to and subordinate to the rights and conditions attaching to the First Preferred Shares.

Issued and outstanding*First Preferred Shares Series I*

On January 4, 2002, the Company issued 4,000,000 First Preferred Shares, Series I for a 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 the Company to redeem them for cash, in which case the Company must redeem the shares if it has received sufficient cash to do so pursuant to a licensing agreement with the holder; and, if not, the Company may convert such shares at the market price at the date of conversion. At December 31, 2004, the conditions required for a cash redemption were not met. If no election is made prior to December 31, 2006, the Company 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 are presented as a long-term liability on the balance sheet. Determination of the fair value of these preferred shares is not practicable as, under the terms and conditions of these shares various alternatives are available to the holder.

11. CAPITAL STOCK [Cont'd]*Common shares*

	Number of shares	Share capital \$
Balance as at December 31, 2002	52,411,708	42,172,621
Issued on conversion of Units	7,844,445	3,137,778
Issued in exchange for shares of Pharmacor Inc.	6,999,996	2,800,000
Unit issuance costs – cash	—	(276,386)
Issued for cash on exercise of options	79,750	40,163
Balance as at December 31, 2003	67,335,899	47,874,176
Issued on conversion of Units	17,250,000	15,180,000
Unit issuance costs – cash	—	(1,418,076)
Unit issuance costs – broker compensation warrants	—	(475,981)
Issued on exercise of options	568,000	301,781
Balance as at December 31, 2004	85,153,899	61,461,900

On April 7, 2004, the Company issued 17,250,000 Units at \$1.00 each for total cash proceeds of \$17,250,000, before issue expenses. Each Unit consisted of one common share and one-half common share purchase warrant for a total of 8,625,000 common share purchase warrants. Each whole common share purchase warrant entitles the holder to purchase one additional common share for \$1.25 up to April 7, 2006. In addition to the cash commission paid and other issue costs totaling \$1,618,214, the Company has granted to the underwriters, broker compensation warrants to purchase up to 1,207,500 Units at an exercise price of \$1.00 per Unit up to April 7, 2006. The fair value of these broker compensation warrants was estimated at \$540,888, determined using the Black-Scholes option pricing model with a volatility of 81%, a risk-free interest rate of 2.6%, a dividend yield of nil and an expected life of two years. This amount was recorded as Unit issue costs, which reduced the common share and warrant values by \$475,981 and \$64,907, respectively and increased contributed surplus by \$540,888.

On April 17, 2003, the Company issued 6,999,996 common shares in exchange for 100% of the outstanding common shares of Pharmacor Inc. In addition, the Company completed a concurrent \$3,250,000 financing by way of a private placement of 7,222,223 Units at \$0.45 each before cash expenses. Each Unit consists of one common share and 0.4153845 common share purchase warrant, with each whole common share purchase warrant entitling the holder to purchase one additional common share for a period of two years from the date of filing of an IND ["Investigational New Drug"] of Pharmacor's lead compound, at a price per common share equal to the greater of \$0.45 and the market price of the Company's common shares immediately prior to the IND filing. Also on April 17, 2003, a creditor of Pharmacor purchased an additional 622,222 Units on the same terms and conditions, for proceeds of \$280,000.

Employee share purchase loan program

In 2000, the Company implemented an employee share purchase loan program. Key employees were permitted to participate in the 2000 Special Warrant Offering through share purchase loans. Loans were limited to a maximum of \$100,000 to any one individual and related, for each loan, to the purchase of 38,168 special warrants at \$2.62 each. These loans are non-interest bearing and are collateralized by the underlying common shares. As at December 31, 2004, the shares had a market value of approximately \$62,600 and two of these loans totaling \$200,000 were outstanding to officers and directors. The loans are due on April 11, 2013 and can be repaid at any time and must be repaid in full when the market price of the common shares reaches \$2.65 for ten consecutive trading days, or upon termination of the borrowers' employment with the Company, subject to certain conditions.

Stock option plan

The Company has a stock option plan for employees, directors, officers and consultants of the Company. As of December 31, 2004, the maximum number of common shares to be issued pursuant to the stock option plan is 7,990,139. Options granted to employees and officers vest over two years and expire five years [three years prior to November 2004 and five years prior to 2001] from the grant date. Generally, options granted to directors vest immediately.

	2004		2003	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Options outstanding, beginning of year	3,638,500	1.25	3,765,300	1.29
Granted	3,750,361	0.83	506,500	0.41
Forfeited	(364,000)	1.54	(264,900)	0.70
Expired	(1,527,500)	1.78	(288,650)	1.00
Exercised	(568,000)	0.52	(79,750)	0.50
Options outstanding, end of year	4,929,361	0.83	3,638,500	1.25
Exercisable	2,797,440	0.82	3,050,167	1.37

11. CAPITAL STOCK [Cont'd]

Effective January 1, 2003, the Company began prospectively recording compensation expense for awards granted to employees, officers and directors.

An amount of \$816,419 was recorded as an expense and was credited to contributed surplus in 2004 for the fair value of stock options granted to employees, determined using the Black-Scholes option pricing model, with a volatility of from 67% to 82%, a risk-free interest rate of 3% to 4%, a dividend yield of nil and an expected life of the options of from 3 to 5 years.

In November 2004, the life of 465,400 options granted to employees were extended from 3 to 5 years. The result of this change in option life resulted in a remeasurement of the value of the options and \$20,433 was recorded as an expense in the current year and a credit to contributed surplus with an additional \$22,197 to be charged to expense over the remaining vesting period.

An amount of \$35,517 was recorded as an expense and credited to contributed surplus on April 1, 2003, representing the fair value of stock options granted to an officer of the Company in lieu of a cash bonus payment, determined using the Black-Scholes option pricing model with a volatility of 61%, a risk-free interest rate of 3% a dividend yield of nil and an expected life of the option of 3 years. An additional amount of \$17,445 was recorded as an expense and was credited to contributed surplus in 2003 for the fair value of stock options granted to other employees, also determined using the Black-Scholes option pricing model, with a volatility of approximately 60%, a risk-free interest rate of 3% to 4%, a dividend yield of nil and an expected life of the option of 3 years.

Had compensation cost for 2002 been determined based on the fair value of options as of the date of grant using the Black-Scholes option pricing model, using 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 3 years and had the fair value been amortized over the vesting period of the options, the Company's net loss and basic and diluted loss per common share for each of the past two years would have been as follows:

	2004 \$	2003 \$
Net loss – as reported	(18,023,056)	(10,719,002)
Proforma stock-based compensation	(33,958)	(60,070)
Net loss – pro forma	(18,057,014)	(10,779,072)
Loss per share – basic and diluted – as reported	(0.23)	(0.17)
Loss per share – basic and diluted – pro forma	(0.23)	(0.17)

The weighted average grant date fair value of options granted in 2004 was \$0.46 (2003 - \$0.17).

Additional information concerning stock options outstanding as at December 31, 2004 is as follows:

Price range \$	Options outstanding			Options exercisable	
	Number of outstanding options	Weighted average months remaining	Weighted average exercise price \$	Number of exercisable options	Weighted average exercise price \$
0.37 to 0.51	486,500	18	0.45	414,834	0.46
0.57 to 0.83	2,405,361	53	0.71	1,231,356	0.71
0.85 to 1.10	1,737,500	23	0.99	1,021,250	0.98
1.30 to 1.32	227,500	6	1.32	57,500	1.31
1.90 to 2.15	72,500	5	2.05	72,500	2.05
0.37 to 2.15	4,929,361	36	0.83	2,797,440	0.82

Warrants

	Number of common shares reserved for issuance	\$
Balance as at December 31, 2002	9,643,673	952,214
Issued on conversion of Units	3,258,461	392,222
Unit issuance costs - cash	—	(41,325)
Issued in connection with Pharmacor acquisition	150,000	7,443
Issued to Investissement Québec [note 8]	1,503,759	392,952
Expired warrants	(7,584,996)	(952,214)
Balance as at December 31, 2003	6,970,897	751,292
Issued on conversion of Units	8,625,000	2,070,000
Unit issuance costs	—	(265,045)
Broker warrants for Units	1,207,500	—
Warrants from Broker Units	603,750	—
Expired warrants	(482,832)	—
Vesting of warrants previously issued to Investissement Québec [note 8]	—	347,791
Balance as at December 31, 2004	16,924,315	2,904,038

11. CAPITAL STOCK [Cont'd]

The expiry dates and common share equivalent for the outstanding warrants are as follows:

	Expiry date	Common share equivalent
Oncologic warrants [i]	September 30, 2007	1,575,845
Private placement April 17, 2003 [ii]	See note below	3,258,461
Warrants relating to Pharmacor acquisition [iii]	April 17, 2006	150,000
Investissement Québec warrants [note 8]	February 6, 2008	1,503,759
Public offering April 7, 2004 [note 11]	April 7, 2006	8,625,000
Broker warrants for Units [note 11]	April 7, 2006	1,207,500
Warrants from broker Units [note 11]	April 7, 2006	603,750
		16,924,315

[i] In September 1997, warrants were issued to the former shareholders of Oncologic to purchase 1,575,845 common shares at \$0.01 per share. These warrants vest and are exercisable 60 days after the acceptance of an Investigational New Drug application for the ANSA technology by the United States Food & Drug Administration and in any event expire on September 30, 2007. Since the Company has terminated research activities on this technology, the likelihood of these options vesting prior to the expiry date is remote.

[ii] On April 17, 2003, warrants were issued to purchase 3,258,461 common shares for a period of two years from the date of filing of an IND of Pharmacor's lead compound at a price per common share equal to the greater of \$0.45 and the market price of the Company's common shares immediately prior to the IND filing. These warrants will expire on April 17, 2005, if an IND has not been filed by that date.

[iii] Also on April 17, 2003, the Company issued warrants to purchase an additional 150,000 common shares at an exercise price of \$1.35 per common share. These warrants, which were issued in connection with the acquisition of Pharmacor, expire on April 17, 2006 and are recorded at \$7,443, based on their fair value at the date of issue using the Black-Scholes option pricing model with a volatility factor of 61%, a risk-free interest rate of 3%, a dividend yield of nil and an expected life of 3 years.

Contributed surplus

	\$
Balance as at December 31, 2002	1,499,988
Options issued to consultants [i]	45,000
Options granted to employees	52,962
Warrants expired in 2003 [see "Warrants"]	952,214
Balance as at December 31, 2003	2,550,164
Options issued to consultants [ii]	72,736
Options granted to employees	816,419
Extension of life of employee stock options	20,433
Compensation warrants issued to underwriters [see "Common shares"]	540,888
Warrants expired in 2004 [see "Warrants"]	—
Transferred to Common Shares on exercise of options	(4,846)
Balance as at December 31, 2004	3,995,794

[i] During 2002, the Company issued options, expiring in 2005, to consultants to purchase 200,000 common shares at a price of \$1.00 and 25,000 common shares at a price of \$0.57 per share in consideration for services rendered. These options are included in the table under the stock option plan above. Management has estimated the fair value of these options using the Black-Scholes option pricing model, with a volatility factor of 63% and a risk free interest rate of 4%, a dividend yield of nil and an estimated life of 3 years to be approximately \$96,400. This amount has been recorded as an expense over the vesting period with an amount of \$51,400 reported in 2002 and \$45,000 in 2003.

[ii] During 2004, in consideration for services rendered, options were issued to consultants to purchase 40,000 common shares at a price of \$1.32 per share and 30,000 common shares at a price of \$0.72 per share, both expiring in 2007, and 100,000 common shares at a price of \$0.95 per share expiring in 2006. These options are included in the table under the stock option plan above. Management has estimated the fair value of these options using the Black-Scholes option pricing model, with a volatility factor of 75% to 82%, a risk free interest rate of 2.7% to 3.4%, a dividend yield of nil and an estimated life of 2 to 3 years to be approximately \$80,800. This amount has been recorded as an expense over the vesting period with an amount of \$72,700 recorded in 2004 and \$8,100 will be recorded in 2005.

Diluted earnings per share

No options or warrants outstanding at December 31, 2004 and 2003 were included in the calculation of diluted earnings per share, as all such securities would be anti-dilutive. As at December 31, 2004 there were 4,929,361 [2003 – 3,638,500] options and 16,924,315 [2003 – 6,970,897] warrants outstanding. Common shares granted subject to share purchase loans were also excluded since they would also have been anti-dilutive.

12. COMMITMENTS AND GUARANTEES

The Company is committed under operating leases for premises and equipment in the following amounts:

	\$
2005	183,344
2006	76,002
2007	73,413
2008	76,390
2009	75,985
2010 and thereafter	50,567
	535,701

The Company has a commitment under a consulting agreement to pay fees for a remaining term of 30-months at \$7,600/month.

The Company is also committed under an in-licensing for Fibrostat® agreement to pay a minimum royalty of \$10,000 per year. If the Company receives royalty revenues on that product, the annual royalty payment will increase depending upon the amount of such future royalty revenues.

The Company periodically enters into research agreements or strategic alliances with third parties that include indemnification provisions that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party intellectual property claims or damages arising from these transactions. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions is not limited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the intellectual property indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in these consolidated financial statements with respect to these indemnification obligations.

13. 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, substantially all operations are carried out in Canada and all assets, with the exception of certain intellectual property, are located in Canada.

Information by geographic segment is as follows:

	2004 \$	2003 \$
Intellectual property		
Canada	5,180,795	5,622,947
United States	—	1,682,890
	5,180,795	7,305,837

14. FINANCIAL INSTRUMENTS**[i] Fair values***Short-term financial assets and liabilities*

The carrying amounts of cash and cash equivalents, short-term investments, accounts receivable, investment tax credits recoverable and accounts payable are a reasonable estimate of their fair values because of the short maturity of these instruments. The effective rate of return on cash equivalents and short-term investments is approximately 2.2% [2003 – 2.9%].

Long-term financial liabilities

The fair value of the BioLevier loan facility approximates its carrying value due to the variable nature of the interest rate.

The fair value of the convertible debenture using a 9.25% discount rate is estimated at \$20,000 [2003 – \$11,000].

[ii] Concentration of credit risk

Investment tax credits recoverable are due from the Québec government. The cash and cash equivalents are held with one Canadian chartered bank. The short-term investments are held in commercial paper of six major corporations and one banker's acceptance, together with a floating rate note of a government agency [2003 – seven investments in commercial paper and one banker's acceptance] and therefore do not represent a concentration of credit risk.

15. GOVERNMENT ASSISTANCE

The Company incurred research and development expenditures that are eligible for investment tax credits. The investment tax credits recorded are based on management's estimates of amounts that are expected to be recovered and that are subject to audit by taxation authorities. The Company has also earned other non-repayable government assistance related to various research and development projects. These amounts have been recorded as a reduction of research and development expenses, and are as follows:

	Year ended December 31,	
	2004	2003
	\$	\$
Investment tax credits	1,157,869	1,332,062
Other government assistance	3,656	77,383

Investment tax credits earned in connection with certain research and development expenditures incurred in Québec are fully refundable. The non-refundable Federal investment tax credits earned can be applied against taxes payable in future years, and the Company has accumulated Federal non-refundable investment tax credits of approximately \$5,387,000. The benefit of these tax credits has not been reflected in these financial statements. These investment tax credits expire as follows:

	\$
2006	4,000
2007	56,000
2008	366,000
2009	305,000
2010	297,000
2011	998,000
2012	624,000
2013	1,088,000
2014	1,649,000
	5,387,000

16. NET CHANGE IN NON-CASH BALANCES RELATING TO OPERATIONS

The net change in non-cash working capital balances relating to operations represents the following:

	2004	2003
	\$	\$
Decrease (increase) in:		
Accounts receivable	(58,027)	175,808
Investment tax credits recoverable	362,500	866,164
Prepaid expenses	44,773	(60,249)
	349,246	981,723
Increase (decrease) in:		
Accounts payable and accrued liabilities	(511,781)	(1,104,505)
Deferred revenue	(5,200)	(10,600)
	(167,735)	(133,382)

17. SUBSEQUENT EVENT

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 are estimated at approximately \$170,000. The Company is considering alternative approaches to their clinical trial strategy as well as other therapeutic uses for Fibrostat®. Depending on the results, the Company may have to recognize an impairment of the related intellectual property. At December 31, 2004 the net carrying value of intellectual property associated with Fibrostat® amounted to approximately \$188,000.

18. COMPARATIVE FIGURES

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current year consolidated financial statements.

BOARD OF DIRECTORS

Hans J. Mäder
Chairman of the Board, President
and Chief Executive Officer
Procyon Biopharma Inc.

Bernard Coupal, Ph.D.
President
Gestion T²C²/Bio Inc.

Hans C. Fluehler
Chief Executive Officer
The Canfhel Group

Phil Gold,
C.C., O.Q, M.D., Ph.D.
Executive Director, Clinical
Research Centre
The Montreal General Hospital –
McGill University Health Centre

Max Link, Ph.D.
Former Pharmaceutical Executive,
Professional Director

Iain MacInnes
Vice-President, Branch Manager and
Senior Investment Advisor
TD Waterhouse Investment Advice

Chandra J. Panchal,
M.Sc., Ph.D.
Senior Executive Vice-President,
New Technologies
Procyon Biopharma Inc.

Roger Samson
Professional Director

MANAGEMENT TEAM

Hans J. Mäder
Chairman, President and Chief
Executive Officer

Chandra J. Panchal,
M.Sc., Ph.D.
Senior Executive Vice-President,
New Technologies

Judith Cohn, Ph.D., M.D.
Vice-President, Clinical Research
and Regulatory Affairs

Jinzi J. Wu, Ph.D.
Vice-President, Preclinical and Basic
Research

Monique Létourneau,
M.Sc., CFA
Executive Vice-President, Finance
and Chief Financial Officer

Daniel C. Böck, Ph.D.
Vice-President, Business
Development and Licensing

Richard La Rue, L.L.L., D.D.N.
Vice-President, Legal Affairs, Human
Resources and Corporate Secretary

Brian L. Davies, CA
Director, Finance and Controller

GENERAL INFORMATION

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Montréal, Québec

TRANSFER AGENTS
Computershare Trust Company of
Canada
Montréal, Québec

LEGAL COUNSEL
BCF, LLP
Montréal, Québec

ANNUAL GENERAL
AND SPECIAL MEETING
Thursday, June 30th, 2005
at 10:30 A.M.
Centre Mont-Royal,
International Room
2200 Mansfield Street,
Montréal, Québec

STOCK LISTING
Toronto Stock Exchange (TSX)
Ticker symbol: PBP

A copy of the Company's Annual
Information Form and Annual
Report may be obtained by writing
to the head office of the Company
located at 1650 Trans-Canada
Highway, Suite 200, Dorval, Québec,
H9P 1H7 or by faxing requests to
(514) 685-5138.

Ce rapport annuel est également
disponible en français.

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