



**Message to shareholders,**

**May 14, 2002**

We are very pleased to submit this report on the results for the quarter ended March 31, 2002. It was a very important and productive quarter for the Company as we achieved several key milestones.

At the beginning of the year we announced the signing of a licensing agreement with Biovail Corporation for the U.S. rights to our product Fibrostat<sup>®</sup>, a novel topical therapeutic for hypertrophic scars resulting from surgery and burns. The terms of the agreement included an upfront investment of \$4 million in the form of preferred shares in Procyon, milestone licensing payments totaling \$5 million, and a double-digit royalty on sales when Fibrostat<sup>®</sup> is commercialized. In addition, Biovail will also cover all the development costs relating to the clinical trials and obtaining regulatory approval of the product in the U.S. As Procyon already had assigned the Canadian licensing rights to Biovail, the U.S. licensing agreement further strengthens our collaboration with Biovail and allows us to develop a more unified North American strategy for the clinical trials and regulatory approval for Fibrostat<sup>®</sup>.

As planned, we completed the Canadian Phase II trials for Fibrostat<sup>®</sup> and anticipate completion of all statistical analysis of the results in the second quarter of 2002.

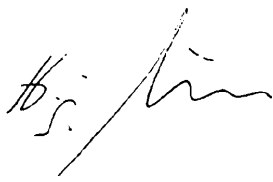
In the first quarter, we were also pleased to announce the signing of an exclusive License Option agreement with Chiron Corporation for one of our platform technologies, the PSP<sup>94</sup> (Prostate Secretory Peptide) technology for prostate cancer therapeutics and diagnostics. The six month option agreement allows Chiron to assess the potential of PSP<sup>94</sup> based therapeutics, particularly the recombinant form of PSP<sup>94</sup>, for possible licensing.

In a subsequent event pertaining to this platform technology, we were delighted to report the approval by the Medicines Control Agency of the U.K. to commence human clinical trials with the drug PCK3145, a synthetic peptide analogue of PSP<sup>94</sup>, for the treatment of late stage hormone resistant prostate cancer. The Phase IIa trial, which is expected to commence in June 2002, represents a major milestone as PCK3145 was entirely developed within Procyon. We continue to make rapid progress in the development of a diagnostic/prognostic assay for prostate cancer, using the PSP<sup>94</sup> technology.

We are on track with the development of the monoclonal antibody c2C5 emanating from our second platform technology, the Antinucleosome Antibody (ANA) technology. A chimeric (murine-human) hybrid antibody is currently scheduled to be produced in a GMP grade suitable for human clinical trials anticipated in late 2002 or early 2003.

Our licensing partner for the Colopath<sup>®</sup> technology, IMI International Medical Innovations Inc., is currently evaluating the technology in clinical trials, in combination with their own ColorectAlert<sup>™</sup> technology for the screening of colorectal cancer. At the same time, negotiations are ongoing with potential marketing partners.

On May 10, 2002, the Company successfully completed a bought deal financing by issuing 6,897,600 Units at \$1.45 each, for total gross proceeds of \$ 10 million. Each Unit consists of one common share of Procyon and one-half of a common share purchase warrant. Each whole common share purchase warrant entitles the holder to purchase one additional common share of the Company for \$1.75 up to November 2003.

A handwritten signature in black ink, appearing to read 'H. J. Mäder', with a long, sweeping horizontal stroke extending to the right.

Hans J. Mäder  
Chairman, President & CEO

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

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

### **RESULTS OF OPERATIONS**

#### **Quarter ended March 31, 2002 compared with the Quarter ended March 31, 2001**

The Company incurred a net loss of \$1,612,835 or \$0.04 per common share for the first quarter of 2002, compared with a net loss of \$1,968,217 or \$0.04 per common share for the same quarter last year.

Revenues for the current quarter were \$71,337, compared with \$177,103 in the corresponding quarter last year. The reduced revenues reflected a decrease in interest income due to the comparatively lower level of cash and short-term investments in the current quarter, together with the decline in interest rates compared with the first quarter of 2001, partially offset by license revenue generated in the first quarter of 2002.

Research and development expenses amounted to \$1,235,285 in the first quarter of 2002, compared with \$1,409,439 in the same quarter last year, a decrease of 12%. The higher level of spending in the first quarter of 2001 primarily reflected significant expenditures on the PSP<sup>94</sup> and ANA technologies. Tax credits increased to \$179,000 in the current quarter from \$159,000 in the same quarter last year. Research and development expenses represented 66% of total expenses before tax credits in the current quarter, compared with 61% in the corresponding period last year.

General and administrative expenses amounted to \$506,960 in the first quarter of 2002, a reduction of \$285,224 or 36% from the same period last year. The lower expenses primarily reflected reduced spending in the current period for professional fees, employee compensation and recruitment expenses.

Amortization expense increased to \$120,654 from \$102,302 in the first quarter of 2001. The increase resulted from the investment during the past year on intellectual property.

### **LIQUIDITY AND CAPITAL RESOURCES**

Cash and cash equivalents and short-term investments at March 31, 2002 totalled \$7,648,032 compared with \$5,566,152 at December 31, 2001. The increase of \$2,081,880 resulted from the issue of \$4,000,000 of First Preferred Shares, Series 1 on January 4, 2002 in connection with the licensing agreement granting the United States marketing rights to FIBROSTAT<sup>®</sup> to Biovail Corporation. This amount was

supplemented by proceeds of \$447,250 from the repayment of a shareholder loan and the issue of common shares during the quarter, resulting from the exercise of stock options. A total of \$2,359,955 was utilized to finance operating activities for the quarter, including an increase of \$867,774 in non-cash working capital.

In addition, on May 10, 2002 the Company realized gross cash proceeds of \$10 million from the issue of units, each comprised of one common share and one-half of a common share purchase warrant. The proceeds of this financing, together with the cash and short-term investments already on hand, are expected to be sufficient to support the Company's activities for more than two years.

### **Safe Harbour Statement**

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

**PROCYON BIOPHARMA INC.**  
**CONSOLIDATED BALANCE SHEETS**

As at	March 31, 2002 (unaudited) \$	December 31, 2001 (audited) \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	5,565,552	540,934
Short-term investments	2,082,480	5,025,218
Accounts receivable	200,700	324,922
Investment tax credits recoverable	1,397,537	1,806,064
Prepaid expenses	62,340	33,263
	<b>9,308,609</b>	<b>7,730,401</b>
Property, plant and equipment	476,728	494,103
Intellectual property	4,748,054	4,845,918
Investments	53,001	53,001
	<b>14,586,392</b>	<b>13,123,423</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	642,724	1,994,153
Deferred revenue	97,933	117,950
	<b>740,657</b>	<b>2,112,103</b>
Convertible debenture	50,000	50,000
Preferred shares (note 3)	4,000,000	-
	<b>4,790,657</b>	<b>2,162,103</b>
<b>Shareholders' equity [note 3]</b>		
Share capital	33,945,337	33,498,087
Other paid-in capital	862,000	862,000
Warrants	233,687	233,687
Equity components of convertible debenture	612,500	612,500
Deficit	(25,857,789)	(24,244,954)
	<b>9,795,735</b>	<b>10,961,320</b>
	<b>14,586,392</b>	<b>13,123,423</b>

See accompanying notes

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

	<b>Three months ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
	<b>\$</b>	<b>\$</b>
<b>REVENUES</b>		
License revenue	20,017	-
Interest and other income	51,320	177,103
	<b>71,337</b>	<b>177,103</b>
<b>EXPENSES</b>		
Research and development	1,235,285	1,409,439
Research and development tax credit	(179,000)	(159,000)
General and administrative	506,960	792,184
Amortization of property, plant and equipment	19,905	20,199
Amortization of intangibles	100,749	82,103
Interest and bank charges	273	395
	<b>1,684,172</b>	<b>2,145,320</b>
<b>Net loss</b>	<b>(1,612,835)</b>	<b>(1,968,217)</b>
Deficit, beginning of period	(24,244,954)	(14,892,791)
<b>Deficit, end of period</b>	<b>(25,857,789)</b>	<b>(16,861,008)</b>
<b>Basic and diluted loss per share</b>	<b>(0.04)</b>	<b>(0.04)</b>
<b>Weighted average number of common shares outstanding</b>	<b>45,210,669</b>	<b>43,887,500</b>

See accompanying notes

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

	<b>Three months ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss	(1,612,835)	(1,968,217)
Add non-cash items		
Amortization	120,654	102,302
	(1,492,181)	(1,865,915)
Net change in non-cash working capital balances related to operations	(867,774)	(149,143)
<b>Cash flows related to operating activities</b>	<b>(2,359,955)</b>	<b>(2,015,058)</b>
<b>INVESTING ACTIVITIES</b>		
Acquisition of intellectual property	(2,885)	(80,822)
Acquisition of property, plant and equipment	(2,530)	(28,972)
Sale of short-term investments	2,942,738	199,892
<b>Cash flows related to investing activities</b>	<b>2,937,323</b>	<b>90,098</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of common shares	447,250	32,716
Issuance of preferred shares	4,000,000	-
Issuance of convertible debenture	-	62,500
<b>Cash flows related to financing activities</b>	<b>4,447,250</b>	<b>95,216</b>
Net increase (decrease) in cash and cash equivalents	5,024,618	(1,829,744)
Cash and cash equivalents, beginning of period	540,934	2,150,290
<b>Cash and cash equivalents, end of period</b>	<b>5,565,552</b>	<b>320,546</b>
<b>Supplemental cash flow information</b>		
Cash paid during the period for interest	-	-

See accompanying notes

**Procyon Biopharma Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2002

(unaudited)

**1. Basis of presentation**

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

**2. Changes in accounting policies**

**(i) Intangible assets**

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

## **Procyon Biopharma Inc.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2002

(unaudited)

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

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

### **3. Share capital**

#### **Common shares**

The Company is authorized to issue an unlimited number of common shares. As at March 31, 2002, 45,429,008 common shares valued at \$33,945,337 were issued and outstanding (45,114,008 common shares valued at \$33,498,087 at December 31, 2001). During the three months ended March 31, 2002 a total of 315,000 common shares were issued for cash on exercise of stock options and a \$100,000 shareholder loan was repaid.

#### **Preferred shares**

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

On January 4, 2002, the Company issued 4,000,000 First Preferred Shares, Series 1 for total consideration of \$4,000,000. From January 1, 2004 to December 31, 2006, the holder of these shares may elect (i) to convert them into common shares at two times the market price on the date of conversion, or (ii) to require Procyon to redeem them for cash, in which case Procyon must redeem the shares if it has received sufficient cash to do so, pursuant to a licensing agreement with the holder, and, if not, Procyon may convert such shares into common shares at the market price at the date of conversion.

## **Procyon Biopharma Inc.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2002

(unaudited)

If no election is made prior to December 31, 2006, Procyon may redeem the shares on or prior to January 30, 2007 for cash or convert them into common shares at the market price on the date of conversion. Since these shares are retractable, they have been included with liabilities on the balance sheet.

### **Stock option plan**

As at March 31, 2002, 3,558,932 stock options were outstanding compared to 3,958,932 as at December 31, 2001. During the three months ended March 31, 2002, no options were granted, 315,000 options were exercised and 85,000 options were forfeited.

### **Warrants**

As at March 31, 2002, there were 5,470,625 common shares reserved for issuance upon the exercise of warrants, which was unchanged from December 31, 2001.

### **4. Comparative figures**

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

### **5. Subsequent events**

On April 5, 2002, the Company amended the terms of the common share purchase warrants issued on July 31, 2000 to lower the exercise price to \$2.62 per common share from \$3.93 per common share and to extend the time up to which the warrants may be exercised until April 10, 2003. For insiders of the Company, these amendments will become effective only upon approval of the shareholders of the Company at the annual and special meeting of shareholders to be held on June 5, 2002. As a result of these amendments, the Company will increase other paid-in capital by \$350,000, with an offsetting charge to the deficit.

On May 10, 2002, the Company sold 6,897,600 Units at \$1.45 each, for total proceeds of \$10,001,520, before cash issue expenses estimated at \$900,000. Each Unit consisted of one common share of the Company and one-half of one Common Share Purchase Warrant. Each whole Common Share Purchase Warrant entitles the holder to purchase one additional common share of the Company for \$1.75 up to November 10, 2003.