



Message to shareholders

November 2nd, 2004

We are very pleased to submit this report on the results for the third quarter ended September 30, 2004. During this quarter, the Company was actively involved in the clinical and preclinical development of our most advanced drug candidates, as they are all expected to advance to new clinical stages in the short-term. PCK3145 is on track for an IND submission before year-end in order to initiate a Phase IIb study early next year; the Fibrostat[®] Phase IIb study is nearing completion and two Phase III studies are expected to follow shortly; and we are currently completing our preclinical program for PL-100 and will soon file an IND to initiate a Phase I/II study in man.

ONCOLOGY UPDATE – En route to an IND submission

We are happy to report that we are getting closer to determining the dual mode-of-action of PCK3145 Therapeutic peptide in reducing tumor size and preventing the metastatic process. We expect to complete this work during the fourth quarter this year. Last August, our scientists along with our McGill University collaborators under the supervision of Dr. Shafaat Rabbani published in *Cancer Research Journal* 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. Following this publication and the release of the Phase IIa trial results, we were invited to present at the prestigious Prostate Cancer Foundation meeting. This meeting, on invitation only, is attended by the leaders in oncology and we were most delighted to present our latest developments with PCK3145. We are still on track to file an IND before year-end in order to initiate our next clinical study.

Major progress with our PSP Serum-based immunoassay

Recent findings at Procyon have been accepted for publication in the *Biochemical Journal* and are currently available online. In the article entitled: "Identification, purification and characterization of a novel human blood protein with binding affinity for prostate secretory protein of 94 amino acids", Procyon scientists show that PSP94 binds to a novel protein, known as PSPBP, in the serum. The determination of the ratio of free to bound PSP94 is believed to be correlated with prognosis of prostate cancer.

Furthermore, in a study on 1,212 patients performed in collaboration with Robert K. Nam, MD, FRCSC, Assistant Professor of Surgery, Division of Urology at the Sunnybrook and Women's College Health Sciences Centre in Toronto, Procyon's new PSP94 blood tests were able to differentiate between patients with prostate cancer and patients with benign conditions. Preliminary results also indicate that PSP94 assays were able to identify patients suffering from a more aggressive disease.

VIROLOGY UPDATE – New formulation of PL-100 for better bioavailability

The preclinical development of PL-100 continues, while our scientists are working at developing a more soluble and potentially more bioavailable formulation of PL-100. This new formulation presents the same favorable resistance and toxicity profiles as PL-100. However, higher bioavailability of the drug would reduce the pill burden of the candidate drug, a desired effect for protease inhibitors. HIV/AIDS patients are treated with drug cocktails that involve a great pill burden, often leading to patient compliance problems. Procyon is currently evaluating both compounds in order to determine which to bring to the clinic in 2005. More news on this front is expected shortly.

DERMATOLOGY UPDATE – Phase IIb nears completion

Also during the quarter, we completed the enrolment of the 207 patients required for the North American Phase IIb clinical trial with Fibrostat[®], our proprietary topical therapeutic intended for the treatment of hypertrophic scars resulting from surgery or burns. The placebo-controlled, double-blind, randomized Phase IIb clinical trial is nearing completion and we are currently entering the data analysis stage. The Company expects to finalize data gathering and analysis of the trial by year-end. The results will be announced in early Q1 2005. We are currently in discussions with potential partners for Europe and Japan and hope to secure a partnering agreement once the final Phase IIb data is available. Following completion of the Phase IIb clinical trial with Fibrostat[®] and regulatory approval of Phase III protocols, Procyon intends to conduct separate pivotal studies in Europe and North America in collaboration with licensee partners for these respective regions.

CORPORATE UPDATE

The Company's three Scientific Advisory Boards (PCK3145, chaired by Dr. Howard I. Scher; PL-100, chaired by Dr. Mark Wainberg; and Fibrostat[®], chaired by Dr. Thomas Mustoe) continue to be actively involved in the development plans of our most advanced therapeutic candidates.

Finally, we initiated a series of road shows in North America and Europe in which we presented to both the scientific and financial communities. We were most happy with the feedback we received on the recent progress of our most-advanced drug candidates. Last August, we were pleased to report that Mark Knapp, Ph.D., MBA, Biotech Analyst at Loewen, Ondaatje, McCutcheon Limited (LOM), had initiated coverage of the Company. Dr. Knapp is the lead analyst in the Biotechnology and Health Sciences Equity Research Group at LOM, where he focuses on identifying high quality growth opportunities. We believe this will increase Procyon's exposure through Loewen, Ondaatje, McCutcheon's clients.

On behalf of our Board of Directors and Management Team, I would like to thank all of our shareholders and employees as we are about to deliver on our most anticipated milestones.

Signed "Hans J. Mäder"

Chairman, President & Chief Executive Officer

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

The following information should be read in conjunction with the Company's unaudited consolidated financial statements and related notes included herein, together with our audited consolidated financial statements for the year ended December 31, 2003 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. 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. All amounts shown are stated in Canadian dollars. This review was prepared by management from information available to October 25, 2004. Additional information relating to the Company, including the Company's Annual Information Form and its quarterly reports to shareholders for the quarters ended March 31, 2004 and June 30, 2004, can be found on SEDAR at www.sedar.com.

OVERVIEW

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

Procyon's products and technologies are steadily advancing from research through development, preclinical and clinical studies. As a result, today Procyon has three near-term value drivers, namely PCK3145, a treatment for prostate cancer for which a Phase IIa trial was completed in June 2004; Fibrostat[®], a topical cream for hypertrophic scars licensed out to Biovail Corporation for North American markets that is currently in a Phase IIb trial; and PL-100, a very unique protease inhibitor that is currently in the pre-clinical phase. The Company is also developing a medical device, PSP⁹⁴ Serum-based immunoassay, a reliable, quick-and-easy test to detect and monitor prostate cancer, and has licensed Colopath[®], a simple screening and monitoring test for colorectal cancer, to IMI International Medical Innovations Inc. The Company is also developing two other therapeutics: ANsA, a technology platform with potential therapeutic applications to various cancers; and PL-2500, an integrase inhibitor that addresses a novel mechanism of action for the treatment of HIV/AIDS. A thorough scientific review of the ANsA technology to determine its future direction commenced in the second quarter and is expected to be completed by year-end.

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

Revenues

We have not generated any significant revenues from product sales since 1997. Revenues have been earned primarily from research and development out-licensing and tax credits, and from interest on available cash balances. We expect to continue to receive such revenues during the next several years, as well as licensing revenues to be earned upon attaining certain milestones.

Research and Development Expenses

Our research and development expenses consist primarily of salaries and related personnel costs, fees paid to external service providers, laboratory supplies and costs for leasing of facilities and equipment. In the first nine months of 2004, fees paid to external service providers were primarily related to Phase IIb clinical trials for Fibrostat[®], Phase IIa trials for PCK3145 and pre-clinical costs for PL-100.

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

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 increase our research and development expenses materially over the next several years. These costs are expected to be borne to some extent by various corporate partners under research collaborations and licensing agreements.

We also have a number of other discovery and development programs to identify and develop other therapeutic and diagnostic products. This process is part of our ongoing research and development activities and, until product candidates are identified, significant clinical expenditures are not anticipated.

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, with the exception of certain intellectual property, are located in Canada.

RESULTS OF OPERATIONS

Quarter ended September 30, 2004 compared with the Quarter ended September 30, 2003

The Company incurred a net loss of \$3,365,623 or \$0.04 per common share for the third quarter of 2004, compared with a net loss of \$2,772,512 or \$0.04 per common share for the same quarter last year.

Revenues for the current quarter were \$82,231, compared with \$62,278 in the corresponding quarter last year. The higher revenues resulted primarily from an increase in interest income, due to the higher level of cash and short-term investments on hand following the \$17,250,000 financing that was closed on April 7, 2004, partially offset by a reduction in interest rates in the current quarter compared to the third quarter of 2003.

Research and development expenses amounted to \$2,695,881 in the third quarter of 2004, compared with \$2,160,536 in the same quarter last year. Higher levels of spending on PL-100 and Fibrostat[®] compared with the third quarter of 2003 were the primary cause of the increase in the current quarter, partly offset by decreased expenditures on PCK3145 and ANsA. Tax credits increased to \$385,000 in the current quarter from \$306,268 in the same quarter last year. Research and development expenses represented 70% of total expenses before tax credits in the current quarter, compared with 69% in the corresponding quarter last year.

General and administrative expenses amounted to \$785,624 in the third quarter of 2004, an increase of \$52,931 or 7% over the total of \$732,693 for the third quarter last year. The higher expenses primarily reflected an increase in compensation costs, in part non-cash compensation resulting from stock options, partially offset by a reduction in consulting fees.

Amortization expense increased to \$269,949 from \$250,873 in the third quarter of 2003. The increase resulted primarily from the amortization of the deferred financing costs incurred for the Biolevier loan facility.

Financial charges increased to \$89,981 from \$1,008 in the third quarter last year. The increase was due to the interest on the Biolevier loan, which is being capitalized and added to the outstanding balance of the loan.

Nine Months ended September 30, 2004 compared with the Nine Months ended September 30, 2003

A net loss of \$11,094,157 or \$0.14 per common share was incurred during the nine months ended September 30, 2004, compared with a net loss of \$7,526,889 or \$0.12 per common share for the nine months ended September 30, 2003.

Revenues of \$247,711 were earned in the first nine months of 2004, compared with \$240,973 in the same period last year. The increase was the result of higher interest income, partially offset by lower license revenue. The higher interest income reflected the favourable effect of higher cash and short-term investment balances in the current period, which more than offset the negative impact of lower interest rates.

Research and development expenses for the nine months ended September 30, 2004 were \$8,630,898, compared with \$5,665,120 in the corresponding period last year. The increase reflected primarily a higher level of spending on the Fibrostat[®] clinical trial, together with the increased expenditures on PL-100, which was acquired in April 2003 through the acquisition of Pharmacor Inc. and consequently did not impact the 2003 expenses until the second quarter. Tax credits increased to \$1,080,000 in the first nine months of 2004, from \$832,575 in the same period last year. Research and development expenses represented 69% of total expenses before tax credits in the current period, compared with 66% in the corresponding period last year.

General and administrative expenses amounted to \$2,739,604 in the first nine months of 2004, an increase of \$457,280 or 20% over the total of \$2,282,324 for the corresponding period last year. The increase was primarily due to higher non-cash compensation from the expensing of stock options.

Amortization expense increased to \$803,187 in the current period from \$615,456 in the same period last year. The increase resulted primarily from the full period effect in the current period of amortization of equipment and intellectual property obtained through the Pharmacor acquisition in April 2003, together with the amortization of the deferred financing costs incurred for the Biolevier loan facility.

Financial charges increased to \$272,773, from \$17,379 in the first nine months last year. The increase was mainly due to the interest on the Biolevier loan, which is being capitalized and added to the outstanding balance of the loan.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations and its acquisitions of technology and capital assets primarily through private placements and public issues of common shares, scientific research investment tax credits, interest income and amounts received under licensing agreements for certain of its products. In addition, a loan agreement entered into in December 2002 expanded the Company's financing base by providing it with a loan facility of \$10 million obtained under the Biolevier program of the Government of Quebec, from which an amount of \$5 million was drawn in November 2003, leaving an amount of \$5 million available for future use.

Cash and cash equivalents and short-term investments totaled \$14,159,531 at September 30, 2004, compared with \$9,917,167 at December 31, 2003. The increase of \$4,242,364 resulted from the net cash proceeds of \$15,642,635 realized from the sale on April 7, 2004 of 17.25 million Units at \$1.00 per Unit, each comprised of one common share of the Company and one-half of a common share purchase warrant. Each whole purchase warrant entitles the holder to purchase one additional common share of the Company at a price of \$1.25 at any time during the 24 months following the closing. A total of \$11,685,026 was utilized to finance operating activities for the first nine months of 2004, including an increase of \$2,088,192 in non-cash working capital. In addition, \$169,198 was spent in the period for the purchase of property, plant and equipment and intellectual property. An amount of \$128,160 was generated from the issue of common shares associated with the exercise

of stock options. An amount of \$330,000 was obtained through the issue of a convertible debenture to Biovail Laboratories Inc. under the Canadian licensing agreement for the development of Fibrostat®.

The Biolevier loan does not adversely impact the Company's liquidity at this time, as no capital or interest is payable on the loan in the first three years following the initial disbursement in November 2003.

Management believes that it has sufficient funds available, including the balance of \$5 million available from the Biolevier loan facility referred to above, to support its ongoing activities through 2005.

Contractual Obligations

There was no material change in the amount of contractual obligations during the quarter ended September 30, 2004. There were no commitments for capital expenditures as at September 30, 2004.

Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet arrangements during the quarter ended September 30, 2004 and does not expect to enter into any, other than in the normal course of business, in the near future.

Related Party Transactions

There has been no material change during the quarter ended September 30, 2004.

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.

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 were reported in the Management's Discussion and Analysis of Financial Condition and Results of Operations for the quarter ended March 31, 2004 and these continue to apply for the quarter ended September 30, 2004.

Changes in Accounting Policies

There have been no changes in accounting policies adopted by the Company during the quarter ended September 30, 2004.

Financial Instruments

The Company does not use currency or other hedging instruments.

Outstanding Share Data

As of October 25, 2004 there are 4,000,000 First Preferred Shares, Series 1 outstanding, unchanged from December 31, 2003. The number of common shares outstanding as of October 25, 2004 is 84,851,399, an increase of 17,515,500 from December 31, 2003, 17,250,000 resulting from the sale of Units on April 7, 2004 and 265,500 from the exercise of stock options. The number of stock options outstanding at October 25, 2004 is 3,604,500, a decrease of 34,000 from December 31, 2003. In addition, 16,924,315 warrants are outstanding on October 25, 2004, compared to 6,970,897 at December 31, 2003. The increase resulted from the sale of Units on April 7, 2004, partially offset by the expiry of 482,832 Broker units issued in May 2002.

Form 52-109FT2 – Certification of Interim Filings during Transition Period

I, Hans J. Mäder, Chairman, President & Chief Executive Officer of Procyon Biopharma Inc., certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Procyon Biopharma Inc., for the interim period ending September 30, 2004;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

Signed "Hans J. Mäder"

Date: October 25th, 2004

Chairman, President
& Chief Executive Officer

I, Monique Létourneau, Executive Vice-President, Finance & Chief Financial Officer of Procyon Biopharma Inc., certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Procyon Biopharma Inc., for the interim period ending September 30, 2004;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

Signed "Monique Létourneau"

Date: October 25th, 2004

Executive Vice-President Finance
& Chief Financial Officer

PROCYON BIOPHARMA INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

As at	September 30, 2004 \$	December 31, 2003 \$
ASSETS		
Current assets		
Cash and cash equivalents	4,016,057	476,673
Short-term investments	10,143,474	9,440,494
Accounts receivable	208,490	213,946
Investment tax credits recoverable	1,917,004	1,047,500
Prepaid expenses	176,024	155,093
	16,461,049	11,333,706
Property, plant and equipment	880,665	1,034,677
Intellectual property	6,875,638	7,305,837
Long-term investments (note 2)	-	7,001
Deferred financing fees	613,908	663,686
	24,831,260	20,344,907
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	380,555	1,582,775
Deferred revenue	-	9,617
	380,555	1,592,392
Biolevier loan facility	5,312,413	5,043,223
Convertible debenture (note 3)	50,000	50,000
Preferred shares	4,000,000	4,000,000
	9,742,968	10,685,615
Shareholders' equity (note 4)		
Share capital	61,297,826	47,874,176
Warrants	2,557,549	751,292
Contributed surplus	3,513,414	2,550,164
Equity component of convertible debenture (note 3)	1,005,000	675,000
Deficit	(53,285,497)	(42,191,340)
	15,088,292	9,659,292
	24,831,260	20,344,907

See accompanying notes

PROCYON BIOPHARMA INC.
CONSOLIDATED STATEMENTS OF
OPERATIONS AND DEFICIT

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
	\$	\$	\$	\$
REVENUES				
License revenue	-	4,417	9,617	23,850
Interest and other income	82,231	57,861	238,094	217,123
	82,231	62,278	247,711	240,973
EXPENSES				
Research and development	2,695,881	2,160,536	8,630,898	5,665,120
Research and development tax credit	(385,000)	(306,268)	(1,080,000)	(832,575)
Net research and development	2,310,881	1,854,268	7,550,898	4,832,545
General and administrative	785,624	732,693	2,739,604	2,282,324
Amortization of property, plant and equipment	80,144	80,613	233,926	181,021
Amortization of intellectual property	173,212	170,260	519,483	434,435
Amortization of deferred financing fees	16,593	-	49,778	-
Interest on Biolevier loan	89,127	-	269,190	-
Write-down of investment	-	-	7,001	46,000
Other financial charges	854	1,008	3,583	17,379
Foreign exchange gains	(8,581)	(4,052)	(31,595)	(25,842)
	3,447,854	2,834,790	11,341,868	7,767,862
Net loss	(3,365,623)	(2,772,512)	(11,094,157)	(7,526,889)
Deficit, beginning of period	(49,919,874)	(36,226,715)	(42,191,340)	(31,472,338)
Deficit, end of period	(53,285,497)	(38,999,227)	(53,285,497)	(38,999,227)
Basic and diluted loss per share	(0.04)	(0.04)	(0.14)	(0.12)
Weighted average number of common shares outstanding	84,600,063	67,179,987	78,476,946	61,416,096

See accompanying notes

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

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss	(3,365,623)	(2,772,512)	(11,094,157)	(7,526,889)
Add non-cash items				
Amortization of property, plant and equipment	80,144	80,613	233,926	181,021
Amortization of intellectual property	173,212	170,260	519,483	434,435
Amortization of deferred financing fees	16,593	-	49,778	-
Write-down of investments	-	-	7,001	46,000
Loan interest capitalized	89,127	-	269,190	-
Non-cash license revenues	-	(4,417)	(4,417)	(13,250)
Non-cash stock-based compensation (note 4)	60,753	-	422,362	80,517
	(2,945,794)	(2,526,056)	(9,596,834)	(6,798,166)
Net change in non-cash balances relating to operations	(951,919)	236,304	(2,088,192)	(1,693,839)
Cash flows related to operating activities	(3,897,713)	(2,289,752)	(11,685,026)	(8,492,005)
INVESTING ACTIVITIES				
Acquisition of intellectual property	(81,041)	(60,237)	(89,284)	(124,963)
Acquisition of property, plant and equipment	(16,399)	(31,607)	(79,914)	(156,459)
Cash and cash equivalents obtained on acquisition of business	-	-	-	159,832
Business acquisition expenses	-	-	-	(236,255)
Purchase of short-term investments	(5,743,474)	(3,502,284)	(10,143,474)	(9,452,184)
Maturities of short-term investments	-	4,957,420	9,440,494	18,316,970
Cash flows related to investing activities	(5,840,914)	1,363,292	(872,178)	8,506,941
FINANCING ACTIVITIES				
Issuance of units	-	-	17,250,000	3,530,000
Unit issue expenses	(14,211)	-	(1,607,365)	(317,711)
Issuance of common shares	44,850	9,600	128,160	9,600
Debt financing costs	-	(25,320)	-	(103,085)
Repayment of long-term debt assumed in an acquisition	(383)	(15,602)	(4,207)	(41,013)
Repayment of bank indebtedness	-	(624,280)	-	(624,280)
Issuance of convertible debenture (note 3)	-	-	330,000	-
Cash flows related to financing activities	30,256	(655,602)	16,096,588	2,453,511
Net increase (decrease) in cash and cash equivalents	(9,708,371)	(1,582,062)	3,539,384	2,468,447
Cash and cash equivalents, beginning of period	13,724,428	4,429,517	476,673	379,008
Cash and cash equivalents, end of period	4,016,057	2,847,455	4,016,057	2,847,455
Supplemental cash flow information				
Cash paid during the period for interest	16	2,608	2,853	15,267

See accompanying notes

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004

(unaudited)

1. Basis of presentation

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to interim financial statements and follow the same accounting policies and methods of application as the most recent annual financial statements. The interim financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the most recent annual financial statements as at and for the year ended December 31, 2003.

2. Long-term investments

As at June 30, 2003 the Company wrote down the carrying value of a warrant to purchase 75,000 common shares of IMI International Medical Innovations Inc. from \$53,000 to \$7,000, management's estimate of the fair value of the warrant at June 30, 2003, using the Black-Scholes option pricing model, with a volatility factor of 47% and a risk-free interest rate of 3%. The write-down was recorded as an expense during the second quarter of 2003. This warrant expired without value on March 19, 2004 and the remaining carrying value of \$7,000 was written off at that time.

3. 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 September 30, 2004, the Company has received \$1,055,000, including \$330,000 that was advanced during the second quarter of 2004. Of the total amount received to date, \$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 interest accretion and at maturity will be equal to the face value of the debenture.

4. Share capital

Common shares

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

	Number of shares	Stated capital \$
Balance as at December 31, 2003	67,335,899	47,874,176
Issued for cash on exercise of stock options	233,000	128,160
Issued on conversion of Units	17,250,000	15,180,000
Unit issuance costs – cash	-	(1,408,529)
Unit issuance costs – broker compensation warrants	-	(475,981)
Balance as at September 30, 2004	84,818,899	61,297,826

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004

(unaudited)

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 of one 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 cash issue costs totaling \$1,607,365, the Company 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 amounts by \$475,981 and \$64,907 respectively and increased Contributed Surplus by \$540,888.

Stock option plan

On June 17, 2004, the maximum number of common shares to be issued pursuant to the Company's stock option plan was increased to 8,467,639. As at September 30, 2004, there were 3,637,000 stock options outstanding, compared to 3,638,500 at December 31, 2003.

	2004		2003	
	Number	Weighted Average Exercise price	Number	Weighted Average Exercise price
Options outstanding January 1	3,638,500	1.25	3,765,300	1.29
Granted	1,854,000	0.97	506,500	0.41
Forfeited	(350,000)	1.55	(14,900)	1.10
Expired	(1,272,500)	1.74	(288,650)	1.00
Exercised	(233,000)	0.55	(16,000)	0.60
Options outstanding September 30	3,637,000	0.95	3,952,250	1.20
Exercisable	2,404,667	0.95	3,072,252	1.38

All options were granted with an exercise price equal to the market price of the Company's shares at the date of grant. Compensation expense of \$355,017 has been recognized in the first nine months of 2004 for stock options granted to employees and directors and an additional amount of \$67,345 has been expensed for options granted to consultants. The expense was based on the fair value of the options at the date of grant determined using the Black-Scholes option pricing model with a volatility factor of from 70% to 82%, a risk-free interest rate of from 3% to 4%, a dividend yield of nil and an expected life of up to three years. Effective January 1, 2003, the Company began prospectively recording compensation expense for awards granted to employees. In 2002, the fair value of options granted to employees was not expensed. Had compensation expense for 2002 been determined based on the fair value of options as of the date of grant using the Black-Scholes option pricing model, with a volatility factor of 63%, a risk-free interest rate of 4%, a dividend yield of nil and a weighted-average expected life of the options of three years, and had the fair value been amortized over the vesting period of the options, the Company's net loss and loss per common share would have been as follows:

Procyon Biopharma Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004

(unaudited)

	Three months ended September 30		Nine months ended September 30	
	2004	2003	2004	2003
	\$	\$	\$	\$
Net loss - as reported	(3,365,623)	(2,772,512)	(11,094,157)	(7,526,889)
Net loss – pro forma	(3,370,794)	(2,787,529)	(11,127,098)	(7,571,941)
Loss per share – basic and diluted				
As reported	(0.04)	(0.04)	(0.14)	(0.12)
Pro forma	(0.04)	(0.04)	(0.14)	(0.12)

Warrants

	Number	\$
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	-	(263,743)
Broker warrants for Units	1,207,500	-
Warrants from Broker Units	603,750	-
Expired Broker warrants	(482,832)	-
Balance as at September 30, 2004	16,924,315	2,557,549

Contributed surplus

	\$
Balance as at December 31, 2003	2,550,164
Compensation warrants issued to underwriters	540,888
Options issued to consultants	67,345
Options granted to employees and directors	355,017
Balance as at September 30, 2004	3,513,414

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

5. Comparative figures

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