

**Dear Shareholders,**

**May 22, 2001**

We are pleased to submit this report, for our First Quarter, ended March 31, 2001. The Company continues to make significant progress in the path to meet its corporate objectives and thereby, build value for its shareholders.

### **Personnel**

During the quarter Dr. Toney Ilenchuk, Vice-president, Clinical and Scientific Development, left the Company to pursue other career opportunities. The Board of Directors of Procyon would like to thank Dr. Ilenchuk for all his contributions and accomplishments while working in both London and subsequently here in Montreal.

To enhance its investor relation's function and increase its visibility within the financial community, Procyon retained the services of Renmark Financial Communications Inc., a Montréal-based Investor Relations firm.

### **Procyon's Science**

In March 2001, four posters presentations were made by Procyon's scientists at the American Association for Cancer Research (AACR) annual meeting. These posters summarized work being done both in-house, as well as in collaboration at academic institutions. These results provide additional validation of the innovative anti-cancer platform technologies being developed by the company:

- 1) The preclinical work being conducted at North-Eastern University in Dr. Vladimir Torchilin's laboratory on Antinuclear Auto-antibodies (ANA) based vaccination strategies has clearly demonstrated the potential of ANA based vaccines as a preventative and therapeutic products against several different types of cancer.
- 2) By binding to a wide range of cancer cells without having an effect on normal cells, the ANA monoclonal antibodies (mAb) could also be used for delivery of imaging agents or drugs to cancer cells. To further this application, Procyon's scientists have developed a method to protect the ANA mAb from inactivation during the process of labeling.
- 3) Research work done at Procyon proved that recombinant human PSP<sup>94</sup> has similar anti-tumor activity both *in vitro* and *in vivo* when compared to native PSP<sup>94</sup> for the treatment of prostate cancer. The recombinant PSP<sup>94</sup> is a backup to the lead synthetic peptide candidate chosen by Procyon for clinical trials.
- 4) The research work conducted by Dr. Michael Clarke at the University of Western Ontario on recombinant rat PSP<sup>94</sup> further validates the potential of PSP<sup>94</sup> as a therapeutic against prostate cancer.

## **Clinical and Business Development**

A major milestone was achieved late this February, when the IND for Phase II dose finding study for FIBROSTAT<sup>®</sup> was approved by the Therapeutics Products Program (TPP) branch of Health Canada. Procyon's development partner, Crystaal, a subsidiary of Biovail Corporation, filed the IND. Currently, the Company is actively involved in pursuing discussions with potential licensing partners for FIBROSTAT<sup>®</sup> in other jurisdictions, including the US and Europe.

On March 20, Procyon announced the signing of a worldwide license agreement with International Medical Innovations Inc. (IMI) for its COLOPATH<sup>®</sup> colorectal cancer screening technology, achieving another corporate objective. This license grants IMI the right to develop, market and distribute its colorectal cancer screening technology COLOPATH<sup>®</sup>. The terms of the agreement include upfront and milestone payments as well as royalties on sales of any rectal mucus based screen test for colorectal cancer. In February, the United States Patent and Trademark Office granted US patent #6,187,591 entitled "Screening test for early detection of colorectal cancer" to Procyon; this is the second US patent related to this technology.

## **FIRST QUARTER FINANCIAL RESULTS**

The Company's net loss for the quarter ended March 31, 2001 was \$1,968,217 compared to a loss of \$1,324,315 for the quarter ended March 31, 2000.

Revenues for the quarter ended March 31, 2001 increased by \$152,182 to \$177,103 from \$24,921 for the quarter ended March 31, 2000. The increased revenue resulted from interest earned from term deposits.

Research and development expenses, before research and development tax credits, increased by \$1,036,442 to \$1,409,439 for the quarter ended March 31, 2001 from \$372,997 for the quarter ended March 31, 2000. The increase is a result of the initiation of clinical trials for Fibrostat<sup>®</sup>, increased research and pre-clinical testing in both PSP<sup>94</sup> and ANA and the increase in the number of employees in the research related area.

For the quarter ended March 31, 2001, the Company accrued \$159,000 in research tax credits on its current expenditures, compared to \$63,458 for the quarter ended March 31, 2000. The increase reflects the higher spend on our research and development projects.

General and administrative expenses for the quarter ended March 31, 2001 decreased by \$72,487 to \$792,184 compared to \$864,671 for the quarter ended March 31, 2000. This decrease is attributed to reduced travel as during the first quarter of 2000 management was involved in many financial presentations, which resulted in a special warrant offering in April of 2000.

In December 2000, management of the Company changed its existing policy and is now amortizing all patent costs and license fees on a straight-line basis over 15 years from date of acquisition. As a result the financial statements for the quarter ended March 31, 2000 have been restated to reflect the accounting change. For the quarter ended March 31, 2001 the amortization

expense increased by \$37,367 to \$102,302 compared to \$64,935 for the quarter ended March 31, 2000. This increase expense is a result of our purchase of the license for Colopath® in late 2000.

### **Financial Position**

Total assets at March 31, 2001 were \$18,159,780, a decrease from December 31, 2000 of \$2,193,483. The decrease in assets is largely attributable to loss for the quarter.

Liabilities decreased by \$ 320,482 to \$734,735 as at March 31, 2001 compared to \$1,055,217 as at December 31, 2000. This decrease can be attributed to a decrease in accounts payable offset by deferred revenue generated by the out-licensing of Colopath®. The deferred revenue will be recognized as income over the next twenty-four months.

### **Liquidity and Capital Resources**

The Company's liquidity consists of cash, cash equivalents and short-term investments. As at March 31,2001, our liquid assets totaled \$12,133,534 compared to \$14,163,170 as at December 31, 2000. This decrease is attributable to the operating loss for the quarter.

Management believes that it has sufficient liquidity to support its activities for at least the next eighteen months. We expect operating expenses to continue to increase as we further advance our research and development activities. Future revenue which will be derived from research contracts and the commercialization of the Company's products may not be realized on a timely basis or be sufficient to support operating cash, therefore the Company may require additional financing to meet its cash requirements and future obligations.

### **Safe Harbour Statement**

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

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

**PROCYON BIOPHARMA INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(unaudited)

As at	March 31, 2001	December 31, 2000
	\$	\$
		[restated - note 2]
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	12,133,534	14,163,170
Accounts receivable	199,515	221,363
Investment tax credits recoverable	427,689	667,000
Prepaid expenses	115,621	25,801
	12,876,359	15,077,334
Fixed assets	506,561	497,788
Intellectual property	4,776,859	4,778,140
Investments	1	1
	18,159,780	20,353,263
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	609,735	1,055,217
Deferred revenue [note 3]	125,000	-
	734,735	1,055,217
Convertible debenture	50,000	50,000
Future income taxes	414,000	414,000
	1,198,735	1,519,217
<b>Shareholders' equity [note 4]</b>		
Share capital	32,490,866	32,458,150
Other paid-in capital	785,000	785,000
Warrants	233,687	233,687
Equity components of convertible debenture	312,500	250,000
Deficit	(16,861,008)	(14,892,791)
	16,961,045	18,834,046
	18,159,780	20,353,263

See accompanying notes

**PROCYON BIOPHARMA INC**  
**CONSOLIDATED STATEMENTS OF**  
**LOSS AND DEFICIT**

(unaudited)

	<b>Three Months ended March 31,</b>	
	<b>2001</b>	<b>2000</b>
	\$	\$
		[restated - note 2]
<b>REVENUES</b>		
Sales	-	3,081
Interest and other income	<b>177,103</b>	21,840
	<b>177,103</b>	24,921
<b>EXPENSES</b>		
Research and development	<b>1,409,439</b>	436,455
Research and development credit	<b>(159,000)</b>	(63,458)
General and administrative	<b>792,184</b>	864,671
Write-down of investment	-	42,494
Depreciation and amortization	<b>102,302</b>	64,935
Interest and bank charges	<b>395</b>	4,139
	<b>2,145,320</b>	1,349,236
<b>Loss for the period</b>	<b>(1,968,217)</b>	(1,324,315)
Adjustment for income taxes	-	(575,000)
Deficit, beginning of period	<b>(14,892,791)</b>	(8,679,343)
<b>Deficit, end of period</b>	<b>(16,861,008)</b>	(10,578,658)
<b>Loss per share</b>	<b>(0.04)</b>	(0.05)
<b>Weighted average number of common shares outstanding</b>	<b>43,887,500</b>	25,192,125

See accompanying notes

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

**Three Months Ended March 31,**

	<b>2001</b>	<b>2000</b>
	\$	\$
		[restated - note - 2]
<b>OPERATING ACTIVITIES</b>		
Net loss for the period	(1,968,217)	(1,899,315)
Add non-cash items		
Amortization of capital assets	102,302	64,935
Write-down of investment	-	42,494
Increase in other paid-in capital	-	120,000
Recovery of future income taxes	-	575,000
	<b>(1,865,915)</b>	<b>(1,096,886)</b>
Net change in non-cash working capital balances related to operations	(149,143)	(280,861)
<b>Cash flows related to operating activities</b>	<b>(2,015,058)</b>	<b>(1,377,747)</b>
<b>INVESTMENT ACTIVITIES</b>		
Intellectual property	(80,822)	(10,461)
Acquisition of capital assets	(28,972)	(31,488)
Disposal of capital assets	-	18,757
<b>Cash flows related to investment activities</b>	<b>(109,794)</b>	<b>(23,192)</b>
<b>FINANCING ACTIVITIES</b>		
Issue of common shares	32,716	981,931
Share issue expenses	-	(115,026)
Repayment of long-term debt	-	(135,442)
Issuance of convertible debenture	62,500	50,000
<b>Cash flows related financing activities</b>	<b>95,216</b>	<b>781,463</b>
Net (decrease) in cash and cash equivalents	(2,029,636)	(619,476)
Cash position, beginning of period	14,163,170	2,034,511
<b>Cash and cash equivalents, end of period</b>	<b>12,133,534</b>	<b>1,415,035</b>
<b>Supplemental cash flow information</b>		
Cash paid during the year for interest	-	2,614

See accompanying notes

## **Procyon Biopharma Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

March 31<sup>st</sup>,

(unaudited)

#### **1. Basis of presentation**

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. 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 period ended December 31, 2000.

#### **2. Change in accounting policy**

In December 2000, the Company changed its accounting policy for the amortization of intellectual property to straight-line amortization over an estimated useful life of 15 years from the date of acquisition. Previously amortization was recorded over an estimated useful life of 10 years from the date of commercialization.

This change has been applied retroactively with a charge to the deficit on December 31, 2000 of \$666,000. The impact of this change is to reduce net income for the quarter ended March 31, 2001 by \$82,103 net income for the quarter ended March 31, 2000 by \$49,768.

#### **3. Revenue recognition**

Deferred revenue from licensing or royalty fees is recognized as income on a straight-line basis in accordance with the contractual agreements with third parties.

#### **4. Share Capital**

##### **Authorized and issued**

The authorized capital is an unlimited number of common shares.

##### **Common shares**

As at March 31, 2001, 43,906,314 common shares valued at \$32,490,866 was issued and outstanding (43,853,685 valued at \$32,458,150 at December 31, 2000) The 47,629 common shares were issued for cash on exercise of stock options.

## Procyon Biopharma Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31<sup>st</sup>,

(unaudited)

#### Stock Option Plan

As at March 31, 2001, 3,918,570 stock options were outstanding compared to 3,858,023 as at December 31, 2000. During the three months period, 230,000 options were granted, 52,629 options were exercised and 116,824 options were forfeited.

#### Warrants

As at March 31, 2001 and December 31, 2000, there were 8,536,726 common shares reserved for issuance upon exercise of warrants.

#### 5. Segmented Information

Information by geographic segment is as follows:

	<b>Three-month Period ended March 31, 2001</b>	<b>Three-month Period ended March 31, 2000</b>
	\$	\$
<b>Revenue</b>		
Canada	-	-
United States	-	-
	<b>As of March 31, 2001</b>	<b>As of December 31, 2000</b>
<b>Intellectual property and fixed assets</b>		
Canada	3,220,511	3,298,143
United States	2,062,909	1,977,785
	<b>5,283,420</b>	<b>5,275,928</b>