First Quarter Results 2005

TRANSITION THERAPEUTICS INC.

IN BUSINESS TO MAKE A DIFFERENCE

Transition therapeutics inc.

TO OUR SHAREHOLDERS

Fiscal 2005 started extremely well as we made a series of important clinical and partnering advances central to our long-term success. These events, which both validated our business model and paved the road for an exciting year ahead, were as follows:

- Signed a definitive licensing agreement with Novo Nordisk A/S ("Novo Nordisk") for the Islet Neogenesis Therapy ("I.N.T.™") technology (the "Licensing Agreement") including an equity investment of CDN $6 million, upfront and development milestones potentially totaling up to U.S. $48 million as well as commercial milestones and royalty payments; and
- Commenced a Phase II clinical trial for the Company's first Interferon Enhancing Therapy ("I.E.T.") product, MS-I.E.T., in patients with multiple sclerosis ("MS").

Subsequent to quarter-end, the Company:

- Received clearance to initiate an exploratory Phase IIa clinical trial to evaluate efficacy, safety and tolerability for E1-I.N.T.™ in patients with type I diabetes;
- Initiated clinical development of a second I.E.T. product, HCV-I.E.T., for the treatment of hepatitis C;
- Sold its wholly-owned subsidiary, Stem Cell Therapeutics Inc. ("SCT"), for upfront and anniversary payments totaling $3.5 million; and
- Acquired a 17% interest in Ellipsis Neurotherapeutics Inc. ("ENI") with the potential to increase this interest to approximately 52% through stock conversion by ENI shareholders and consideration for the Company's management services.

Definitive Licensing Agreement

The conclusion of the Licensing Agreement with Novo Nordisk provided not only significant validation of both our science and business model but also access to world class diabetes-specific expertise. Under the terms of the Licensing Agreement, Novo Nordisk received exclusive worldwide rights to the Company's I.N.T.™ technology, except for I.N.T.™ for transplantation. In exchange for this license, Novo Nordisk agreed to make upfront and milestone payments which, assuming all development milestones are achieved, will total U.S. $48 million, an equity investment in the Company of $6 million, commercial milestone payments and royalty payments on future net sales and to also assume all future costs for the development of the licensed I.N.T.™ technology.

Expanded Clinical Strategy

In the quarters ahead, we expect to see, what are for Transition, unprecedented levels of clinical activity. Products across our pipeline, from both core technology platforms, have or will be commencing clinical trials in the intended patient population.

The Licensing Agreement with Novo Nordisk allows Transition to continue advancing programs that are already in clinical development. On this basis, we recently received clearance from the United States Food and Drug Administration ("FDA") to initiate a clinical trial for E1-I.N.T.™ in patients with type I diabetes. This clinical trial will evaluate the efficacy, safety, and tolerability of a 28-day course of daily E1-I.N.T.™ treatments

Expanded Clinical Strategy (continued)

with a six-month follow-up and will be conducted in the United States. Transition plans to expand these trials into type II diabetes patients, in the near future, and will fund development of these clinical trials until Novo Nordisk takes over the program, at its option, at which point Novo Nordisk has agreed to retroactively reimburse Transition for costs incurred.

Last year, we expanded our I.N.T.™ technology to include GLP1-I.N.T.™, a combination of one of the leading diabetes drug candidates, Glucagon-Like-Peptide-1 ("GLP-1"), and Transition's gastrin analogue ("G1"). We are working closely with our partner Novo Nordisk, to complete pre-clinical efficacy and toxicity studies for GLP1-I.N.T.™.

One of our core objectives this year is to advance our I.E.T. products through clinical development. Our first I.E.T. product, MS-I.E.T., has commenced a Phase II clinical trial in patients with MS and patient enrollment for this trial is expected to begin before the end of the second quarter of fiscal 2005. Our second I.E.T. product, HCV-I.E.T., is currently in pre-clinical development and is preparing to commence a Phase I/II clinical trial in hepatitis C patients during the third quarter of fiscal 2005.

Sale of SCT

Subsequent to quarter end, on October 4, 2004, we sold SCT for upfront and anniversary payments totaling $3.5 million, plus future royalties on sales and other income. This sale will add to our already strong cash position and will help fund the clinical development of our products and as well as the acquisition of additional technologies that are more in line with our strategic plan for future growth.

Acquisition of Interest in ENI

Effective November 4, 2004, the Company acquired a 17% interest in ENI with the potential to increase this interest to approximately 52% through stock conversion by ENI shareholders and consideration for the Company's management services. ENI is developing a series of compounds for the treatment of Alzheimer's disease. ENI's lead compound, AZD-103, meets key criteria for clinical development of an Alzheimer's therapy. It has equal or better efficacy compared to other disease modifying Alzheimer's products under clinical development, has an excellent safety profile, is administered orally, and crosses the blood brain barrier. We are excited by the promise of this technology and believe that the pre-clinical data supports rapid advancement of AZD-103 into a Phase I clinical trial.

Enhanced Financial Flexibility

On August 27, 2004, we closed a private placement financing issuing 5 million common shares to Novo Nordisk at a purchase price of $1.20 per common share, for total gross proceeds of $6 million. This private placement represented an upfront investment in Transition by our partner, Novo Nordisk, and was made in connection with the signing of the Licensing Agreement for the I.N.T.™ technology. The proceeds from the financing will be used for ongoing research and development and general corporate purposes. The Company will leverage its strong financial position to advance its products through the clinic as well as seek partnerships and new value creating acquisitions.

Outlook

Even though our focus for the year is on advancing products through the clinic and pursuing partnership discussions, we have not forgotten the need to build and maintain a robust pipeline. Consequently, we continue to evaluate additional opportunities to move new products and technologies in behind those that are advancing into and through the clinic. This strategy will allow us to leverage our business model and generate stable long-term growth.

We look forward to keeping all shareholders updated on our clinical, partnering and pipeline initiatives in what promises to be a very busy year ahead.

Dr. Tony Cruz
Chairman and CEO
Transition Therapeutics Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following information should be read in conjunction with the Company's unaudited interim financial statements included herein as well as the audited consolidated financial statements for the year ended June 30, 2004 and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. This Management's Discussion and Analysis ("**MD&A**") provides a review of the performance of the Company for the three-month period ended September 30, 2004 as compared to the three-month period ended September 30, 2003. This review was performed by management with information available as of November 5, 2004.

Where "we", "us", "our", "Transition" or the "Company" is used, it is referring to Transition Therapeutics Inc. and its wholly-owned subsidiaries, unless otherwise indicated. All amounts are in Canadian dollars, unless otherwise indicated.

Additional information relating to the Company, including the Company's most recently filed Annual Information Form, can be found on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

To the extent any statements made in this MD&A contain information that is not historical, these statements are forward-looking statements. Forward-looking statements are identified by words such as "expect", "believe", "intend", "anticipate", "will", "may", or other similar expressions. These forward-looking statements by their nature are not guarantees of the Company's future performance and involve risks and uncertainties that could cause the actual results to differ materially from those discussed in, or implied by, these forward-looking statements. The Company considers the assumptions on which these forward-looking statements are based to be reasonable at the time this MD&A was prepared, but cautions the reader that these assumptions may ultimately prove to be incorrect due to certain risks and uncertainties including, but not limited to, the difficulty of predicting regulatory approvals, acceptance and demand for new pharmaceutical products, the impact of competitive products and pricing, the Company's ability to finance, manufacture and commercialize its products, the protection of intellectual property and any other similar or related risks and uncertainties. The Company disclaims any intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Given these uncertainties, the reader should not place undue reliance on these forward-looking statements.

OVERVIEW

Transition is a product-focused biopharmaceutical company, developing novel therapeutics for disease indications with large markets. The Company has two lead technologies, Islet Neogenesis Therapy ("**I.N.T.™**") for the treatment of diabetes and Interferon Enhancing Therapy for the treatment of multiple sclerosis ("**MS**") and hepatitis C. These technologies have resulted in four lead products: E1-I.N.T.™ and GLP1-I.N.T.™ for the treatment of diabetes, MS-I.E.T. for the treatment of MS and HCV-I.E.T. for the treatment of hepatitis C.

General Risk Factors for the Biotechnology Industry

Prospects for companies in the biopharmaceutical industry generally may be regarded as uncertain given the nature of the industry and, accordingly, investments in such companies should be regarded as highly speculative. It is not possible to predict, based upon studies in animals and early clinical data, whether a new therapeutic or device will prove to be safe and effective in humans or whether it will ultimately receive regulatory approval. In addition, there is also no assurance that adequate funds or relationships required to continue product development, such as those with employees, collaborators, or other third parties, will be available and sustained.

General Risk Factors for the Biotechnology Industry (continued)

If a product is ultimately approved for sale, there is also no assurance that it will ever result in significant revenues or profitable operations. There are many factors such as competition, patent protection and the regulatory environment that can influence a product's profitability potential.

In addition, due to the speculative nature of this industry, market prices for securities of biotechnology companies may be highly volatile and subject to significant fluctuation and may not necessarily be related to the operating or other performances of such companies.

Recent Achievements

During the three-month period ended September 30, 2004 and up to the date of this MD&A, the Company achieved the following significant milestones:

- Signed a definitive licensing agreement with Novo Nordisk A/S ("**Novo Nordisk**") for the I.N.T.™ technology including an equity investment of CDN $6 million, upfront and development milestones potentially totaling up to U.S. $48 million as well as commercial milestones and royalty payments;
- Received clearance to initiate an exploratory Phase IIa clinical trial to evaluate efficacy, safety and tolerability for E1-I.N.T.™ in patients with type I diabetes;
- Commenced a Phase II clinical trial for MS-I.E.T. in patients with MS;
- Initiated clinical development of HCV-I.E.T., indicated for the treatment of hepatitis C;
- Acquired a 17% interest in Ellipsis Neurotherapeutics Inc. ("**ENI**") with the potential to increase this interest to approximately 52% through stock conversion by ENI shareholders and consideration for the Company's management services; and
- Sold its wholly-owned subsidiary, Stem Cell Therapeutics Inc. ("**SCT**").

The Company's cash and cash equivalents were $23,366,911 at September 30, 2004, and the net working capital position was $23,838,449. The Company believes that it has adequate financial resources for anticipated expenditures until early fiscal 2008.

PROGRAMS

Transition is focused on developing innovative therapies in several distinct areas of opportunity. Transition's vision is to build a company that has a strong foundation for growth based on multiple technologies and product opportunities, which reduces risk and enhances return. The Company's two lead technologies are described below.

I.N.T.™ for Diabetes

General

Transition has developed a patented diabetes therapy, which offers a new paradigm in the treatment of insulin-dependent diabetes through the regeneration of insulin producing cells in the body. It is estimated that there are currently more than 4 million people in the U.S. alone that suffer from insulin-dependent diabetes. Transition is currently actively developing two I.N.T.™ products, in partnership with Novo Nordisk, E1-I.N.T.™ and GLP1- I.N.T.™.

Licensing Agreement

In August 2004, the Company signed a licensing agreement (the "**Licensing Agreement**") with Novo Nordisk for the I.N.T.™ technology. Under the terms of the Licensing Agreement, Novo Nordisk received exclusive worldwide rights to the Company's I.N.T.™ technology, except for I.N.T.™ for transplantation. In exchange for this license, Novo Nordisk agreed to make upfront and milestone payments which, assuming all development milestones are achieved, will total U.S. $48 million, an equity investment in the Company of $6 million, commercial milestone payments and royalty payments on future net sales and to also assume all future costs for the development of the licensed I.N.T.™ technology.

To date, under the Licensing Agreement, in addition to a $6 million equity investment, the Company has received a total of $1,968,580 (U.S. $1,500,000) which has been recorded as deferred revenue and will be recorded as licensing fee revenue over the term of the Licensing Agreement, which has been estimated as 15 years.

In addition, under the terms of an agreement between the Company and the General Hospital Corporation ("**GHC**"), the Company paid to GHC sub-licensing fees of $132,400 (U.S. $100,000), in respect of certain payments received under the Licensing Agreement. These sub-licensing fees have been recorded as deferred charges and will be recorded as research and development, net over the term of the Licensing Agreement.

E1-I.N.T.™

E1-I.N.T.™, a combination of Transition's epidermal growth factor analogue ("**E1**") and gastrin analogue ("**G1**"), has completed two Phase I clinical trials, in which it was shown that E1-I.N.T.™ is safe to administer. In October 2004, Transition received clearance from the United States Food and Drug Administration ("**FDA**") to initiate a clinical trial for E1-I.N.T.™ in patients with type I diabetes, in the United States. This clinical trial will be evaluating efficacy, safety, and tolerability of a 28-day course of daily E1-I.N.T.™ treatments with a six-month follow-up. In the near future, Transition plans to expand these trials into type II diabetes patients.

GLP1-I.N.T.™

GLP1-I.N.T.™, a combination of one of the leading diabetes drug candidates, Glucagon-Like-Peptide-1 ("**GLP-1**"), with G1, is currently in pre-clinical development in partnership with Novo Nordisk.

Expenditures for the I.N.T.™ Program

During the three-month period ended September 30, 2004, the Company incurred direct research and development costs for this program as follows:

	I.N.T.™ Program[(1)]
Clinical studies	$52,216
Manufacturing	$112,296
Pre-clinical toxicity studies	$124,221
Other direct research	$23,567
TOTAL	**$312,300**

Note:
[(1)] These costs are direct research costs only and do not include, patent costs, investment tax credits, salaries and benefits or an allocation of Company overhead.

I.E.T. for MS and Hepatitis C

MS

MS is a complex and unpredictable progressive disease of the central nervous system that can severely debilitate sufferers by attacking the myelin sheath that surrounds nerve fibres, disrupting the flow of messages from the brain and affecting motor function. MS typically afflicts people aged 20 to 40 and more often women than men. It is estimated that 2.5 million people worldwide suffer from MS.

Interferon-ß products are one of the primary therapeutic options for the treatment of MS and are used to slow disease progression and palliate symptoms. However, these treatments are not effective in all patients, may have limited duration of benefit and possess a side effect profile that reduces utility. To enhance the efficacy of interferon-ß alone, the Company has developed MS-I.E.T., a combination of the Company's EMZ701 and interferon-ß. The Company has completed a Phase I trial for EMZ701 and has commenced a Phase II clinical trial for MS-I.E.T. in patients with MS. The Company expects to commence enrollment for the Phase II trial by the end of the second quarter of fiscal 2005.

Hepatitis C

Transition has expanded its I.E.T. technology to include a second product, HCV-I.E.T, which is the combination of interferon- , ribavirin and Transition's EMZ702. HCV-I.E.T. is currently in pre-clinical development and is preparing to commence a Phase I/II clinical trial in patients with hepatitis C.

Expenditures for the I.E.T. Program

During the three-month period ended September 30, 2004, the Company incurred direct research and development costs for this program as follows:

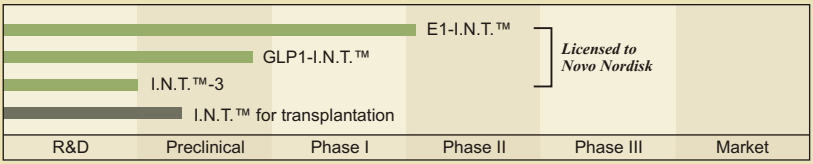
	I.E.T. Program[1]
Clinical studies	$35,860
Manufacturing	$66,705
Pre-clinical toxicity studies	$0
Other direct research	$28,696
TOTAL	**$131,261**

Note:
[1] These costs are direct research costs only and do not include, patent costs, investment tax credits, salaries and benefits or an allocation of Company overhead.

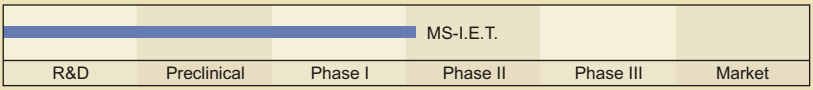
The Next Steps

Transition's goal for each of the above programs is to achieve product approval and ultimately significant revenues or royalties. To achieve product approval, the Company must successfully complete clinical trials and achieve regulatory approval. The stage of development of the Company's two lead programs is illustrated below:

Islet Neogenesis Therapy (I.N.T.™) for Diabetes



Interferon Enhancing Therapy (I.E.T.) for Multiple Sclerosis



Interferon Enhancing Therapy (I.E.T.) for Hepatitis C

In October 2004, Transition received clearance from the FDA to initiate a clinical trial for E1-I.N.T.™ in patients with type I diabetes to evaluate efficacy, safety, and tolerability. In the near future, Transition plans to expand these trials into type II diabetes patients.

Transition will fund development of these trials until Novo Nordisk takes over the program, at its option, at which point Novo Nordisk has agreed to retroactively reimburse the Company for costs incurred. The Company is currently completing pre-clinical efficacy and toxicity studies for GLP1-I.N.T.™, in partnership with Novo Nordisk.

In terms of I.E.T., the Company has commenced a Phase II clinical trial for MS-I.E.T. and expects to begin enrolling MS patients by the end of the second quarter of fiscal 2005. The Company is also preparing pre-clinical data for the initiation of a Phase I/II clinical trial for hepatitis C in the third quarter of fiscal 2005. The I.E.T. products are now well positioned for partnering and the Company is currently pursuing partnership discussions.

FIRST QUARTER RESULTS OF OPERATIONS

(for the three-month period ended September 30, 2004 and 2003)

Results of Operations

For the three-month period ended September 30, 2004, the Company recorded a net loss of $2,543,441 ($0.02 per common and Class B share) compared to a net loss of $2,292,926 ($0.03 per common and Class B share) for the three-month period ended September 30, 2003. This increase of $250,515 or 11% is primarily due to an increase in research and development and general and administrative expenses, partially offset by an increase in interest income and an increase in recovery of future income taxes.

Research and Development, net

Research and development, net increased to $758,852 for the three-month period ended September 30, 2004 from $423,433 for the same period in fiscal 2004. This increase of $335,419 or 79% was primarily the result of the following: an increase in clinical trial consulting, manufacturing and formulation expenses relating to the Company's I.E.T. and I.N.T.™ technologies; additions to the Company's product development team; and expenses relating to early validation of the Company's HCV-I.E.T. product. The Company anticipates that research and development, net will increase during the second quarter of fiscal 2005, as it begins to enroll patients in the MS-I.E.T. Phase II clinical trial, commences a clinical trial for E1-I.N.T.™ in patients with type I diabetes, prepares to initiate a clinical trial for E1-I.N.T.™ in patients with type II diabetes, prepares for a clinical trial for HCV-I.E.T. and strengthens its product development team.

General and Administrative

General and administrative expenses increased to $600,944 for the three-month period ended September 30, 2004 from $363,943 for the three-month period ended September 30, 2003. This increase of $237,001 or 65% primarily resulted from an increase in accounting and legal fees primarily resulting from the negotiation of the Licensing Agreement, an increase in insurance costs and an increase in investor relation and regulatory fees. The Company anticipates that general and administrative expenses will remain consistent for the second quarter of fiscal 2005.

Interest Income, net

Interest income for the three-month period ended September 30, 2004, was $104,505 as compared to $44,456 for the three-month period ended September 30, 2003. This increase of $60,049 or 135% in interest income primarily resulted from higher cash balances. Due to the Company completing a $6 million equity investment with Novo Nordisk during the first quarter of fiscal 2005, interest income is expected to increase during the second quarter of fiscal 2005.

Capital Expenditures

During the three-month period ended September 30, 2004, the Company's capital expenditures were $2,419, as compared to $4,135 for the three-month period ended September 30, 2003. The expenditures during fiscal 2005 were for lab equipment. The Company anticipates an increase in capital expenditures during the second quarter of fiscal 2005 as it acquires computer equipment for its expanding management team.

Sale of SCT

On October 4, 2004, the Company signed an agreement to sell one of its wholly-owned subsidiaries, SCT, whose only significant asset is technology. SCT is developing a series of regenerative therapies for the treatment of neurological diseases including stroke and Parkinson's disease. The agreement includes an upfront cash payment of $325,000, anniversary payments totaling $3.175 million that may be settled in either cash or shares at the option of the purchaser, and royalties on sales and other income.

Sale of SCT (continued)

The Company anticipates that this transaction will not be recorded as a sale for accounting purposes as the risks and rewards of the ownership of SCT have not been transferred to the purchaser under the terms of the share purchase agreement. The Company does not anticipate that the transaction will qualify for sale accounting within the next twelve months. Therefore, the Company does not plan to reclassify the assets and liabilities of SCT as held for sale as of the date it entered into the transaction. In the future, if circumstances change such that a transfer of the risks and rewards to the purchaser is expected within the next twelve months, the Company will reclassify SCT's assets and liabilities as Held For Sale at that time.

Acquisition of Interest in ENI

Effective November 4, 2004, the Company acquired a 17% interest in ENI with the potential to increase this interest to approximately 52% through stock conversion by ENI shareholders and consideration for the Company's management services. ENI is developing a series of compounds for the treatment of Alzheimer's disease.

Under the terms of the agreement, the Company has received 2,400,000 ENI common shares, in exchange for i) 884,956 common shares of the Company (the "**Acquired Shares**"), ii) $1,000,000 in cash, and iii) 4,000,000 exchange rights (the "**Exchange Rights**"). Each Exchange Right allows the holder to convert one ENI common share into 0.8264 of a common share of the Company, until they expire on February 4, 2006.

In addition, through the provision of the Company's management services in the development of the ENI products, the Company will also have the potential to earn up to 1,600,000 ENI common shares, over the next 24 months, through the achievement of milestones.

Also included in the agreement is a provision which states that if at the second anniversary of the agreement, the aggregate of the total proceeds from any sale of the Acquired Shares and the fair market value of the Acquired Shares retained (at this time) by ENI is less than $1,000,000, then the Company will compensate ENI for any deficiency. In addition, under this provision during the 24 month period after the closing date, the Company can direct ENI to sell the Acquired Shares, and if ENI intends to sell the Acquired Shares (during this period), ENI shall give the Company the opportunity to assist in such sale.

SUMMARY OF QUARTERLY RESULTS

The following table is a summary of selected quarterly consolidated financial information of the Company for each of the eight most recently completed quarters ending at September 30, 2004.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005				
Revenue	$10,937			
Net loss[(1)]	$2,543,441			
Basic and fully diluted net loss per Common and Class B Share	$0.02			
2004				
Revenue	$ -	$ -	$ -	$ -
Net loss[(1)]	$2,292,926	$2,574,126	$2,985,493	$2,706,956
Basic and fully diluted net loss per Common and Class B Share	$0.03	$0.03	$0.03	$0.03
2003				
Revenue		$ -	$ -	$ -
Net loss[(1)]		$2,714,625	$3,020,981	$2,735,980
Basic and fully diluted net loss per Common and Class B Share		$0.05	$0.05	$0.04

Note:
[(1)] Net loss before discontinued operations and extraordinary items was equivalent to the net loss for such periods.

The quarterly results of Transition have remained fairly stable with fluctuation primarily the result of the clinical trials being performed by the Company, the Company's closure of the Waratah Pharmaceuticals Inc. ("**Waratah**") facility in Woburn, MA, amortization of the technology acquired through the acquisition of SCT, and changes in the recovery of future income taxes and the structure of the Company's management team.

CRITICAL ACCOUNTING ESTIMATES

The Company's critical accounting estimates are as described in the Company's annual MD&A, which can be found on SEDAR at www.sedar.com.

CHANGES AND ADOPTIONS OF ACCOUNTING POLICIES

Other than the following, the Company has not adopted any new accounting policies during the three-month period ended September 30, 2004.

Stock-Based Compensation

In November 2003, the Canadian Institute of Chartered Accountants ("**CICA**") amended CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments", to require the expensing of all stock-based compensation awards for fiscal years beginning on or after January 1, 2004. Effective July 1, 2004, the Company adopted the recommendations of the amended CICA Handbook Section 3870, which will result in the fair value method of accounting being used for all stock-based compensation. The standard has been applied on a retroactive basis. The consolidated statements of loss and deficit for the three-month period ended September 30, 2003

Stock-Based Compensation (continued)

have not been restated. During the three-month period ended September 30, 2004, the cumulative impact of stock-based compensation for the fiscal years ended June 30, 2004 and 2003 was recognized in the consolidated financial statements as an adjustment to opening deficit. The impact of the adoption was a one-time increase to deficit of $45,180, to stock options of $39,755 and to common shares of $5,425.

In the three-month period ended September 30, 2004, the effect of the adoption of the fair value method of stock-based compensation expense was an increase to general and administrative expenses of $27,296 and an increase to research and development, net of $13,648, with the corresponding total included as an increase to stock options.

Compensation expense is recognized for stock options based on the fair value of the options at the grant date. The fair value of the options is recognized over the vesting period of the options as general and administrative expense or research and development, net, with the corresponding amount included in equity as stock options.

The fair value of stock options is estimated at the grant date using the Black-Scholes option pricing model. This model requires the input of a number of assumptions, including expected dividend yields, expected stock price volatility, expected time until exercise and risk-free interest rates. Although the assumptions used reflect management's best estimates, they involve inherent uncertainties based on conditions outside of the Company's control. If other assumptions are used, stock-based compensation could be significantly impacted.

The stock option balance is reduced as the options are exercised or when the stock options expire unexercised. If the stock options are exercised, the amount initially recorded for the options in stock options is credited to common shares, along with the proceeds received on the exercise. If the stock options expire unexercised, the amount initially recorded for the options in stock options is credited to contributed surplus.

LIQUIDITY AND CAPITAL RESOURCES

Overview

The Company commenced operations in July 1998, and has devoted its resources primarily to fund its research and development programs. All revenue to date has been generated from interest income on surplus funds, the sale of reagents and licensing fees. The Company has incurred a cumulative deficit to September 30, 2004 of $34,806,423. Losses are expected to continue for the next several years as the Company invests in research and development, pre-clinical studies, clinical trials, manufacturing and regulatory compliance.

Since inception, the Company has been financed primarily from public and private sales of equity, the exercise of warrants and stock options and interest earned on cash deposits and short-term investments.

The Company's cash and cash equivalents and the Company's working capital position were $23,366,911 and $23,838,449, respectively, at September 30, 2004, up significantly from June 30, 2004 balances of $17,641,155 and $17,818,393, respectively. The increase is primarily the net result of the Novo Nordisk equity investment completed in August 2004 and expenditures incurred during the three-month

Overview (continued)

period ended September 30, 2004. The Company believes that it has adequate financial resources for anticipated expenditures until early fiscal 2008.

The success of the Company is dependent on its ability to bring its products to market, obtain the necessary regulatory approvals and achieve future profitable operations. The continuation of the research and development activities and the commercialization of its products are dependent on the Company's ability to successfully complete these activities and to obtain adequate financing through a combination of financing activities and operations. It is not possible to predict either the outcome of future research and development programs or the Company's ability to fund these programs going forward.

Financing Activities

During the three-month period ended September 30, 2004, the Company sold 5,000,000 common shares, through a private placement to Novo Nordisk to raise gross proceeds of $6 million. It also issued 638,096 common shares for total cash proceeds of $425,130 through the exercise of 500,000 share purchase warrants and 138,096 stock options. Subsequent to the quarter end, the Company issued 5,204 common shares for total cash proceeds of $4,713 through the exercise of 5,204 stock options and issued 884,956 common shares in connection with the acquisition of its interest in ENI.

OUTSTANDING SHARE DATA

Authorized

The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of Class B shares.

The common shares are voting and are entitled to dividends if, as and when declared by the Board of Directors. The Class B shares are non-voting, and are convertible on a one for one basis into common shares without additional consideration. Holders of the Class B shares do not have the right to receive dividends and have equal priority with the holders of the common shares with respect to return of capital on liquidation, dissolution or wind-up.

Issued and Outstanding

The following details the issued and outstanding equity securities of the Company:

Common Shares

As at November 5, 2004, the Company has 113,050,991 common shares outstanding.

Class B Shares

As at November 5, 2004, the Company has no Class B shares outstanding.

Share Purchase Warrants

The following is a summary of the share purchase warrants outstanding as at November 5, 2004:

Share Purchase Warrants (continued)

Issue Date	Expiry Date	Number Outstanding (#)	Exercise Price ($)
May 23, 2003	May 23, 2005	25,000	0.32
June 4, 2003	June 4, 2005	35,098	0.32
June 24, 2003	December 24, 2004	4,837,289	0.58
February 24, 2004	February 24, 2006	1,384,615	1.00
TOTAL		**6,282,002**	

Each share purchase warrant entitles the holder, upon exercise and full payment of the exercise price, to acquire one common share of the Company until they expire at the dates indicated above. At November 5, 2004, on an if-converted basis, these share purchase warrants would result in the issuance of 6,282,002 common shares for aggregate proceeds of $4,209,474.

Agents' Warrants

The following is a summary of the Agents' Warrants outstanding as at November 5, 2004:

Issue Date	Expiry Date	Number Outstanding (#)	Exercise Price ($)
June 24, 2003	June 24, 2005	1,431,800	0.38

Each Agents' Warrant entitles the holder, upon exercise and the full payment of the exercise price, to acquire one common share and one-half of one share purchase warrant of the Company until December 24, 2004. Each whole underlying share purchase warrant, may then be exercised to acquire one common share of the Company for $0.58, until they expire on December 24, 2004. After December 24, 2004, each Agents' Warrant may only be exercised to acquire one common share of the Company, until they expire on June 24, 2005. At November 5, 2004, on an if-converted basis, these Agents' Warrants would result in the issuance of 2,147,700 common shares for aggregate proceeds of $959,306, assuming the exercise of the underlying share purchase warrants.

Stock Options

As at November 5, 2004, the Company has 3,570,662 stock options outstanding (on an after exchanged basis for Waratah options) with exercise prices ranging from $0.28 to $3.30 and expiry dates ranging from September 19, 2005 to July 7, 2009. At November 5, 2004, on an if-converted basis, these stock options would result in the issuance of 3,570,662 common shares at an aggregate exercise price of $4,300,900.

Exchange Rights

As at November 5, 2004, the Company has 4,000,000 Exchange Rights outstanding. Each Exchange Right entitles the holder, upon exercise, to exchange one common share of ENI for 0.8264 of a common share of the Company. These Exchange Rights expire on February 4, 2006.

RISKS AND UNCERTAINTIES

The Company's risks and uncertainties are as described in the Company's annual MD&A, which can be found on SEDAR at www.sedar.com.

TO THE SHAREHOLDERS OF TRANSITION THERAPEUTICS INC.

The consolidated balance sheet of Transition Therapeutics Inc. as at September 30, 2004 and the consolidated statements of loss and deficit and cash flows for the period then ended have not been reviewed by the Company's auditors, Ernst & Young LLP. These financial statements are the responsibility of management and have been reviewed and approved by the Company's Audit Committee.

CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2004 $	June 30, 2004 $
ASSETS		
Current		
Cash and cash equivalents [*note 5*]	**23,366,911**	17,641,155
Receivables	**167,085**	270,126
Investment tax credits receivable	**551,821**	511,821
Research inventory	**524,636**	559,378
Prepaid expenses and other assets	**517,428**	119,325
Future tax asset	**73,524**	106,277
Total current assets	**25,201,405**	19,208,082
Long-term deposits	**136,064**	143,850
Deferred charges [*note 4*]	**131,664**	-
Capital assets, net	**420,011**	440,783
Technology [*note 3*]	**20,290,608**	22,436,674
	46,179,752	42,229,389
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**1,340,096**	1,366,983
Current portion of leasehold inducement	**3,698**	3,698
Current portion of obligation under capital leases	**19,162**	19,008
Total current liabilities	**1,362,956**	1,389,689
Leasehold inducement	**16,955**	17,880
Obligation under capital leases	**66,443**	67,356
Provision for facility closure	**152,636**	225,982
Deferred revenue [*note 4*]	**1,957,643**	920,580
Future tax liability	**260,289**	1,154,601
Total liabilities	**3,816,922**	3,776,088
Commitments [*note 8*]		
Guarantees [*note 10*]		
Subsequent events [*note 11*]		
Shareholders' equity		
Share capital		
Common shares [*note 6[b]*]	**72,553,383**	66,001,437
Contributed surplus	**2,646,643**	2,646,643
Stock options [*note 6[d]*]	**572,096**	566,997
Warrants [*note 6[c]*]	**1,397,131**	1,456,026
Deficit	**(34,806,423)**	(32,217,802)
Total shareholders' equity	**42,362,830**	38,453,301
	46,179,752	42,229,389

See accompanying notes

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(Unaudited)

	Three-month period ended September 30, 2004 $	Three-month period ended September 30, 2003 $
REVENUES		
Licensing fees	**10,937**	-
EXPENSES		
Research and development, net of investment tax credits of $40,000 [2003 - $10,000]	**758,852**	423,433
General and administrative	**600,944**	363,943
Amortization	**2,157,579**	2,162,789
Foreign exchange loss (gain)	**3,067**	(3,198)
	3,520,442	2,946,967
Loss before the following	**(3,509,505)**	(2,946,967)
Interest income, net	**104,505**	44,456
Loss before income taxes	**(3,405,000)**	(2,902,511)
Recovery of (provision for) income taxes		
Current	**-**	-
Future	**861,559**	609,585
Net loss for the period	**(2,543,441)**	(2,292,926)
Deficit, beginning of period, as originally presented	**(32,217,802)**	(21,658,301)
Adjustment for change in accounting policy related to stock-based compensation [*note 2*]	**(45,180)**	-
Deficit, beginning of period, restated	**(32,262,982)**	(21,658,301)
Deficit, end of period	**(34,806,423)**	(23,951,227)
Basic and fully diluted net loss per common and Class B share [*note 6[b][ii]*]	**$(0.02)**	$(0.03)

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three-month period ended September 30, 2004 $	Three-month period ended September 30, 2003 $
OPERATING ACTIVITIES		
Net loss for the period	**(2,543,441)**	(2,292,926)
Add (deduct) items not involving cash		
Amortization	**2,169,257**	2,166,068
Amortization of leasehold inducement	**(925)**	(924)
Recovery of income taxes - future	**(861,559)**	(609,585)
Stock-based compensation expense [*note 2*]	**40,944**	-
	(1,195,724)	(737,367)
Net change in non-cash working capital balances related to operations [*note 7*]	**512,632**	(188,173)
Cash used in operating activities	**(683,092)**	(925,540)
INVESTING ACTIVITIES		
Purchase of capital assets	**(2,419)**	(4,135)
Cash used in investing activities	**(2,419)**	(4,135)
FINANCING ACTIVITIES		
Repayment of obligation under capital leases	**(759)**	(7,098)
Proceeds from issuance of common shares, net [*note 6[b]*]	**6,412,026**	474,325
Cash provided by financing activities	**6,411,267**	467,227
Net increase (decrease) in cash and cash equivalents during the period	**5,725,756**	(462,448)
Cash and cash equivalents, beginning of period	**17,641,155**	6,857,576
Cash and cash equivalents, end of period	**23,366,911**	6,395,128

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Transition Therapeutics Inc. [the "Company"] is a biopharmaceutical company, incorporated on July 6, 1998 under the Business Corporations Act (Ontario). The Company is a product-focused biopharmaceutical company developing therapeutics for disease indications with large markets. The Company's lead technologies are focused on the treatment of diabetes, multiple sclerosis and hepatitis C.

The success of the Company is dependent on bringing its products to market, obtaining the necessary regulatory approvals and achieving future profitable operations. The continuation of the research and development activities and the commercialization of its products are dependent on the Company's ability to successfully complete these activities and to obtain adequate financing through a combination of financing activities and operations. It is not possible to predict either the outcome of future research and development programs or the Company's ability to fund these programs going forward.

The unaudited interim consolidated financial statements do not conform in all respects to the requirements of Canadian generally accepted accounting principles for annual financial statements. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the June 30, 2004 annual consolidated financial statements.

These interim consolidated financial statements have been prepared using the same accounting principles used in the annual audited consolidated financial statements for the year ended June 30, 2004, except for the accounting principles discussed in note 2.

2. CHANGE IN ACCOUNTING POLICY

Stock-based compensation plans

In November 2003, the Canadian Institute of Chartered Accountants ("CICA") amended CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments", to require the expensing of all stock-based compensation awards for fiscal years beginning on or after January 1, 2004. Effective July 1, 2004, the Company adopted the recommendations of the amended CICA Handbook Section 3870, which will result in the fair value method of accounting being used for all stock-based compensation. The standard has been applied on a retroactive basis. The consolidated statement of loss and deficit for the three-month period ended September 30, 2003 has not been restated. During the three-month period ended September 30, 2004, the cumulative impact of stock-based compensation for the fiscal years ended June 30, 2004 and 2003 was recognized in the consolidated financial statements as an adjustment to opening deficit. The impact of the adoption was a one-time increase to deficit of $45,180, to stock options of $39,755 and to common shares of $5,425.

In the three-month period ended September 30, 2004, the effect of the adoption of the fair value method of stock-based compensation expense was an increase to general and administrative expenses of $27,296 and an increase to research and development, net of $13,648, with the corresponding total included as an increase to stock options.

Stock-based compensation plans (continued)

Compensation expense is recognized for stock options based on the fair value of the options at the grant date. The fair value of the options is recognized over the vesting period of the options as general and administrative expense or research and development, net, with the corresponding amount included in equity as stock options.

The fair value of stock options is estimated at the grant date using the Black-Scholes option pricing model. This model requires the input of a number of assumptions, including expected dividend yields, expected stock price volatility, expected time until exercise and risk-free interest rates. Although the assumptions used reflect management's best estimates, they involve inherent uncertainties based on conditions outside of the Company's control. If other assumptions are used, stock-based compensation could be significantly impacted.

The stock option balance is reduced as the options are exercised or when the options expire unexercised. If the stock options are exercised, the amount initially recorded for the options in stock options is credited to common shares, along with the proceeds received on the exercise. If the options expire unexercised, the amount initially recorded for the options in stock options is credited to contributed surplus.

The fair value of the options at the date of grant, for options granted during the three-month period ended September 30, 2004, was estimated using the Black-Scholes option pricing model based on the following assumptions: expected option life of 4 years, volatility of 1.07, a risk-free interest rate of 2.85% and a dividend yield of 0%. The weighted average grant date fair value of options granted during the three-month period ended September 30, 2004 was $1.00. No options were granted during the three-month period ended September 30, 2003.

If the fair value method of accounting for stock-based compensation had been applied to the Company's results prior to the adoption of the fair value method effective July 1, 2004, the Company's pro forma net loss and basic and fully diluted net loss per common and Class B share would have been as follows:

		Three-month period ended September 30, 2003 $
Net loss	As reported	2,292,926
	Pro-forma	2,293,676
Basic and fully diluted net loss per common and Class B share	As reported	$0.03
	Pro-forma	$0.03

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. TECHNOLOGY

Technology consists of the following:

	September 30, 2004		
	Cost $	Accumulated amortization $	Net book value $
Acquired on acquisition of Waratah Pharmaceuticals Inc. ("Waratah")	**39,799,917**	**21,558,288**	**18,241,629**
Acquired from Biogenesys, Inc.	**137,000**	**77,628**	**59,372**
Acquired on acquisition of Stem Cell Therapeutics Inc. ("SCT")	**3,055,560**	**1,065,953**	**1,989,607**
	42,992,477	**22,701,869**	**20,290,608**

	June 30, 2004		
	Cost $	Accumulated amortization $	Net book value $
Acquired on acquisition of Waratah	39,799,917	19,568,292	20,231,625
Acquired from Biogenesys, Inc.	137,000	70,779	66,221
Acquired on acquisition of SCT	3,055,560	916,732	2,138,828
	42,992,477	20,555,803	22,436,674

The amortization to be taken on the technology by fiscal year is as follows:

	$
2005	8,584,266
2006	8,584,266
2007	4,919,962
2008	348,180
	22,436,674

4. DEFERRED REVENUE AND CHARGES

In August 2004, the Company signed a licensing agreement with Novo Nordisk [the "Licensing Agreement"]. Under the terms of the Licensing Agreement Novo Nordisk received exclusive worldwide rights to the I.N.T.™ technology, except for I.N.T.™ for transplantation. In exchange for this license, Novo Nordisk will pay to the Company upfront and milestone payments which, assuming all development milestones are achieved, will total U.S. $48 million, an equity investment in the Company of $6 million [*note 6[b][i]*] and commercial milestone payments and royalty payments on net sales. In addition, Novo Nordisk will assume all future costs for the development for the licensed I.N.T.™ technology.

The Licensing Agreement also provides for the Company to continue advancing programs that are already in clinical development, specifically E1-I.N.T.™. In October 2004, the Company announced that it has received clearance from the FDA to initiate a clinical trial for E1-I.N.T.™, in patients with type I diabetes, to evaluate efficacy, safety and tolerability and that it intends to expand these trials into type II diabetes patients in the near future. The Company, will fund development of these trials until Novo Nordisk

4. DEFERRED REVENUE AND CHARGES (continued)

takes over the program, at its option, at which point Novo Nordisk will retroactively reimburse the Company for costs incurred.

To date, under the Licensing Agreement, the Company has received a total of $1,968,580 [U.S. $1,500,000] which has been recorded as deferred revenue and will be recorded as licensing fee revenue over the term of the Licensing Agreement, which has been estimated as 15 years.

In addition, under the terms of an agreement between the Company and the General Hospital Corporation ["GHC"], the Company paid to GHC sub-licensing fees of $132,400 [U.S. $100,000], in respect of certain payments received under the Licensing Agreement. These sub-licensing fees have been recorded as deferred charges and will be recorded as research and development, net over the term of the Licensing Agreement.

5. CASH AND CASH EQUIVALENTS

Included in cash and cash equivalents at September 30, 2004 is cash denominated in U.S. dollars of U.S. $658,023 [June 30, 2004 - U.S. $26,078].

6. SHARE CAPITAL

[a] Authorized

The authorized share capital of the Company consists of unlimited common shares and unlimited Class B shares.

The common shares are voting and are entitled to dividends if, as and when declared by the Board of Directors. The Class B shares are non-voting, and are convertible by the holder on a one for one basis into common shares without additional consideration. Holders of the Class B shares do not have any right to receive dividends, but have equal priority with the holders of the common shares with respect to return of capital on liquidation, dissolution or wind-up.

[b] Issued and outstanding and changes during the period

Common shares	#	$
Balance, June 30, 2004	**106,522,735**	**66,001,437**
Retroactive adjustment for stock-based compensation [*note 2*]	**-**	**5,425**
Issued pursuant to private placement, net [*i*]	**5,000,000**	**5,986,896**
Exercise of share purchase warrants [*note 6[c][i]*]	**500,000**	**348,895**
Exercise of stock options [*note 6[d][i]*]	**138,096**	**210,730**
Balance, September 30, 2004	**112,160,831**	**72,553,383**

Class B shares	#	$
Balance, June 30, 2004 and September 30, 2004	**-**	**-**
Total common and Class B shares	**112,160,831**	**72,553,383**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

[b] Issued and outstanding and changes during the period (continued)

[i] On August 27, 2004, under the terms of the Licensing Agreement, the Company sold 5,000,000 common shares to Novo Nordisk at a purchase price of $1.20 per common share, through a private placement, for a total amount of $6,000,000. The cash proceeds from the private placement, net of expenses, were $5,986,896.

[ii] The weighted average number of common and Class B shares used in the computation of basic and fully diluted net loss per common and Class B share for the three-month period ended September 30, 2004 is 108,078,907 [three-month period ended September 30, 2003 - 80,412,878].

For the three-month period ended September 30, 2004, 780,764 [three-month period ended September 30, 2003 - 1,009,511] contingently returnable common shares were excluded from the basic and fully diluted net loss per common and Class B share calculation. The contingently returnable common shares relate to employment contracts and will be released from escrow based on the achievement of certain corporate milestones.

[c] Share purchase warrants and Agents' Warrants

Share purchase warrants	#	$
Share purchase warrants outstanding, June 30, 2004	**6,782,002**	**1,126,712**
Exercise of share purchase warrants [*i*]	**(500,000)**	**(58,895)**
Share purchase warrants outstanding, September 30, 2004	**6,282,002**	**1,067,817**

Agents' Warrants	#	$
Agents' Warrants outstanding, June 30, 2004 and September 30, 2004	**1,431,800**	**329,314**
Total warrants	**7,713,802**	**1,397,131**

[i] Share purchase warrants totaling 500,000 were exercised during the three-month period ended September 30, 2004. These warrants had a recorded value of $58,895 and resulted in cash proceeds to the Company of $290,000.

[ii] The maximum possible cash proceeds to the Company from the exercise of the share purchase warrants and the Agents' Warrants outstanding as at September 30, 2004 is $5,168,780 [June 30, 2004 - $5,458,780].

[d] Stock options

Stock options	#	$
Stock options outstanding, June 30, 2004	**3,585,031**	**566,997**
Retroactive adjustment for stock-based compensation [*note 2*]	**-**	**39,755**
Stock options expired	**(51,904)**	**-**
Exercise of stock options [*i*]	**(138,096)**	**(75,600)**
Stock options issued [*note 2*]	**375,000**	**21,876**
Compensation expense for options issued in prior periods	**-**	**19,068**
Stock options outstanding, September 30, 2004	**3,770,031**	**572,096**

[d] Stock options (continued)

[i] Stock options totaling 138,096 were exercised during the three-month period ended September 30, 2004. These stock options had a recorded value of $75,600 and resulted in cash proceeds to the Company of $135,130.

[ii] The maximum possible cash proceeds to the Company from the exercise of the stock options outstanding as at September 30, 2004 is $4,503,662 [June 30, 2004 - $4,147,063].

7. CONSOLIDATED STATEMENTS OF CASH FLOWS

The net change in non-cash working capital balances related to operations consists of the following:

	Three-month period ended September 30, 2004 $	Three-month period ended September 30, 2003 $
Receivables	**103,041**	46,618
Investment tax credits receivable	**(40,000)**	(10,000)
Research inventory	**34,742**	10,248
Prepaid expenses and other assets	**(398,103)**	(46,798)
Long-term deposits	**7,786**	2,615
Deferred charges	**(131,664)**	-
Accounts payable and accrued liabilities	**(26,887)**	(118,963)
Deferred revenue	**1,037,063**	-
Provision for facility closure	**(73,346)**	(71,893)
	512,632	(188,173)
Supplemental cash flow information		
Interest paid	**590**	2,959
Taxes paid	**-**	26,642

8. COMMITMENTS

As at September 30, 2004, the Company is committed to aggregate expenditures of $206,200 [June 30, 2004 - $173,252] under its collaboration agreements. In addition, at September 30, 2004, the Company is committed to aggregate expenditures of approximately $40,800 [June 30, 2004 - $151,763] for clinical and toxicity studies to be completed during fiscal 2005 and approximately $1,346,000 [June 30, 2004 - $78,215] for manufacturing agreements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. SEGMENTED INFORMATION

The Company considers itself to be in one business segment, that is the research and development of therapeutic agents. Following the acquisition of Waratah, the Company's operations are conducted in Canada and the United States. Geographic segment information is as follows:

	Canada $	United States $
Net loss (income):		
Three-month period ended September 30, 2004	**2,575,079**	**(31,638)**
Three-month period ended September 30, 2003	2,270,773	22,153
Amortization of capital assets:		
Three-month period ended September 30, 2004	**23,191**	**-**
Three-month period ended September 30, 2003	21,217	3,285
Interest income (expense), net:		
Three-month period ended September 30, 2004	**104,505**	**-**
Three-month period ended September 30, 2003	44,800	(344)
Recovery of (provision for) income taxes - current:		
Three-month period ended September 30, 2004	**-**	**-**
Three-month period ended September 30, 2003	-	-
Recovery of (provision for) income taxes - future:		
Three-month period ended September 30, 2004	**894,312**	**(32,753)**
Three-month period ended September 30, 2003	645,520	(35,935)
Technology:		
September 30, 2004	**20,290,608**	**-**
June 30, 2004	22,436,674	-
Capital assets:		
September 30, 2004	**420,011**	**-**
June 30, 2004	440,783	-

10. GUARANTEES

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

11. SUBSEQUENT EVENTS

[a] On October 4, 2004, the Company signed an agreement to sell one of its wholly-owned subsidiaries, SCT, whose only significant asset is technology. SCT is developing a series of regenerative therapies for the treatment of neurological diseases including stroke and Parkinson's disease. The agreement includes an upfront cash payment of $325,000, anniversary payments totaling $3.175 million that may be settled in either cash or shares at the option of the purchaser and royalties on sales and other income.

The Company anticipates that this transaction will not be recorded as a sale for accounting purposes as the risks and rewards of the ownership of SCT have not been transferred to the purchaser under the terms of the share purchase agreement. The Company does not anticipate that the transaction will qualify for sale accounting within the next twelve months. Therefore, the Company does not plan to reclassify the assets and liabilities of SCT as held for sale as of the date it entered into the transaction. In the future, if circumstances change such that a transfer of the risks and rewards to the purchaser is expected within the next twelve months, the Company will reclassify SCT's assets and liabilities as Held For Sale at that time.

[b] Effective November 4, 2004, the Company acquired a 17% interest in Ellipsis Neurotherapeutics Inc. [“ENI”] with the potential to increase this interest to approximately 52% through stock conversion by ENI shareholders and consideration for the Company’s management services. ENI is developing a series of compounds for the treatment of Alzheimer’s disease.

Under the terms of the agreement, the Company has received 2,400,000 ENI common shares, in exchange for i) 884,956 common shares of the Company [the “Acquired Shares”], ii) $1,000,000 in cash, and iii) 4,000,000 exchange rights [the “Exchange Rights”]. Each Exchange Right allows the holder to convert one ENI common share into 0.8264 of a common share of the Company, until they expire on February 4, 2006.

In addition, through the provision of the Company’s management services in the development of the ENI products, the Company will also have the potential to earn up to 1,600,000 ENI common shares, over the next 24 months, through the achievement of milestones.

Also included in the agreement is a provision which states that if at the second anniversary of the agreement, the aggregate of the total proceeds from any sale of the Acquired Shares and the fair market value of the Acquired Shares retained (at this time) by ENI is less than $1,000,000, then the Company will compensate ENI for any deficiency. In addition, under this provision during the 24-month period after the closing date, the Company can direct ENI to sell the Acquired Shares, and if ENI intends to sell the Acquired Shares (during this period), ENI shall give the Company the opportunity to assist in such sale.

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