



Third Quarter Results 2001

To Our Shareholders,

It is my pleasure to report on the material events of the three-month period ended March 31, 2001, which represents the first reportable quarter of Transition Therapeutic Inc. ("Transition") as a public company.

The quarter was highlighted by:

- As the result of an initial public offering, which raised gross proceeds of approximately \$5.3 million, Transition now has in excess of \$8.5 million in cash and short term investments;
- The signing of an exclusive license agreement with HSC Research and Development Limited Partnership; and
- An expanded partnership arrangement with Cangene Corporation ("Cangene") for research and development.

The third quarter of fiscal 2001 was pivotal in the development of Transition, most notably due to the successful initial public offering which raised gross proceeds of approximately \$5.3 million via the issuance of 4,225,000 common shares, including an over-allotment of 225,000 shares, at a price of \$1.25 per share.

Concurrent with the completion of the offering, on February 28, 2001 Transition's common shares commenced trading on The Canadian Venture Exchange under the symbol "TTH". The funds raised by the initial public offering will empower us to accelerate the development of our lead products in the areas of Multiple Sclerosis ("MS"), Diabetes, Obesity, Restenosis and Scarring as well as to complete animal studies necessary or the filing of INDs required to initiate human studies.

The success of our IPO undoubtedly reflects investor excitement about the prospects for our innovative technologies. Our platform technology focuses on the development of therapeutic inhibitors that block normal cells from undergoing a conversion to a diseased state. In addition to our platform technology, Transition is also developing proprietary products that are designed to enhance the efficacy and scope of existing and emerging therapies. This new approach will allow Transition to develop products which possess potential to move more rapidly to the clinic stage.

Transition has maintained a successful working relationship with Cangene since January 2000. During the quarter, we expanded our existing agreement with Cangene to include access to recombinant high affinity peptides, manufactured by Cangene for research and development purposes. This manufacturing ability allows Transition to produce its products at a significantly lower cost than if it has its own in-house facility and therefore, accelerate its technology from research and development to the clinic.

In addition, Transition signed an exclusive license with HSC Research and Development Limited Partnership, the licensing agent of The Hospital for Sick Children for the use of a transgenic mouse model for Multiple Sclerosis research. This model will be used to further advance Transition's lead compound for its MS program. The model compliments the more traditional Experimental Allergic Encephalomyelitis mouse model by providing all of the key pathologies associated with human MS.

Transition also added expertise to the management team this quarter. Catherine Auld has joined us as our Director of Finance. Ms. Auld joins Transition from, KPMG LLP, where she was most recently a senior manager in the assurance practice.

Financial Highlights

During the third quarter of fiscal 2001, Transition's research and development spending amounted to \$328,215, compared to \$301,697 for the first two quarters combined. The increase in R&D expense is largely due to a write-off of receivables from Cangene that enables Transition to strengthen its partnership with Cangene in manufacturing and the co-development of products in cancer and scarring. Further, the Company's general and administrative expense amounted to \$300,962 for the third quarter, compared to \$323,462 for the first two quarters combined. This increase is the result of hiring new management and scientific positions, as well as hiring several consultants. These added resources will allow Transition to advance its programs more effectively.

On behalf of the Board, I thank everyone at Transition for continuing to support this Company through talent and dedication. I also thank our new shareholders for investing in the Company and share their enthusiasm or what the future may bring. We look forward to keeping you informed of our future progress.



Tony Cruz
President and CEO

CONSOLIDATED BALANCE SHEETS

	Unaudited March 31, 2001 \$	Audited June 30, 2000 \$
ASSETS		
Current		
Cash and cash equivalents	4,309,518	285,533
Short-term investments	4,200,000	40,000
Share subscription receivables	76	30,579
Interest receivable	106,011	—
GST receivable	93,913	16,672
Accrued accounts receivable	—	104,096
Investment tax credits receivable	80,400	80,400
Prepaid expenses	249,059	28,289
Total current assets	9,038,977	585,569
Capital assets, net [note 2]	252,557	159,546
	9,291,534	745,115
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	519,932	135,638
Advance from related parties		65,629
Current portion of leasehold inducement	3,698	3,698
Current portion of obligation under capital leases	14,705	14,705
Total current liabilities	538,335	219,670
Leasehold inducement	29,894	32,666
Obligation under capital leases	41,448	52,321
	609,677	304,657
Commitments [note 5]		
Shareholders' equity		
Share Capital [note 3]	10,371,599	970,266
Deficit	(1,689,742)	(529,808)
Total shareholders' equity	8,681,857	440,458
	9,291,534	745,115

See accompanying notes

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

unaudited

	Three-month period ended March 31, 2001 \$	Nine-month period ended March 31, 2001 \$	Cumulative since inception on July 6, 1998 \$
REVENUE			
Product [note 4]	—	—	58,021
	—	—	58,021
EXPENSES			
Research and Development, net [note 4]	328,215	629,912	903,733
General and administrative	300,962	624,424	935,547
Amortization	17,705	33,191	38,476
	646,882	1,287,527	1,877,756
Loss before the undernoted	(646,882)	(1,287,527)	(1,819,735)
Interest income (expense)	77,281	127,593	129,993
Net loss for the period	(569,601)	(1,159,934)	(1,689,742)
Deficit, beginning of period	(1,120,141)	(529,808)	—
Deficit, end of period	(1,689,742)	(1,689,742)	(1,689,742)
Net Loss per Class A and Class B Share	0.03	0.08	

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

unaudited

	Three-month period ended March 31, 2001 \$	Nine-month period ended March 31, 2001 \$	Cumulative since inception on July 6, 1998 \$
OPERATING ACTIVITIES			
Net loss for the period	(569,601)	(1,159,934)	(1,689,742)
Add (deduct) items not involving cash			
Amortization	17,705	33,191	38,476
Amortization of leasehold inducement	(924)	(2,772)	(3,388)
	(552,820)	(1,129,515)	(1,654,654)
Net change in non-cash working capital balances related to operations	68,315	114,871	92,531
Cash and cash equivalents used in operating activities	(484,505)	(1,014,644)	(1,562,123)
INVESTING ACTIVITIES			
Purchase of short-term investments	—	(4,160,000)	(4,200,000)
Purchase of capital assets [note 2]	(122,642)	(126,202)	(224,007)
Cash and cash equivalents used in investing activities	(122,642)	(4,286,202)	(4,424,007)
FINANCING ACTIVITIES			
Increase (decrease) in advance from related parties	(60,000)	(65,629)	—
Repayment of obligation under capital leases	(3,742)	(10,873)	(10,873)
Decrease in prepaid financing costs	105,003		
Net proceeds from issuance of special warrants [note 3]	—	4,914,941	4,914,941
Net proceeds from issuance of common shares [note 3]	4,486,305	4,486,392	5,391,580
Cash and cash equivalents provided by (used in) financing activities	4,527,566	9,324,831	10,295,648
Net increase (decrease) in cash and cash equivalents during the period	3,920,419	4,023,985	4,309,518
Cash and cash equivalents, beginning of period	389,099	285,533	—
Cash and cash equivalents, end of period	4,309,518	4,309,518	4,309,518
Supplemental cash flow information			
Interest paid	18,383	27,325	28,479

See accompanying notes

I. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Transition Therapeutics Inc. [the "Company"] is a biopharmaceutical development company, incorporated on July 6, 1998 under the Business Corporations Act (Ontario). The Company is engaged in the business of developing therapeutic agents that prevent and inhibit inflammatory and fibrotic diseases through disease specific, non-toxic mechanisms. To date, the Company has not earned significant revenues and is considered to be in the development stage.

These consolidated financial statements include the accounts of Transition Therapeutics Leaseholds Inc., its wholly-owned subsidiary, incorporated on March 10, 2000 under the Business Corporations Act (Ontario).

Information with respect to the June 30, 2000 balance sheet is derived from the Company's audited financial statements. These financial statements have been prepared using the same accounting principles used in the audited financial statements for the period ended June 30, 2000. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in Canada have been omitted. It is suggested that these interim financial statements should be read in conjunction with the financial statements for the year ended June 30, 2000. Prior quarterly financial information is not presented as it is not required under securities rules.

2. CAPITAL ASSETS

Capital assets consist of the following:

	March 31, 2001		
	Cost \$	Accumulated amortization \$	Net book value \$
Computer equipment	50,173	10,235	39,938
Office equipment and furniture	101,609	17,082	84,527
Lab equipment	95,534	7,165	88,369
Leasehold improvements	43,717	3,994	39,723
	<u>291,033</u>	<u>38,476</u>	<u>252,557</u>

Included in the net book value of computer equipment and office equipment and furniture at March 31, 2001, is equipment under capital lease of \$54,377 [June 30, 2000 - \$67,026].

	June 30, 2000		
	Cost \$	Accumulated amortization \$	Net book value \$
Computer equipment	30,356	1,518	28,838
Office equipment and furniture	91,554	3,052	88,502
Leasehold improvements	42,921	715	42,206
	<u>164,831</u>	<u>5,285</u>	<u>159,546</u>

3. CAPITAL STOCK

[a] Authorized

Unlimited common shares

On October 10, 2000, the Corporation subdivided the outstanding and issued common shares on the basis of 3.25649 common shares for each issued and outstanding common share. All share figures have been retroactively adjusted to reflect this change.

3. CAPITAL STOCK (continued)
[b] Issued and outstanding and changes during the period

Common shares	#	\$
Balance, June 30, 2000	10,916,855	970,266
Issuance for cash	1,953,894	60
Issuance for employment services	553,603	17
Issuance for consulting services	162,824	5
Issuance for laboratory services	162,824	5
Balance, September 30, 2000 and December 31, 2000	13,750,000	970,353
Conversion of Class B Shares	2,000,000	1,512,290
Issued for cash pursuant to initial public offering – net [i]	4,225,000	4,486,305
Balance, March 31, 2001	19,975,000	6,968,948

Class B Shares	#	\$
Issuance pursuant to private placement – net [ii]	6,500,000	4,914,941
Balance, December 31, 2000	6,500,000	4,914,941
Conversion to common shares	(2,000,000)	(1,512,290)
Balance, March 31, 2001	4,500,000	3,402,651

[i] Under the terms of an agency agreement, dated February 19, 2001, including the exercised over-allotment, the Company issued 4,225,000 common shares at the offering price of \$1.25 for a total amount of \$5,281,250. The net proceeds of this initial public offering are \$4,486,305, net of the issue expenses and underwriters' fees in the aggregate amount of \$794,945.

[ii] On October 20, 2000, the Company sold 6,500,000 special warrants at a purchase price of \$0.80 per special warrant through a private placement for a total amount of \$5,200,000. The net proceeds of the private placement are \$4,914,941. Each Special Warrant entitled the holder to acquire, without payment of additional consideration, a Class B share and one half of a share purchase warrant. Each Class B share is convertible to one common share without payment of additional consideration. Each whole share purchase warrant entitles the holder to purchase one common share of the Company at \$1.25. The special warrants were deemed exercised on the closing of the initial public offering on February 28, 2001.

[c] Stock options and warrants

[i] As at March 31, 2001 the Company has 3,250,000 share purchase warrants outstanding. Each warrant entitles the holder to purchase one common share of the Company at \$1.25 per share. The warrants expire on December 29, 2001.

[ii] During the nine months ended March 31, 2001, the Company issued 1,405,000 stock options outstanding with a weighted average exercise price of \$1.05 expiring at various dates from October 24, 2005 to February 28, 2006. Prior to the nine month period, no stock options had been issued.

4. RESEARCH AND DEVELOPMENT PROJECTS
[a] Project funding

The Company operates research and development on a number of projects which are described in detail in the Company's annual audited financial statements. The costs incurred during the nine months ended March 31, 2001 and since inception of the projects are detailed below:

[i] Treatment of Multiple Sclerosis

	\$
Research and development expenses for the year ended June 30, 2000	52,726
Research and development expenses for the nine-month period ended March 31, 2001	90,835
Cumulative research and development expenses	143,561

[ii] Treatment of Diabetes and Obesity

	\$
Research and development expenses for the year ended June 30, 2000	47,983
Research and development expenses for the nine-month period ended March 31, 2001	64,735
Cumulative research and development expenses	112,718

[iii] Treatment of Restenosis

	\$
Research and development expenses for the year ended June 30, 2000	22,068
Research and development expenses for the nine-month period ended March 31, 2001	20,933
Cumulative research and development expenses	43,001

[iv] Treatment of Scarring/Wound Healing

	\$
Research and development expenses for the year ended June 30, 2000	93,212
Research and development expenses for the nine-month period ended March 31, 2001	329,665
Cumulative research and development expenses	422,877

[v] Discovery and Manufacturing Program

	\$
Research and development expenses for the year ended June 30, 2000	—
Research and development expenses for the nine-month period ended March 31, 2001	123,744
Cumulative research and development expenses	123,744

[b] Research and development agreement with Cangene Corporation

During the three months ended March 31, 2001, the Company's agreement with Cangene Corporation ("Cangene") was amended such that the Company is responsible for the first \$400,000 of costs incurred under the agreement. Under this agreement, the Company had recorded accounts receivable as at June 30, 2000 of \$64,528, and a further \$24,291 was recorded during the three months ended September 30, 2000. As a result of the amendment the Company has included the write off of these amounts of \$88,819 in research and development expenses in the three months ended March 31, 2001. The contributions that had been expected from Cangene have been recorded as a reduction in research and development expenses for the nine months ended March 31, 2001 and for the period from inception on July 6, 1998. Previously, these amounts had been presented as collaboration revenue.

5. COMMITMENTS

[i] On March 1, 2001, the Company entered into an exclusive license agreement with HSC Research Limited Partnership ["HSC"] for a Transgenic Mouse Model for Multiple Sclerosis. The maximum financial consideration due to HSC from the Company will be \$100,000 and 10% of net revenues from sub licensing of the Model. The \$100,000 can be decreased by any research sponsorship agreements signed with HSC. To date, the Company has signed sufficient research sponsorship agreements to decrease the \$100,000 commitment to nil.

As at March 31, 2001, the Company is committed to aggregate expenditures of approximately \$1,780,000 under the terms of all of its licensing agreements.

[ii] The Company has established one new operating lease for premises. The lease term ends on September 30, 2002. The aggregate minimum annual lease payments are \$32,130.

The background of the slide is a solid blue color. On the left side, there is a circular inset showing a microscopic view of a cell with various organelles like mitochondria and a nucleus. On the right side, there is a diagram of a molecular structure consisting of several circles connected by lines, representing atoms and bonds.

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