TRANSITION THERAPEUTICS INC.

Third Quarter Results
2004

Transition
therapeutics inc.

TO OUR SHAREHOLDERS

It is my pleasure to report on our third quarter results. It was another strong quarter for Transition, highlighted by:

- Completion of a private placement financing that significantly strengthens the balance sheet, raising gross proceeds of $15 million;
- Reporting of the issuance of the two patents for our Islet Neogenesis Therapy ("I.N.T.™") further strengthening Transition's patent position for regenerative therapies;
- Completion of the enrolment and dosing phase of an extended Phase I clinical trial for I.N.T.™; and
- Reporting of positive pre-clinical data for a second Islet Neogenesis Therapy, GLP1-I.N.T.™.

Subsequent to quarter end, the Company's shares began trading on the Toronto Stock Exchange ("TSX"). Graduation to the TSX represents the achievement of a major milestone in Transition's development and reflects the Company's maturing drug development pipeline and organization. The move will also allow us to raise the Company's profile and access a broader base of investors.

In addition, on May 10, 2004, Ms. Suzanne Cadden joined Transition as Vice President, Product Development. Ms. Cadden has 17 years of experience in the biotech and pharmaceutical industry and she will lead a product development team that will be responsible for expediting the development of our strong pipeline.

ADVANCING MULTIPLE PROGRAMS

During the third quarter, Transition completed the enrolment and dosing phase of an extended Phase I clinical trial for its I.N.T.™ technology. All subjects completed the escalation to the maximum doses and no serious or unexpected adverse events were observed. Transition intends to commence a Phase II clinical trial for I.N.T.™ during the first quarter of fiscal 2005.

Transition has completed a Phase I clinical trial for its interferon enhancer, EMZ701. During this trial, all dose levels were well tolerated and no adverse events occurred. Transition is now preparing to initiate a Phase II clinical trial in patients with multiple sclerosis and expects to commence this trial during the fourth quarter of fiscal 2004.

During the third quarter, Transition also reported positive pre-clinical efficacy data for a second Islet Neogenesis Therapy, GLP1-I.N.T.™. GLP1-I.N.T.™ combines the current leading diabetes drug candidate, Glucagon-Like Peptide ("GLP-1"), with Transition's gastrin analogue ("G1"). Based on this efficacy data, Transition is pursuing two additional product opportunities including the development of GLP1-I.N.T.™, a combination GLP-1 - G1 compound, and a stand alone G1 compound as an adjunct to other GLP-1 products currently in development. Transition is currently completing pre-clinical work on GLP1-I.N.T.™, with the intention of advancing it into a phase I/II clinical trial in fiscal 2005.

The restenosis program is continuing to advance, however Transition's resources have been prioritized towards partnership activities and clinical development of its two lead programs.

FINANCIAL STRENGTH

On February 24, 2004, the Company closed a private placement financing issuing 23,076,923 common shares at a purchase price of $0.65 per common share, for total gross proceeds of $15 million. The proceeds from this financing will be used for research and development and general corporate purposes. Based on the Company's current anticipated expenditures, the Company believes that it will have adequate financing until early fiscal 2007.

OUTLOOK

Looking ahead, we continue to focus on driving shareholder value by advancing our products through clinical trials and partnering. In the coming quarters, we intend to commence two important Phase II clinical trials as we look to establish strong evidence of human efficacy. In addition, Transition will continue to identify new product opportunities such as GLP1-I.N.T.™ and accelerate their entry into the clinic.

Transition will also continue to work closely with Novo Nordisk in pursuit of a long-term agreement that will support further development of the expanding I.N.T.™ platform technology. We are also pursuing discussions with potential corporate partners concerning licensing, co-development and other opportunities for other products in our pipeline including our interferon enhancing technology and our restenosis inhibitors.

On behalf of the Board of Directors, I would like to express my thanks to our investors and employees for their commitment and dedication to Transition. I look forward to reporting on our progress over the coming months as we pursue critical new development milestones for our novel therapeutics.

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 June 30, 2003 audited consolidated financial statements and the related notes, which are prepared in accordance with Canadian generally accepted accounting principles. Except for historical information, the following report includes statements which are forward looking. Readers are cautioned that the actual results may differ materially from the results projected in any forward looking statements.

Overview

Transition Therapeutics Inc. (the "Company") is a Canadian biopharmaceutical company, engaged in the business of developing novel approaches and therapeutics with the potential for enhancing the quality of life of patients with such debilitating diseases as diabetes, multiple sclerosis and restenosis. 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 and the sale of reagents. The Company has incurred a cumulative deficit to March 31, 2004 of $29,510,846. 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. The success of the Company is dependent on bringing its products to market, obtaining necessary regulatory approvals and achieving future profitable operations.

The Company's cash and cash equivalents were $18,693,814 at March 31, 2004, and the net working capital position was $18,556,129. The Company believes that it has adequate financing for anticipated expenditures until early fiscal 2007.

Financing activities

On February 24, 2004, under the terms of an underwriters agreement, the Company sold 23,076,923 common shares at a purchase price of $0.65 per common share, through a private placement, for total gross proceeds of $15 million. As consideration in connection with the financing, the Company paid the underwriters a cash fee of $1.05 million and granted the underwriters 1,384,615 non-transferable warrants. Each warrant entitles the holder to purchase one common share of the Company at a purchase price of $1.00. These warrants expire on February 24, 2006 and the fair value of these warrants has been recorded as an additional expense for the private placement.

During the third quarter, the Company raised total proceeds of $792,755 from the issuance of 1,316,000 common shares through the exercise of share purchase warrants and 64,779 common shares through the exercise of stock options.

On July 24, 2003, the Company sold 1,111,111 common shares to Novo Nordisk A/S ("Novo Nordisk") at a purchase price of $0.45 per common share through a private placement for a total amount of $500,000. The cash proceeds from the private placement, net of expenses, were $474,325. In addition, the Company also granted Novo Nordisk a non-transferable right to acquire up to an additional 10,101,010 common shares of the Company at a price of $0.495 per share which expired on October 1, 2003.

Option agreement

In November 2003, the Company signed an agreement granting Novo Nordisk an exclusive option to license the Company's Islet Neogenesis Therapy ("I.N.T.™"). Under the agreement, Novo Nordisk has provided the Company with $652,400 (US$500,000)

Option agreement (continued)

for the further development of the I.N.T.™ technology. Following the review of research data from the ongoing development program, which the Company expects to occur in the third quarter of calendar 2004, Novo Nordisk must exercise its exclusive option or the option will expire.

If the option is exercised, Novo Nordisk will execute a licensing agreement with an upfront payment and equity investment (at then market prices) of approximately US$5 million and development milestone payments potentially worth up to an additional US$51.5 million. In addition, the Company will be entitled to receive commercial milestone payments and royalty payments on sales.

The $652,400 received from Novo Nordisk has been recorded as deferred revenue. If the option is exercised, this amount will be taken into revenue over the term of the license agreement. If the option is not exercised, this amount will be taken into revenue when the option expires.

Results of operations

For the three months ended March 31, 2004, the Company recorded a net loss of $2,985,493 ($0.03 per common and Class B share) compared to a net loss of $3,020,981 ($0.05 per common and Class B share) for the three months ended March 31, 2003. For the nine months ended March 31, 2004, the Company recorded a net loss of $7,852,545 ($0.09 per common and Class B share) compared to a net loss of $8,847,366 ($0.17 per common and Class B share) for the nine months ended March 31, 2003. The small decrease in the loss for the three month period is primarily due to a decrease in facility closure costs and an increase in recovery of future income taxes, partially offset by an increase in research and development expenditures, as the Company completed an extended Phase I clinical trial and commenced toxicity and formulation studies in preparation for Phase II clinical trials. The decrease in the loss for the nine month period is primarily due to a decrease in research and development expenditures and facility closure costs, partially offset by an increase in amortization due to the technology acquired from Stem Cell Therapeutics Inc., and a decrease in the recovery of future income taxes.

Interest income

Interest income for the three months ended March 31, 2004, was $69,309 as compared to $6,476 for the three months ended March 31, 2003. Interest income for the nine months ended March 31, 2004, was $166,061 as compared to $30,178 for the nine months ended March 31, 2003. The increase in interest income resulted from an increase in cash and cash equivalents and short-term investments between March 31, 2003 and March 31, 2004 of $16,949,187. This increase resulted from the Company completing several private placements in the fourth quarter of fiscal 2003 and two private placements during the first three quarters of fiscal 2004, offset by expenditures incurred between the dates. Interest income is expected to increase during the fourth quarter of fiscal 2004 due to higher cash balances resulting from the financing completed in February 2004.

Research and development

Research and development expenses increased to $1,270,319 for the three months ended March 31, 2004 from $595,691 for the same period in fiscal 2003. Research and development expenses decreased to $2,370,696 for the nine months ended March 31,

Research and development (continued)

2004 from $3,119,758 for the same period in fiscal 2003. The increase for the three month period resulted from the Company completing an extended Phase I clinical trial for its I.N.T.™ technology as well as commencing toxicity and formulation studies in preparation for Phase II clinical trials for its Interferon Enhancing Therapy ("I.E.T.") in patients with multiple sclerosis and I.N.T.™ in patients with diabetes. The decrease for the nine month period resulted primarily from a temporary decrease in clinical study expenses. The Company anticipates that research and development expenses will increase during the fourth quarter of fiscal 2004, as it completes toxicity and formulation studies, commences a Phase II clinical trial for I.E.T., prepares for Phase II clinical trials for I.N.T.™, and commences additional pre-clinical, manufacturing and toxicity studies for its technologies.

General and administrative expenses

General and administrative expenses increased to $451,677 for the three months ended March 31, 2004 from $395,724 for the three months ended March 31, 2003. General and administrative expenses increased to $1,391,602 for the nine months ended March 31, 2004 from $1,152,618 for the nine months ended March 31, 2003. The increase for the three month period primarily resulted from an increase in accounting and regulatory fees. The increase for the nine month period primarily resulted from an increase in accounting and regulatory fees and severance costs incurred relating to changes in the Company's management team, partially offset by savings realized from management's decision to close the Waratah Pharmaceuticals Inc. facility in Woburn, MA. The Company anticipates that general and administrative expenses will increase for the fourth quarter of fiscal 2004 due to costs associated with the Company's move to the Toronto Stock Exchange.

Liquidity and capital resources

The Company's cash and cash equivalents and the Company's working capital position were $18,693,814 and $18,556,129, respectively at March 31, 2004, up from June 30, 2003 balances of $6,857,576 and $6,343,029, respectively. The increase is the net result of the private placements completed during July 2003 and February 2004 and expenditures incurred during the nine months ended March 31, 2004.

The Company believes that it has adequate financing for anticipated expenditures until early fiscal 2007.

Capital expenditures

During the three months ended March 31, 2004, the Company's capital expenditures were $15,472, as compared to nil for the three months ended March 31, 2003. During the nine months ended March 31, 2004, the Company's capital expenditures were $21,713, as compared to $605 for the nine months ended March 31, 2003. The expenditures during the first three quarters of fiscal 2004 were for computer equipment and office equipment. The Company does not anticipate any significant capital expenditures during the fourth quarter of fiscal 2004.

Risks and uncertainties

Prospects for companies in the biopharmaceutical industry generally may be regarded as uncertain given the nature of the industry and, accordingly, investments in such

Risks and uncertainties (continued)

companies should be regarded as highly speculative. The Company's technologies are currently in either the research and development stage or early in the clinical development stage, which are both risky stages for a company in the biopharmaceutical industry. 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. To date, the Company has not introduced a product into the market and there is no assurance that research and development programs conducted by the Company will result in any commercially viable products.

The Company has incurred losses and anticipates that it will continue to incur losses as it continues its research and development and clinical trials and eventually seeks regulatory approval for the sale of its products. If a product is approved for sale, there is no assurance that the Company will generate adequate funds to continue development or will ever achieve profitable operations. There are many factors such as competition, proprietary rights, patent protection and the regulatory environment that can influence the Company's ability to be profitable.

From time to time, the Company will seek additional funding through public or private placements, corporate collaborations or partnership arrangements. The Company's ability to access the capital markets or to enlist partners is mainly dependent on the progress of its research and development and regulatory approval of its products. There is no assurance that additional funding will be available on acceptable terms, if at all.

To continue the Company's research and development programs and to conduct future clinical trials, the Company will rely upon employees, collaborators and other third party relationships. There is no assurance that the Company will be able to maintain or establish these relationships as required.

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.

Outlook

The Company continues to be focused on driving shareholder value by advancing its products through clinical trials and partnering. In February 2004, the Company completed the enrolment and dosing phase of an extended Phase I clinical trial for I.N.T.™. All subjects completed the escalation to the maximum doses and no serious or unexpected adverse events were observed.

During the fourth quarter of fiscal 2004, the Company intends to commence a Phase II clinical trial for I.E.T. in patients with multiple sclerosis, complete toxicity and formulation studies, and commence additional pre-clinical, manufacturing and toxicity studies for its technologies. During the first quarter of fiscal 2005, the Company intends to commence a Phase II clinical trial for I.N.T.™ and during fiscal 2005, the Company intends to initiate a Phase I/II study for GLP1-I.N.T.™.

The Company continues to work closely with Novo Nordisk, who holds an option to license I.N.T.™, and is also pursuing discussions with potential corporate partners concerning licensing, co-development and other opportunities for its I.E.T and restenosis inhibitor technologies.

CONSOLIDATED BALANCE SHEETS

	Unaudited March 31, 2004 $	Audited June 30, 2003 $
ASSETS		
Current		
Cash and cash equivalents	**18,693,814**	6,857,576
Receivables	**77,059**	93,208
Investment tax credits receivable	**247,821**	458,400
Research inventory	**532,956**	379,956
Prepaid expenses and other assets	**143,341**	84,089
Future tax asset	**-**	66,250
Total current assets	**19,694,991**	7,939,479
Long-term deposits	**141,424**	148,202
Long-term research inventory	**-**	303,239
Capital assets, net	**463,310**	469,110
Technology *[note 2]*	**24,582,741**	31,020,940
	44,882,466	39,880,970
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**1,116,903**	1,576,741
Current portion of leasehold inducement	**3,698**	3,698
Current portion of obligation under capital leases	**18,261**	16,011
Total current liabilities	**1,138,862**	1,596,450
Leasehold inducement	**18,806**	21,578
Obligation under capital leases	**76,256**	36,261
Provision for facility closure	**294,424**	470,769
Deferred revenue *[note 3]*	**652,400**	-
Future tax liability	**1,963,373**	4,257,090
Total liabilities	**4,144,121**	6,382,148
Research commitments *[note 6]*		
Guarantees *[note 8]*		
Shareholders' equity		
Common shares *[note 4[b]]*	**65,452,017**	48,415,433
Class B shares *[note 4[b]]*	**-**	2,276,120
Contributed surplus *[note 4[d]]*	**2,646,643**	2,461,769
Stock options *[note 4[d]]*	**629,997**	814,871
Warrants *[note 4[c]]*	**1,520,534**	1,188,930
Deficit	**(29,510,846)**	(21,658,301)
Total shareholders' equity	**40,738,345**	33,498,822
	44,882,466	39,880,970

See accompanying notes

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(Unaudited)

	Nine-month period ended March 31, 2004 $	Nine-month period ended March 31, 2003 $	Three-month period ended March 31, 2004 $	Three-month period ended March 31, 2003 $
EXPENSES				
Research and development, net	**2,370,696**	3,119,758	**1,270,319**	595,691
General and administrative	**1,391,602**	1,152,618	**451,677**	395,724
Facility closure	**60,129**	661,914	**60,129**	440,837
Amortization	**6,481,208**	6,177,929	**2,161,492**	2,124,783
Foreign exchange (gain) loss	**(19,353)**	17,344	**11,219**	20,683
	10,284,282	11,129,563	**3,954,836**	3,577,718
Loss before the following	**(10,284,282)**	(11,129,563)	**(3,954,836)**	(3,577,718)
Interest income, net	**166,061**	30,178	**69,309**	6,476
Equity loss in affiliate	**-**	(154,746)	**-**	(144,321)
Loss before income taxes	**(10,118,221)**	(11,254,131)	**(3,885,527)**	(3,715,563)
Recovery of (provision for) income taxes				
Current	**38,209**	(29,600)	**(15,709)**	(6,200)
Future	**2,227,467**	2,436,365	**915,743**	700,782
Net loss for the period	**(7,852,545)**	(8,847,366)	**(2,985,493)**	(3,020,981)
Deficit, beginning of period	**(21,658,301)**	(10,074,955)	**(26,525,353)**	(15,901,340)
Deficit, end of period	**(29,510,846)**	(18,922,321)	**(26,510,846)**	(18,922,321)
Basic net loss per common and Class B share *[note 4[b][iii]]*	**$(0.09)**	$(0.17)	**$(0.03)**	$(0.05)

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine-month period ended March 31, 2004 $	Nine-month period ended March 31, 2003 $	Three-month period ended March 31, 2004 $	Three-month period ended March 31, 2003 $
OPERATING ACTIVITIES				
Net loss for the period	**(7,852,545)**	(8,847,366)	**(2,985,493)**	(3,020,981)
Add (deduct) items not involving cash				
Amortization	**6,524,517**	6,190,223	**2,176,064**	2,128,882
Amortization of leasehold inducement	**(2,772)**	(2,772)	**(924)**	(924)
Write-off of inventory	**24,588**	-	**24,588**	-
Recovery of income taxes - future	**(2,227,467)**	(2,436,365)	**(915,743)**	(700,782)
Equity loss in affiliate	**-**	154,746	**-**	144,321
	(3,533,679)	(4,941,534)	**(1,701,508)**	(1,449,484)
Net change in non-cash working capital balances related to operations *[note 5]*	**316,122**	110,194	**79,676**	85,905
Cash used in operating activities	**(3,217,557)**	(4,831,340)	**(1,621,832)**	(1,363,579)
INVESTING ACTIVITIES				
Maturity of short-term investments	**-**	400,000	**-**	-
Purchase of capital assets	**(21,713)**	(605)	**(15,472)**	-
Cash acquired on SCT purchase, net of acquisition costs	**-**	226,063	**-**	247,882
Cash provided by (used in) investing activities	**(21,713)**	625,458	**(15,472)**	247,882
FINANCING ACTIVITIES				
Repayment of obligation under capital leases	**(16,560)**	(21,440)	**(691)**	(9,401)
Proceeds from issuance of common shares, net *[note 4[b]]*	**15,092,068**	1,960,947	**14,617,743**	-
Cash provided by (used in) financing activities	**15,075,508**	1,939,507	**14,617,052**	(9,401)
Net increase (decrease) in cash and cash equivalents during the period	**11,836,238**	(2,266,375)	**12,979,748**	(1,125,098)
Cash and cash equivalents, beginning of period	**6,857,576**	2,894,277	**5,714,066**	1,753,000
Cash and cash equivalents, end of period	**18,693,814**	627,902	**18,693,814**	627,902

See accompanying notes

1. NATURE OF OPERATIONS

Transition Therapeutics Inc. (the "Company") is a biopharmaceutical company, incorporated on July 6, 1998 under the Business Corporations Act (Ontario). The Company is engaged in the business of developing novel approaches and therapeutics with the potential for enhancing the quality of life of patients with such debilitating diseases as diabetes, multiple sclerosis and restenosis.

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.

These consolidated financial statements have been prepared using the same accounting principles used in the audited consolidated financial statements for the period ended June 30, 2003.

2. TECHNOLOGY

Technology consists of the following:

	March 31, 2004		
	Cost $	Accumulated amortization $	Net book value $
Acquired on acquisition of Waratah Pharmaceuticals Inc.	**39,799,917**	**17,578,297**	**22,221,620**
Acquired from Biogenesys, Inc.	**137,000**	**63,927**	**73,073**
Acquired on acquisition of Stem Cell Therapeutics Inc.	**3,055,560**	**767,512**	**2,288,048**
	42,992,477	**18,409,736**	**24,582,741**

	June 30, 2003		
	Cost $	Accumulated amortization $	Net book value $
Acquired on acquisition of Waratah Pharmaceuticals Inc.	39,799,917	11,608,309	28,191,608
Acquired from Biogenesys, Inc.	137,000	43,378	93,622
Acquired on acquisition of Stem Cell Therapeutics Inc.	3,055,560	319,850	2,735,710
	42,992,477	11,971,537	31,020,940

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

	$
2004	**8,584,266**
2005	**8,584,266**
2006	**8,584,266**
2007	**4,919,962**
2008	**348,180**
	31,020,940

3. OPTION AGREEMENT

In November 2003, the Company signed an agreement granting Novo Nordisk A/S ("Novo Nordisk") an exclusive option to license the Company's Islet Neogenesis Therapy ("I.N.T.™"). Under the agreement, Novo Nordisk has provided the Company with $652,400 (US$500,000) for the further development of the I.N.T.™ technology. Following the review of research data from the ongoing development program, which the Company expects to occur in the third quarter of calendar 2004, Novo Nordisk must exercise its exclusive option or the option will expire.

If the option is exercised, Novo Nordisk will execute a licensing agreement with an upfront payment and equity investment (at then market prices) of approximately US$5 million and development milestone payments potentially worth up to an additional US$51.5 million. In addition, the Company will be entitled to receive commercial milestone payments and royalty payments on sales.

The $652,400 received from Novo Nordisk has been recorded as deferred revenue. If the option is exercised, this amount will be taken into revenue over the term of the license agreement. If the option is not exercised, this amount will be taken into revenue when the option expires.

4. SHARE CAPITAL

[a] Authorized

Unlimited common shares

Unlimited Class B shares, which are convertible on a one to one basis into common shares without additional consideration

[b] Issued and outstanding and changes during the period

Common shares	#	$
Balance, June 30, 2003	**72,460,056**	**48,415,433**
Issued pursuant to private placement, net *[i]*	**1,111,111**	**474,325**
Conversion of Class B shares	**8,129,000**	**2,276,120**
Exercise of share purchase warrants *[note 4[c][i]]*	**1,316,000**	**918,291**
Exercise of stock options *[note 4[d][i]]*	**64,779**	**29,475**
Issued pursuant to private placement, net *[ii]*	**23,076,923**	**13,338,373**
Balance, March 31, 2004	**106,157,869**	**65,452,017**

Class B shares	#	$
Balance, June 30, 2003	**8,129,000**	**2,276,120**
Conversion to common shares	**(8,129,000)**	**(2,276,120)**
Balance, March 31, 2004	**-**	**-**
Total common and Class B shares, March 31, 2004	**106,157,869**	**65,452,017**

[i] On July 24, 2003, the Company sold 1,111,111 common shares to Novo Nordisk at a purchase price of $0.45 per common share through a private placement for a total amount of $500,000. The cash proceeds from the private placement, net of expenses, were $474,325. In addition, the Company also granted Novo Nordisk a non-transferable right to acquire up to an additional 10,101,010 common shares of the Company at $0.495 per common share which right expired on October 1, 2003.

[ii] On February 24, 2004, under the terms of an underwriters agreement, the Company sold 23,076,923 common shares at a purchase price of $0.65 per

4. SHARE CAPITAL (continued)

common share, through a private placement, for total gross proceeds of $15 million. The net cash proceeds of the private placement were $13,824,988. As consideration in connection with the financing, the Company paid the underwriters a cash fee of $1.05 million and granted the underwriters 1,384,615 non-transferable warrants. Each warrant entitles the holder to purchase one common share of the Company at a purchase price of $1.00. The fair value of the warrants at the date of grant was estimated at $486,615 using the Black-Scholes pricing model based on the following assumptions: expected warrant life of 2 years, volatility of 1.219, a risk free rate of 1.75% and a dividend yield of 0%. These warrants expire on February 24, 2006 and the fair value of these warrants has been recorded as an additional expense for the private placement.

[iii] The weighted average number of shares used in the computation of basic net loss per common and Class B share for the nine-month period ended March 31, 2004 is 83,746,438 (nine-month period ended March 31, 2003 - 51,885,853) and for the three-month period ended March 31, 2004 is 90,355,887 (three-month period ended March 31, 2003 - 60,687,076).

For the nine-month period ended March 31, 2003, 1,090,906 (nine-month period ended March 31, 2003 - 1,009,511) and for the three-month period ended March 31, 2004, 1,105,590 (three-month period ended March 31, 2003 - 1,009,511) contingently returnable common shares were excluded from the basic net loss per common and Class B share calculation.

[c] Share purchase warrants and Agents' Warrants

Share purchase warrants	#	$
Share purchase warrants outstanding, June 30, 2003	**7,245,098**	**859,616**
Exercise of share purchase warrants *[i]*	**(1,316,000)**	**(155,011)**
Share purchase warrants issued pursuant to private placement *[note 4[b][ii]]*	**1,384,615**	**486,615**
Share purchase warrants outstanding, March 31, 2004	**7,313,713**	**1,191,220**

Agents' Warrants	#	$
Agents' Warrants outstanding, June 30, 2003 and March 31, 2004	**1,431,800**	**329,314**
Total warrants, March 31, 2004	**8,745,513**	**1,520,534**

[i] Share purchase warrants totaling 1,316,000 were exercised in February and March 2004. These warrants had a recorded value of $155,011 and resulted in cash proceeds to the Company of $763,280.

[ii] The maximum possible cash proceeds to the Company from the exercise of the share purchase warrants and the Agents' Warrants outstanding as at March 31, 2004 is $5,761,192.

[d] Stock options

Stock options	#	$
Stock options outstanding, June 30, 2003	**3,830,197**	**814,871**
Stock options issued	**419,000**	**-**
Exercise of stock options *[i]*	**(64,779)**	**-**
Stock options expired *[iii]*	**(729,387)**	**(184,874)**
Stock options outstanding, March 31, 2004	**3,455,031**	**629,997**

4. SHARE CAPITAL (continued)

[i] Stock options totaling 64,779 were exercised in January and March 2004. These stock options had a recorded value of nil and resulted in cash proceeds to the Company of $29,475.

[ii] The maximum cash proceeds to the Company from the exercise of the stock options outstanding as at March 31, 2004 is $3,948,063.

[iii] Of the stock options that expired, 295,832 were included as part of the consideration for the acquisition of Waratah Pharmaceuticals Inc. Therefore, the consideration associated with these options was reclassified to contributed surplus when they expired.

[iv] The pro forma information below, regarding net loss and basic net loss per common and Class B share, has been determined as if the Company had accounted for stock options granted to employees, officers and directors on or after July 1, 2002 under the fair value based method of accounting for stock-based compensation.

	Nine-month period ended March 31, 2004 $	Nine-month period ended March 31, 2003 $	Three-month period ended March 31, 2004 $	Three-month period ended March 31, 2003 $
Net loss				
As reported	**7,852,545**	8,847,366	**2,985,493**	3,020,981
Pro forma	**7,876,821**	8,854,866	**2,989,586**	3,021,731
Basic net loss per common and Class B share				
As reported	**$0.09**	$0.17	**$0.03**	$0.05
Pro forma	**$0.09**	$0.17	**$0.03**	$0.05

5. CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Nine-month period ended March 31, 2004 $	Nine-month period ended March 31, 2003 $	Three-month period ended March 31, 2004 $	Three-month period ended March 31, 2003 $
Receivables	**16,149**	(53,943)	**(38,374)**	(29,523)
Investment tax credits receivable	**210,579**	(127,000)	**28,115**	(33,000)
Research inventory	**125,651**	33,584	**105,558**	2,361
Deposits on collaborations	**-**	282,201	**-**	-
Prepaid expenses and other assets	**(59,252)**	95,694	**(55,063)**	(12,219)
Long-term deposits	**6,778**	5,467	**(1,596)**	12,028
Accounts payable and accrued liabilities	**(459,838)**	(466,179)	**95,716**	146,258
Deferred revenue	**652,400**	-	**-**	-
Provision for facility closure	**(176,345)**	340,370	**(54,680)**	-
	316,122	110,194	**79,676**	85,905
Supplemental cash flow information				
Interest paid	**4,064**	11,593	**776**	6,417
Taxes paid	**133,796**	23,881	**107,154**	12,441

6. RESEARCH COMMITMENTS

As at March 31, 2004, the Company is committed to aggregate expenditures of approximately $167,250 (June 30, 2003 - $115,250) under its collaboration agreements. In addition, as at March 31, 2004, the Company is committed to aggregate expenditures of approximately $413,075 (June 30, 2003 - $41,773) for clinical and toxicity studies and approximately $138,919 (June 30, 2003 - nil) for manufacturing agreements.

7. 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 Pharmaceuticals Inc., the Company's operations are conducted in Canada and the United States. Geographic segment information is as follows:

	Canada $	United States $
Net loss:		
Nine months ended March 31, 2004	**7,768,311**	**84,234**
Nine months ended March 31, 2003	7,650,815	1,196,551
Three months ended March 31, 2004	**2,887,610**	**97,883**
Three months ended March 31, 2003	2,388,070	632,911
Amortization of capital assets:		
Nine months ended March 31, 2004	**80,843**	**5,475**
Nine months ended March 31, 2003	43,257	56,952
Three months ended March 31, 2004	**29,998**	**-**
Three months ended March 31, 2003	14,418	18,139
Interest income (expense):		
Nine months ended March 31, 2004	**166,405**	**(344)**
Nine months ended March 31, 2003	34,964	(4,786)
Three months ended March 31, 2004	**69,309**	-
Three months ended March 31, 2003	7,005	(529)
Recovery of (provision for) income taxes - current:		
Nine months ended March 31, 2004	-	**38,209**
Nine months ended March 31, 2003	-	(29,600)
Three months ended March 31, 2004	-	**(15,709)**
Three months ended March 31, 2003	-	(6,200)
Recovery of (provision for) income taxes - future:		
Nine months ended March 31, 2004	**2,293,717**	**(66,250)**
Nine months ended March 31, 2003	2,436,365	-
Three months ended March 31, 2004	**915,743**	**-**
Three months ended March 31, 2003	700,782	-
Capital assets:		
March 31, 2004	**463,310**	-
June 30, 2003	403,404	65,706

8. 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.

Stock symbol: **TTH**
Exchange: **TSX**
Fiscal year end: **JUNE 30**

Transition Therapeutics Inc.
415 Yonge St., Suite 1103
T. 416.260.7770
F. 416.260.2886
info@transitiontherapeutics.com
www.transitiontherapeutics.com