

*discovery*

*human health*

*Mycobacterium phlei*

*innovation*

*technology*

*bladder cancer*

*hyaluronans*

*food safety*

*prostate cancer*

*animal health*

*MCC*

*apoptosis*

*vaccines*

**2005**

# LETTER TO SHAREHOLDERS — Q3, 2005

(JAN. 1/05 TO MAR. 31/05)

Bioniche Life Sciences has reached the end of the third quarter in its 2005 fiscal year, a challenging but interesting period for us. We've been reminded that we work in an environment of complex regulatory requirements in which sudden, unexpected curves can prevent a smooth journey to projected endpoints. As we navigate these curves behind-the-scenes, it can be frustrating for shareholders when timelines become extended. Nonetheless, we are confident that our projects are on track and, given the talented teams at Bioniche who are directing these projects, they will reach their endpoints.

## ***E. coli* O157:H7 Cattle Vaccine**

We are pleased with the momentum that appears to be building around our *E. Coli* O157:H7 cattle vaccine. We are anticipating the final regulatory requirements for Canadian and U.S. licensing with the agencies responsible — the United States Department of Agriculture (USDA) and the Canadian Food Inspection Agency (CFIA). Regulators are working with Bioniche to ensure that the regulatory package is complete prior to being made available to them for final review.

We at Bioniche have worked very hard with our partners to ensure that the regulatory pathway for this vaccine is clear. Given that this is the first animal vaccine of its kind, there was some uncertainty as to who should be involved in its regulation in the U.S. It is now clear that the United States Department of Agriculture (USDA) will be responsible. The Canadian Food Inspection Agency (CFIA) will regulate the vaccine in Canada.

As we finalize data for the regulators, we are also considering all possible options for the production of the vaccine. There are approximately 115 million cattle in North America, 25 million of which are found in feedlots, our first target market for the *E. Coli* O157:H7 vaccine. This means that we could require a significant quantity of the vaccine soon after licensing.

In the meantime, we've had further positive results in the latest three University of Nebraska feedlot studies utilizing the *E. coli* O157:H7 vaccine. These studies were conducted during the past two summers and will be published in a peer-reviewed journal later this year.

In one study, there were 73% fewer animals detectably shedding *E. Coli* O157:H7 bacteria in their manure. Another study analyzed colonization in the terminal rectal junction in the cattle, where the bacteria are known to colonize and reproduce. After vaccination, 97% fewer animals had detectable bacterial colonization. A third study, involving 19 feedlots and 21,691 cattle, demonstrated that the vaccine was effective in commercial feedlot settings. In that study, vaccinated cattle were 75% less likely to have detectable bacterial colonization. The consistent results in the University of Nebraska efficacy studies give us confidence as we move toward licensing of this important vaccine.

### Planned Phase III Clinical Trial for Bladder Cancer

On the human health side, our Investigational New Drug (IND) application for the planned Phase III clinical trial with Mycobacterial Cell Wall-DNA Complex (MCC – named *Urocidin*) for bladder cancer is being finalized. We are working with external consulting groups to review and finalize the package prior to its final submission to the regulators.

We continue to anticipate the recruitment of approximately 600 patients for this trial, with the involvement of 60 North American and European sites/investigators.

Our state-of-the-art, fully validated MCC manufacturing facility in Montreal, Quebec, Canada is manufacturing both the raw material and the final dosage form of *Urocidin* for the planned clinical trial and the commercial product that will follow its registration.

### Third Quarter Financial Results

Consolidated revenues for the quarter were \$12.8 million as compared to \$13.3 million for the same quarter of fiscal 2004, a decrease of \$0.5 million, or 4%. Year-to-date, consolidated revenues were \$33.2 million compared to \$36.6 million in the same period of 2004, a \$3.4 million, or 9%, decrease.

In Animal Health, we have seen strong growth in our U.S. business, and stable sales in Europe and Australia, which have helped to offset the impact of the unresolved Bovine Spongiform Encephalopathy (BSE) crisis on Canadian sales.

On the Human Health side of our business, our proprietary urology product — Cystistat® — continues to perform well, with a year-to-date gain of 30% over last year. Bioniche Pharma sales are down year-to-date by \$3.4 million over 2004, however, we are looking forward to the successful validation of our newly-built 20,000 square foot plant in Ireland. We expect to be producing commercial product in this new facility by the end of this year.

### Activities of Note in the Quarter

#### Latest Feedlot Studies with *E. coli* O157:H7 Vaccine

As mentioned earlier in this letter, we've had further positive results in the latest three University of Nebraska feedlot studies utilizing the *E. Coli* O157:H7 vaccine. These studies were conducted during the past two summers.

#### More Promising Data on MCC for Cancer

Bioniche researchers presented further positive data at the 2005 European Association of Urology 20<sup>th</sup> Congress in Istanbul, Turkey demonstrating the efficacy of our proprietary Mycobacterial Cell Wall-DNA Complex (MCC) in the treatment of cancer.

These data, presented by Dr. Nigel C. Phillips, Chief Scientific Officer at Bioniche Life Sciences Inc., show: a) that MCC interacts rapidly with bladder cancer cells *in vitro* (interaction evident after two minutes and maximal interaction after 3 to 4 hours incubation) and shows strong synergistic interaction with Gemcitabine, a chemotherapeutic drug; b) that the direct anticancer activity of MCC is not inhibited by the presence of urinary anti-MCC antibodies generated in patients with bladder cancer who have been treated with MCC; and c) that MCC has a unique immune stimulatory profile as determined by measurement of urinary cytokines in patients with bladder cancer who have been treated with MCC.

### **Further Reinforcement of Intellectual Property Portfolio**

An additional European patent was granted this quarter by the European Patent Office (EPO) on our core mycobacterial cell wall technology: "Treatment of Bladder Cancer by *Mycobacterium phlei* Cell Wall" (EP1054680B1), inventors Nigel C. Phillips and Mario C. Filion.

This patent further consolidates our intellectual property portfolio for the mycobacterial cell wall technology. Recognition of the unique, innovative activities of MCC by the EPO, and its application in the treatment of bladder cancer is a significant event in our developmental program for this technology.

The patent covers 18 European countries, with a population of approximately 390 million. It is estimated that there are 136,000 new cases of bladder cancer diagnosed in Europe each year.

We now have a total of 98 patents applied for or issued related to MCC.

### **Folltropin-V Availability Expanded in Europe**

In January, we announced that we had been granted authorization to market our Folltropin<sup>®</sup>-V embryo transfer technology in additional European Union (EU) countries — specifically, in the United Kingdom, the Netherlands, and Spain. We will continue to seek registrations in other EU countries. The product was already being sold in Ireland.

*Folltropin-V* is a follicle stimulating hormone for livestock and enjoys a significant presence in the world market for the embryo transfer market. The product was available in Canada, the United States, Australia, New Zealand, Argentina, Brazil, Ireland, and China for a number of years prior to the addition of the three latest EU countries. Veterinary reproduction specialists in the EU had been eagerly awaiting its arrival on the broader European market.

### Improving Sow Breeding with a Combination of Two Bioniche Products

Recent research using Bioniche products has shown the potential to consistently predict the timing of ovulation in sows. The research, conducted by Dr. Glen Cassar, Assistant Professor at the Ontario Veterinary College at the University of Guelph, was presented at the Annual Meeting of the American Association of Swine Veterinarians in Toronto in March. Dr. Cassar's research showed that when Canadian Bioniche products *Pregnecol* (eCG) and *Lutropin-V* (pLH) were administered at specific times, ovulation was managed so precisely that just a single, timed, insemination was effective in more than 89% of the sows. Further research to validate these results is underway.

### Looking Ahead

As we close our 25<sup>th</sup> anniversary year and enter our 26<sup>th</sup> year in business, we are feeling optimistic about several key projects reaching important milestones in the near future.

Corporate performance is measured by more than financial results. Our success as a company and, indeed, our longevity, can be attributed to the creativity and flexibility of our employees, the wisdom and support of our Board of Directors, the loyalty of our customers, and the patience of our shareholders.

We are continuing to make progress, and we know that our business plan — developing proprietary technologies through to late stage before considering potential partnerships — will yield the best possible return to all of our stakeholders.

Sincerely,

A handwritten signature in black ink, appearing to read "Graeme McRae". The signature is fluid and cursive.

**Graeme McRae**

President & CEO

Bioniche Life Sciences Inc.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS FROM OPERATIONS

The following discussion and analysis is the responsibility of management. It should be read in conjunction with the accompanying consolidated financial statements and associated notes. The discussion in this report contains forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear. The Company's actual results could differ materially from those discussed here. Factors that could cause or contribute to these differences include those discussed in the Annual Report for fiscal 2004. All amounts are in Canadian dollars unless otherwise indicated.

## OVERVIEW

Bioniche is a research-based, technology-driven Canadian biopharmaceutical company that discovers, develops, manufactures, and markets proprietary products for human and animal health markets worldwide. The fully-integrated Company employs approximately 300 people and has four reportable segments: Bioniche Animal Health, Bioniche Food Safety, Bioniche Therapeutics, and Bioniche Pharma (the two latter segments fall under the Company's Human Health division). Corporate headquarters are located in Belleville, Ontario, Canada, with research, manufacturing, and marketing/sales facilities in Belleville, Ontario, Canada; Montreal, Quebec, Canada; Armidale, New South Wales, Australia; Athens, Georgia, U.S.A.; Pullman, Washington, U.S.A.; and Galway, Republic of Ireland.

Bioniche has an expanded global presence and a portfolio of products and technologies in development that promise to have a profound impact on the converging world of human and animal health. Effective therapies for bladder cancer and potentially other cancers; a cattle vaccine to help prevent *E. coli* O157:H7 contamination of food and water; technologies to improve livestock reproduction; and technologies that could replace the use of antibiotics in livestock: these are the key areas of strategic focus for Bioniche.

## HIGHLIGHTS FOR THE THIRD QUARTER

The Company reported several operating highlights in the course of its third fiscal quarter. These events and highlights are summarized as follows:

- On March 29<sup>th</sup>, the Company reported that an additional European patent was granted by the European Patent Office (EPO) on its core mycobacterial cell wall technology: "Treatment of Bladder Cancer by *Mycobacterium phlei* Cell Wall" (EP1054680B1). This patent further consolidates Bioniche's intellectual property portfolio for the mycobacterial cell wall technology. The patent covers 18 European countries, with a population of approximately 390 million. According to Globocan, there are approximately 136,000 new cases of bladder cancer diagnosed in Europe each year.

- On March 22<sup>nd</sup>, Bioniche reported that its researchers presented further positive data demonstrating the efficacy of the Company's proprietary Mycobacterial Cell Wall-DNA Complex (MCC) in the treatment of cancer at the 2005 European Association of Urology 20<sup>th</sup> Congress in Istanbul, Turkey. The non-clinical and translational studies support MCC's unique dual mechanism of action: direct chemotherapeutic activity against cancer cells and immune stimulant activity.
- On March 14<sup>th</sup>, Bioniche announced the positive results found in the latest three University of Nebraska feedlot studies utilizing the *E. coli* O157:H7 vaccine. These studies were conducted during the past two summers and will be published in a peer-reviewed journal later this year. In one study, with cattle receiving three doses of vaccine, there were 73% fewer animals detectably shedding *E. coli* O157:H7 bacteria in their manure. Another three-dose study analyzed colonization in the terminal rectal junction in the cattle, where the bacteria are known to colonize and reproduce. After vaccination, 97% fewer animals had detectable bacterial colonization. A third study, involving 19 feedlots and 21,691 cattle, demonstrated that the vaccine was effective in commercial feedlot settings. In that study, vaccinated cattle were 75% less likely to have detectable bacterial colonization.
- On January 21<sup>st</sup>, Bioniche announced that it had been granted authorization to market its Folltropin<sup>®</sup>-V embryo transfer technology in additional European Union (EU) countries — specifically, the United Kingdom, the Netherlands, and Spain. The Company will continue to seek registrations in other EU countries. The product was already being sold in Ireland.
- Recent research using Bioniche products has shown the potential to consistently predict the timing of ovulation in sows. The research, conducted by Dr. Glen Cassar, Assistant Professor at the Ontario Veterinary College at the University of Guelph, was presented at the Annual Meeting of the American Association of Swine Veterinarians in Toronto on March 7<sup>th</sup>. Dr. Cassar's research showed that when Canadian Bioniche products *Pregnecol* (eCG) and *Lutropin-V* (pLH) were administered at specific times, ovulation was managed so precisely that just a single, timed, insemination was effective in more than 89% of the sows. Further research to validate these results is underway which could result in expanded sales in the sow breeding market.

### **THREE-MONTH PERIOD ENDED MARCH 31, 2005 COMPARED TO THE SAME PERIOD ENDED MARCH 31, 2004**

Fiscal 2005 has been a challenging year for Bioniche Life Sciences. The poor results seen in the second quarter have continued in the third, although to a somewhat lesser extent. The Company has seen some volume increases in certain products; however, pricing pressures have caused net losses. Other contributing factors include the difficult economic environment for Canadian exporters due to the impact of foreign currency fluctuations and the ongoing effect of the Bovine Spongiform Encephalopathy (BSE – "mad cow") crisis on the agricultural sector. More information on the quarterly and nine month revenue variances can be found below.

The Company made key advancements in research and development during the quarter, as shown in the above-mentioned highlights. The Company is pleased with the directive that the United States Department of Agriculture (USDA) will be responsible for regulating the *E. coli* O157:H7 cattle vaccine in the U.S. Given that this is the first animal vaccine of its kind, there was some uncertainty as to who should be involved in its regulation. This has now been resolved. The Canadian Food Inspection Agency (CFIA) will regulate the vaccine in Canada.

Business is typically stronger in the last quarter of the Company's fiscal year. Consequently, due to the seasonality of the business, the results of operations for the three and nine months ended March 31, 2005 are not necessarily indicative of annual results. It should be noted, however, that consolidated revenues for fiscal 2005 are expected to be lower than those experienced last year.

	2005					
	Q3		Q2		Q1	
	\$	%	\$	%	\$	%
Total revenue and quarterly variation over the previous year	12.8	-4%	10.3	-24%	10.1	3%
Net income (loss)	(3.6)		(4.8)		(4.7)	
Loss per share	(0.10)		(0.13)		(0.13)	

## REVENUES

The Company's consolidated revenues for the third quarter of fiscal year 2005 reached \$12.8 million as compared to \$13.3 million for the same quarter of fiscal year 2004, a decrease of \$0.5 million, or 4%.

As well, the Company's Pharma division deferred, over a period of four years, a non-refundable licensing fee arrangement of \$0.8 million (€500,000) in connection with the renewal of a German distribution agreement after the acquisition of the former distributor by Recordati S.p.A. This revenue, in accordance with revenue recognition guidance, has been deferred over the duration of the initial contract.

Total consolidated revenues for the nine months ending March 31, 2005 were \$33.2 million. This compares to \$36.6 million reported in the same period last year, a decrease of \$3.4 million, or 9%. Adjusted for currency fluctuations, revenues for the fiscal year 2005 would have reached \$34.9 million, for a net decrease of 5% as compared to fiscal 2004.

## REVENUES BY REPORTING SEGMENT

(number in millions and % variation over 2004)

	2005				2004	
	Q3		YTD		Q3	YTD
	\$	%	\$	%	\$	\$
Human Health – Pharma	5.4	-7%	12.4	-22%	5.8	15.8
Human Health – Therapeutics	0.9	0%	2.8	40%	0.9	2.0
Animal Health	6.5	-2%	18.0	-4%	6.6	18.8
Food Safety	—		—		—	—
<b>Total Revenues</b>	<b>12.8</b>	<b>-4%</b>	<b>33.2</b>	<b>-9%</b>	<b>13.3</b>	<b>36.6</b>

The Company has four reportable segments, described in Note 3 of the financial statements. These are: Bioniche Therapeutics, and Bioniche Pharma (these two segments fall under the Company's Human Health division) Bioniche Animal Health, and Bioniche Food Safety.

In the Human Health Pharma division, the Company recorded revenues of \$5.4 million for the 3 months ending March 31, 2005. This reflects a reduction in total revenues of \$0.4 million, or 7%, for the third quarter as compared to \$5.8 million in the same period last year. Year-to-date Pharma revenues are \$12.4 million compared to \$15.8 million in the same period last year. This represents a total decline of \$3.4 million, or 22%, excluding receipt of a non-refundable, non-recurring licensing fee of \$0.8 million. The Company recorded this fee under deferred income according to Revenue Recognition Guideline EIC 141. This licensing fee relates to the German distribution agreement for the Company's Osteoarthritis product (*Suplasyn*), where a new distributor took over the existing agreement and acquired an option to renew it for a further 5 years. Bioniche Pharma continues to experience some pricing pressure from worldwide competition.

At the same time, the Company is looking forward to the successful validation of its newly-built 20,000 square foot plant in Ireland. It is expected that commercial product will be produced in this new facility by the end of this year.

In the Human Health Therapeutics division, revenues from the Company's proprietary urological product (*Cystistat*) were slightly behind in the third quarter by \$0.3 million over the same period last year. However, *Cystistat* sales maintained a \$0.6 million, or 30%, gain for the first nine months of 2005 as compared to the same period last year.

In the Animal Health division, the Company's total revenues declined \$0.1 million for the third quarter over the same period last year with the year-to-date decline totaling \$0.8 million as compared to the same period in 2004. Although the sales decline appears to be ending, the unresolved BSE situation and stronger Canadian dollar continue to negatively affect Animal Health revenues in Canada.

The Company's revenues are primarily derived from a number of products sold in areas of key market focus, as described below.

## AREAS OF MARKET FOCUS

(number in millions and % variation over 2004)

	2005				2004	
	Q3		YTD		Q3	YTD
	\$	%	\$	%	\$	\$
<b>Human Health – Pharma</b>						
Osteoarthritis	2.7	17%	6.5	-17%	2.3	7.8
Specialty Pharmaceutical (ANDA)	1.4	-33%	3.1	-26%	2.1	4.2
<b>Human Health – Therapeutics</b>						
Urology	0.6	-33%	2.6	30%	0.9	2.0
	4.7	-11%	12.2	-13%	5.3	14.0
<b>Animal Health</b>						
Reproduction	4.4	-2%	11.9	-7%	4.5	12.8
Immune Stimulants	0.9	0%	2.6	4%	0.9	2.5
Osteoarthritis	0.1	0%	0.4	33%	0.1	0.3
<b>Food Safety</b>						
Product Pending	—		—		—	—
	5.4	-2%	14.9	-4%	5.5	15.6
<b>Revenues from Area of Focus</b>	10.1	-6%	27.1	-8%	10.8	29.6
% of Total Sales	79%		82%		81%	81%
Others	2.7	8%	6.1	-13%	2.5	7.0
<b>Total Revenues</b>	12.8	-4%	33.2	-9%	13.3	36.6

The revenues derived from products in the Company's specific areas of market focus for the third quarter were stable at 79% of the total revenues. Year-to-date, they represent 82% of total revenues compared with 81% in the same period last year.

The remaining revenues under "Others" in the above chart were derived from non-branded generic human and animal health product sales, which were slightly better for the quarter as compared to the same period last year and 13% lower on a year-to-date basis over 2004.

## HUMAN HEALTH DIVISION

**Bioniche Pharma:** Bioniche Pharma's products are classified under the following categories: Osteoarthritis, Specialty Pharmaceutical, and other non-branded generics.

### Osteoarthritis

*Suplasyn* is the Company's main product in this category. The sales of *Suplasyn* reached \$2.7 million for the third quarter of 2005 compared with \$2.3 million for the same period in 2004, an increase of \$0.4 million, or 17%. Total consolidated revenues in this category for the nine months ending March 31, 2005 were \$6.5 million. This compares to \$7.8 million reported in the same period last year, a decrease of \$1.3 million, or 17%. Although the Company has experienced a good third quarter, competitive pricing in its largest marketplace has contributed to less than optimum sales overall. *Suplasyn* is a sterile, sodium hyaluronate solution injected into synovial joints such as the knee to replace or augment synovial fluid, the naturally occurring lubricant in the joints. *Suplasyn* is now recognized as one of the leading hyaluronan products in Europe.

The Company is in the process of launching a new mini-dosage formula of *Suplasyn* — *SuplasynMD* — in most countries in Europe. *SuplasynMD* targets smaller human joints. The Company believes this will help differentiate Bioniche from the competition and improve the profitability of this brand.

Management does not believe that all of the *Suplasyn* revenues lost year-to-date will be regained in the remainder of fiscal year 2005, but does remain optimistic about this product due to the market share it has secured. The new German distributor is recording increased unit sales.

### Specialty Pharmaceutical (ANDA)

Over the past four years, the Bioniche Pharma business unit has evolved into a Specialty Pharmaceutical company, identifying niche segments, and developing and obtaining product approvals for promising specialty pharmaceutical products. The Company files Abbreviated New Drug Applications (ANDAs), and manufactures and markets the products after approval.

At the end of March, 2005, eight ANDAs were approved by the U.S. Food and Drug Administration (FDA), generating sales of \$3.1 million for the first nine months of fiscal 2005, compared with \$4.2 million for the same period in 2004, a decrease of 26%. This decrease is attributed for the most part to sales of *Amiodarone* (an antiarrhythmic agent that is used to treat ventricular arrhythmias and atrial fibrillation) that were stronger last year following its market launch.

At this time, the Company is not forecasting any gains in its sterile injectables business for fiscal 2005 due primarily to delays experienced with new ANDA approvals and launches, as well as price and volume erosion on a specific product.

Management remains positive for fiscal year 2006, based on the anticipated market launch of its new product *Sotradecol* Injection (Sodium Tetradecyl Sulfate Injection) for the treatment of varicose veins. The Company is currently finalizing production and preparing for the market launch of this new ANDA, projected to occur in the near term.

**Bioniche Therapeutics:** Revenues from sales of the Company's Urology product are reported under Bioniche Therapeutics.

### Urology

*Cystistat* is currently the Company's only product in this category. The sales of *Cystistat* reached \$2.6 million for the first nine months of fiscal 2005, compared with \$2.0 million in the same period last year, an increase of \$0.6 million, or 30%. *Cystistat* is a treatment that provides relief from the symptoms of multiple forms of cystitis, including interstitial, bacterial, and radiation-induced cystitis. *Cystistat* is a sterile sodium hyaluronate solution that serves as a temporary replacement of the glycosaminoglycan (GAG) layer in the bladder.

Building core expertise in the Urology field is one of the Company's key priorities. During 2005, the Company will continue to develop its own sales force, while maintaining a global network of distributors. This strategy has resulted in increased margins and the establishment of key contacts within the Urology field, contacts who will be called upon as the Company advances its key research and development platform — Mycobacterial Cell Wall-DNA Complex (MCC — *Urocidin*) — for use in bladder cancer. The Company expects current product sales in the Urology sector to continue to increase for the remainder of fiscal 2005 compared to 2004, due to further expansion of its direct sales force and increasing market acceptance of *Cystistat*.

### ANIMAL HEALTH DIVISION

The Company is encouraged to see some resurgence of growth in this division despite the continuing adverse affect of the Bovine Spongiform Encephalopathy (BSE — "mad cow") crisis on Canadian sales. The U.S. business has experienced strong growth which, when combined with stable sales in Europe and Australia, has helped to offset the impact of the unresolved BSE situation in Canada.

Bioniche Animal Health U.S.A. sales are continuing to grow, recording an increase of \$1.2 million, or 12%, after the first nine months of fiscal 2005 as compared to the same period last year. This occurred despite the strengthening of the Canadian currency. The acquisition of the AB Technology product line in the prior fiscal year has provided for some of this growth, however, the Company is also recording growth in the remainder of its U.S. product line as compared to the same period last year.

Canadian Animal Health sales have decreased by \$1.8 million, or 26%, year-to-date, as compared to the same period last year. Over and above the impact of the BSE crisis, the Company experienced a loss of \$1.2 million due to the expiry of the Canadian distribution rights to CIDR™, a reproductive product.

The Company has acquired the *Cue-Mate* device to replace the *CIDR* product. *Cue-Mate* is currently registered in Australia and New Zealand, generating \$0.3 million in revenues year-to-date. The Company has a strategy to expand registrations of this product in the future.

The Australian and European Animal Health operations recorded little variation after nine months as compared to the same period last year.

Management is optimistic about positive results in the U.S. and Europe for the remainder of 2005. At the same time, Canadian sales are expected to remain much lower until some new strategic initiatives have been implemented and/or the Canadian beef crisis is resolved.

### Reproduction Products

The Company's Animal Health division developed the original proprietary platforms and expertise employed across the Company today. Over the years, Bioniche Animal Health has achieved a significant leadership presence in the livestock reproduction segment. Revenues from Animal Health reproduction products were \$11.9 million for the nine months ending March 31, 2005 as compared with \$12.8 million in the same period last year. In 2004, the Company made two important strategic acquisitions to complement its reproductive franchise. Gross sales contributions from these products alone was \$2.1 million in the first nine months of fiscal 2005.

The Company's Animal Health team is working diligently to offset the revenue downturn in Canada by pursuing new markets for its reproductive products, including China and Europe. China, in particular, is a growing economy where there is governmental interest in increasing the number of beef and dairy cattle. This is encouraging for sales of the Company's bovine reproductive products. The Company recently announced the launch of its *Folltropin-V* a follicle stimulating hormone for livestock, in additional European countries: the United Kingdom, the Netherlands, and Spain. Veterinary reproduction specialists in the EU had been eagerly awaiting its arrival on the broader European market. As disclosed in the second quarter, the Company is pursuing additional European registrations.

The latest market offering is for the swine industry — the use of *Pregnenol*, a superovulatory gonadotropin, and *Lutropin-V*, a purified lutenizing hormone, for induction of ovulation. *Pregnenol* stimulates the ovary to develop follicles and *Lutropin-V* stimulates the release of ova from the follicles. Together, these products narrow the ovulation window and make the timing of ovulation specific and predictable. This increases conception rates in sows and reduces the time and cost involved for breeders. Research studies conducted in Canada and Brazil using this product combination resulted in an 89% pregnancy rate with a single, timed insemination.

### Immune Stimulant Products

A core area of research focus of the Company is immune stimulants, particularly how they can offer an alternative to the use of antibiotics in livestock. At the end of March, 2005, the Company had a total of five products sold in this category, generating \$2.6 million in revenue, as compared with \$2.5 million for the same period last year.

During the second quarter, the Company launched Settle™ in the United States for the treatment of Equine Endometritis caused by *Streptococcus zooepidemicus*. This product, developed from the Company's mycobacterial cell wall technology, has been clinically proven as a fast-acting, specific endometritis therapy for broodmares. It is the result of clinical research conducted over a period of five breeding seasons. The Company plans to register this product in other jurisdictions, including Canada.

## Osteoarthritis Products

Total consolidated revenues from Animal Health Osteoarthritis products for the nine months ending March 31, 2005 were \$0.4 million. This compares to \$0.3 million reported in the same period last year, an increase of \$0.1 million, or 33%. The Company only started to record Animal Health Osteoarthritis products as an area of market focus in fiscal 2004, when increased marketing efforts were put into the promotion of the Company's proprietary product, Enhance<sup>®</sup>, for intra-articular injection in horses in Australia and New Zealand. *Enhance* is used to treat synovitis and/or osteoarthritis.

## FOOD SAFETY DIVISION

### *E. coli* O157:H7 Cattle Vaccine

The Company has worked very hard with its partners to ensure that the regulatory pathway for this vaccine is clear. Given that this is the first animal vaccine of its kind, there was some uncertainty as to who should be involved in its regulation in the U.S. It is now clear that the United States Department of Agriculture (USDA) will be responsible. The Canadian Food Inspection Agency (CFIA) will regulate the vaccine in Canada.

As the Company finalizes data for the regulators, it is also considering all possible options for the production of the vaccine. There are approximately 115 million cattle in North America, 25 million of which are found in feedlots, the first target market for the *E. coli* O157:H7 vaccine. This means that a significant quantity of the vaccine could be required soon after licensing.

No revenues are reported for the third quarter of fiscal 2005. However, upon registration and introduction of the *E. coli* O157:H7 vaccine, the Company anticipates revenues to grow quickly.

## COMPANY-WIDE NON-BRANDED GENERICS & OTHER REVENUES

The Company experienced an increase of 8% in third quarter revenues of non-branded human and animal generic products over the same quarter last year. This increase is predominantly due to licensing revenues received during the period. Total revenues in this category reached \$6.1 million after nine months this year, as compared to \$7.0 million for the same period last year.

## GROSS MARGINS

Gross profit on product sales was \$7.5 million, or 59%, on sales of \$12.8 million this quarter. This compares to \$8.2 million, or 62%, on product sales of \$13.3 million in the same period last year. In the first nine months of fiscal 2005, gross profit reached \$18.7 million, or 56%, on sales of \$33.2 million as compared to \$21 million, or 58%, on sales of \$36.4 million in the same period last year. Price erosion on such human health products as *Amiodarone* and *Suplasyn* have contributed to this result, as have foreign exchange losses.

The Company expects future gross margins to deteriorate if the Canadian dollar continues to strengthen. New product approvals and pending applications are anticipated to contribute higher margins than the current average, which should help to offset this situation.

## OPERATING EXPENSES

Total operating expenses were \$7.5 million for the third quarter of fiscal 2005, compared with \$6.6 million for the same period in 2004. For the first nine months of fiscal 2005, total operating expenses were \$22.6 million, compared with \$18.6 million for the same period in 2004. Excluding a one-time gain in 2004, the net increase was \$2.3 million, which came primarily in the areas of administration, more specifically, in documentation and compliance in internal control, and from marketing.

The Company expects selling, general, and administrative expenses to increase proportionally in 2005 compared to 2004 due to its continuing investment in global commercial operations, bringing internal controls into compliance with National Instrument (NI) 52 — 109, and enhancing its sales and marketing force to distribute products in global markets. This investment in building a multinational infrastructure is in line with the Company's business plan, which focuses on commercializing the Company's own proprietary technologies to maximize returns.

*(expressed in millions of Canadian dollars and % of revenue)*

	Operating Expenses					
	2005			2004		
	Q3	YTD		Q3	YTD	
	\$	\$	%	\$	\$	%
<b>Revenues</b>	12.8	33.2	100%	13.3	36.6	100%
Administration	2.5	6.7	20%	1.7	5.8	16%
Selling and Marketing	2.5	7.0	21%	2.2	6.2	17%
Quality Assurance	0.9	2.8	8%	1.0	2.7	7%
<b>Sub total</b>	5.9	16.5	49%	4.9	14.7	40%
<b>Non cash items</b>						
Pensions and Incentives	0.1	0.5	2%	0.1	0.5	2%
Amortization	0.8	2.3	7%	0.7	2.0	5%
Imputed Interest	0.2	0.7	2%	0.2	0.7	2%
<b>Sub total</b>	1.1	3.5	11%	1.0	3.2	9%
<b>Other Items</b>						
Interest	0.6	1.9	6%	0.7	2.0	6%
Gain on Debt Extinguishment	—	—	0%	—	(1.7)	-5%
Foreign Exchange	(0.1)	0.7	2%	0.0	0.4	1%
<b>Sub total</b>	0.5	2.6	8%	0.7	0.7	2%
<b>Total Operating Expenses</b>	7.5	22.6	68%	6.6	18.6	51%

## EBITDA BEFORE RESEARCH & DEVELOPMENT

(expressed in millions of Canadian dollars)

	2005		2004	
	Q3	YTD	Q3	YTD
Human Health – Pharma	0.7	(1.5)	0.6	1.5
Human Health – Therapeutics	0.1	1.2	0.6	1.1
Animal Health	0.8	2.0	1.9	3.4
Food Safety	—	—	—	—
<b>EBITDA* before Research and Development</b>	<b>1.6</b>	<b>1.7</b>	<b>3.1</b>	<b>6.0</b>

\*EBITDA means earnings before interest, taxes, depreciation, and amortization. For more information, please refer to the section, “Non-GAAP Measures” below.

EBITDA before Research and Development was \$1.6 million for the third quarter of fiscal 2005 compared with \$3.1 million for the same period in 2004. For the first nine months of fiscal 2005, total EBITDA before research and development was \$1.7 million, compared with \$6.0 million for the same period in 2004. The decrease of \$4.3 million came in the Human Health Pharma and Animal Health business units. Economic factors, including the strengthening of the Canadian currency and the Canadian BSE situation, as well as global competition on certain Pharma products, contributed to this decline in profitability before research and development.

## RESEARCH & DEVELOPMENT

Gross research and development expenses were \$3.6 million for the third quarter of fiscal 2005, compared with \$3.8 million for the same period in 2004. Year-to-date, gross research and development expenses were \$10.1 million compared with \$9.6 million for the same period in 2004. This increase of \$0.5 million reflects higher investment into the Food Safety division. Key expenditures during this period include \$0.3 million in support of the Industrial Research Chairs at the University of Saskatchewan, along with continuing *E. coli* O157:H7 vaccine clinical trials to supplement the data package for its regulatory submission.

During the quarter, Bioniche researchers presented further positive data demonstrating the efficacy of the Company’s proprietary Mycobacterial Cell Wall-DNA Complex (MCC) in the treatment of cancer. These data show: a) that MCC interacts rapidly with bladder cancer cells *in vitro* (interaction evident after two minutes and maximal interaction after 3 to 4 hours incubation) and shows strong synergistic interaction with Gemcitabine, a chemotherapeutic drug; b) that the direct anticancer activity of MCC is not inhibited by the presence of urinary anti-MCC antibodies generated in patients with bladder cancer who have been treated with MCC; and c) that MCC has a unique immune stimulatory profile as determined by measurement of urinary cytokines in patients with bladder cancer who have been treated with MCC.

The Company expects research and development expenses to increase during the remainder of 2005 due to an anticipated increase in clinical activity related to the start of the Phase III clinical trial with Mycobacterial Cell Wall-DNA Complex (MCC) for bladder cancer. The future level of research and development expenditures will depend upon, among other things, the outcome of clinical testing of current products under development, delays or changes in government-required testing and approval procedures, technological and competitive developments, strategic marketing decisions, and availability of funds.

## RESEARCH & DEVELOPMENT EXPENDITURES

(expressed in millions of Canadian dollars)

	Key Areas					
	2005			2004		
	Q3	YTD		Q3	YTD	
	\$	\$	%	\$	\$	%
Human Health – Pharma	0.2	0.6	6%	0.4	1.1	11%
Human Health – Therapeutics	2.1	6.2	61%	2.4	6.1	64%
Animal Health	0.8	2.1	21%	0.6	1.8	19%
Food Safety	0.5	1.2	12%	0.4	0.6	6%
<b>Research and Development, Gross</b>	<b>3.6</b>	<b>10.1</b>	<b>100%</b>	<b>3.8</b>	<b>9.6</b>	<b>100%</b>

## RESULTS OF OPERATIONS

The Company's net loss for the third quarter of fiscal 2005 was \$3.6 million, or (\$0.10) per share, compared with \$2.1 million, or (\$0.06) per share, for the same period in 2004. For the first nine months of fiscal 2005, the total net loss was \$13.1 million, or (\$0.36) per share, compared with \$6.3 million, or (\$0.20) per share, for the same period in 2004.

The current loss is partly due to the substantial ongoing investment in research and development, predominantly in the area of bladder cancer, as the Company prepares for its upcoming Phase III clinical trial with MCC (*Urocidin*) as well as further clinical studies related to its *E. coli* O157:H7 cattle vaccine. The increase in net loss over last year is also due to a one-time gain recorded last year of \$1.7 million resulting from the settlement of long-term debt. In addition, the Company expanded its operational base in preparation for new technologies coming to market.

## LIQUIDITY, FINANCING, AND CAPITAL RESOURCES

As of March 31, 2005, the Company's consolidated cash and cash equivalents were \$8.4 million, of which the Bioniche Pharma business unit held \$2.9 million. This \$2.9 million is to be used exclusively to develop the Bioniche Pharma business. Working capital at March 31, 2005 and March 31, 2004 was \$19.0 million and \$18.7 million respectively.

The cash flow used in operations (before change in non-cash working capital balances related to operations) was \$9.1 million for the nine months ended March 31, 2005. This represents a burn rate\* of approximately \$1.0 million per month on average. This is a significant increase from \$3.9 million for the nine-month period ended March 31, 2004 and can be attributed to the Company's revenue decrease and its investment in marketing and internal control compliance activities. As a result, the Company does not anticipate having positive cash flows from operations in fiscal 2005.

Effective March 31, 2005, the Company amended a debt service coverage ratio under its \$13.5 million loan agreement with a syndicate of three Canadian institutions. For the period of January 1, 2005 to September 30, 2005, the parties agreed to an amendment to this agreement which was favourable to the Company.

The Company believes that it will be able to continue to support its current corporate objectives, including research and clinical development programs in both animal and human health, by obtaining long-term equity capital as required. In the event that such resources are not forthcoming, corporate objectives will be revisited accordingly.

*\* Burn rate means cash flow used in operations. For more information, please refer to the section, "Non-GAAP Measures" below.*

### **Quarterly Variation from Previously Reported Commitments**

In February, 2004, the Company acquired the net assets of AB Technology Inc., an American veterinary product company in Pullman, Washington, U.S.A. which was a leader in the development of embryo transfer media, materials, and equipment for the bovine and equine markets. As part of the acquisition, the Company paid monthly installments totaling \$538,571 (or \$426,666 USD) for the nine-month period ending March 31, 2005. This commitment has now been paid in full.

On March 29, 2004, the Company acquired from Pfizer Inc. the intellectual property and other assets of the *Cue-Mate* business, an innovative livestock reproductive technology. At the end of March, 2005, the Company was obligated to pay the balance of the purchase price of \$367,080 (or \$300,000 USD) to Pfizer Inc.

On May 20, 2004, Bioniche Pharma Group Limited entered into a financing agreement with the Bank of Ireland for the purchase and building of an expanded facility in Galway, Ireland for the manufacture of pharmaceutical injectable products. During the quarter, the Company drew 1.5 million Euro (\$2.4 million CDN) against Facilities 1 and 2 with the Bank of Ireland, bringing the total drawn at March 31, 2005 to 8.2 million Euro (\$12.9 million CDN).

On November 3, 2004 the Company completed a financing totaling \$12,000,000 with the Fonds de Solidarité des Travailleurs du Québec (FSTQ) and with the Fonds d'investissement Bioalimentaire (Fonds Bio). The financing consists of a private placement offering of 12,000,000 newly created Series 2 preferred shares to FSTQ and Fonds Bio. These preferred shares can convert into common shares over a period of five years according to a predefined formula. For more financial disclosure, please see Note 2[c] in the financial statements.

### **OUTSTANDING SHARE DATA**

The Company has total common shares outstanding at May 5, 2005 of 36,270,006 and 12,000,000 Series 2 Preferred Shares. In addition, the Company has 3,506,250 outstanding warrants and 2,910,000 outstanding options, each exchangeable for one common share upon exercise. Outstanding conversion rights on Series 2 Preferred Shares are exchangeable for no more than 8.9 million common shares. The Company also has a commitment to issue warrants to Technology Partnerships Canada (TPC).

### **NON-GAAP MEASURES**

The following measures included in the report do not have a standardized meaning under Canadian Generally Accepted Accounting Principles (GAAP) and, therefore, are unlikely to be comparable to similar measures presented by other companies:

## EBITDA

“EBITDA” means “Earnings Before Interest, Taxes, Depreciation, and Amortization”. The Company considers EBITDA to be an effective measure of each segment’s contribution to the Company on an operational basis, before allocating the cost of income taxes and capital investments. It is management’s understanding that this measure is used by analysts and shareholders to evaluate the Company’s operations.

## Burn Rate

“Burn Rate” means “cash flow used in operations”. This information can be found in the Consolidated Statements of Cash Flows under “Operating Activities”. It shows the cash flow used in operations (before change in non-cash working capital balances related to operations).

## RISKS AND UNCERTAINTIES

### Early Stage Development

Several of the Company’s products or processes are at an early stage of development. A commitment of substantial time and resources is required to conduct research and clinical trials if the Company is to complete the development of any product or process for commercialization. It is not known whether any of these product or process candidates will meet applicable health regulatory standards and obtain required regulatory approvals, whether such products or processes can be produced in commercial quantities at reasonable costs and be successfully marketed, or if the Company’s investment in any such product or process candidate will be recovered through sales or royalties.

### Government Regulations

The manufacture and sale of animal and human therapeutic products is governed by numerous statutes and regulations in the United States, Canada, Ireland, and other countries where the Company sells or intends to market its products. The subject matter of such legislation includes approval of manufacturing facilities, controlled research and testing procedures, review and approval of manufacturing, pre-clinical and clinical data prior to marketing approval, including adherence to good manufacturing practices (GMP) during production and storage, and regulation or marketing activities, notably advertising and labeling.

The products and procedures to be developed by the Company require lengthy development, pre-clinical and clinical testing, and investment of significant funds prior to their commercialization. There can be no assurance that any such products will actually reach the marketplace. The process of completing clinical testing and obtaining required approvals is likely to take several years and require the expenditure of substantial resources. Furthermore, there can be no assurance that the regulators will not require modification to any submissions that may result in delays or failure to obtain regulatory approvals. Any delay or failure to obtain regulatory approval could adversely affect the ability of the Company to utilize its technology, thereby adversely affecting operations. Further, there can be no assurance that the Company’s product candidates will prove to be safe and effective in clinical trials, or that they will receive the requisite regulatory approval. Foreign markets, other than the United States and Canada, impose similar restrictions.

### **Key Personnel**

The Company's success is also dependent upon its ability to attract and retain a highly-qualified work force, and to establish and maintain close relations with research centres. Competition is intense and the Company's success will depend, to a great extent, on its senior executive, scientific staff, and collaborators. The loss of key personnel could compromise the timing and ultimate success of product development.

### **Foreign Currency Risk**

The Company operates internationally, therefore, a substantial portion of revenues and expenses is translated to Canadian dollars. The Company's exposure to exchange rate fluctuation is reduced by the Company's revenues dominated in currencies other than Canadian dollars matched by a corresponding amount of cost denominated in the same currency.

### **Volatility of Share Prices**

Share prices are subject to change due to numerous factors related to business activity, including reports of new information, changes in the Company's financial situation, the sale of shares in the market, the Company's failure to obtain results in line with the expectations of analysts, or an announcement by the Company or any of its competitors concerning technological innovation. During the past few years, shares of Bioniche Life Sciences Inc., and other biopharmaceutical companies, along with the investment market in general have been subjected to extreme fluctuations that were unrelated to the operational results of the companies affected. There is no guarantee that the market price of Company shares will be protected from any such fluctuations in the future.

### **Intellectual Property Infringement Claims**

Third parties may claim that we infringe on their intellectual property. Any such claims, with or without merit, could materially harm our business and operating results.

### **Government Incentives and Contracts**

The Company relies, in part, on government incentives and contracts to fund its research and development program as well as to expand its facilities. Such incentives are subject to interpretation and estimation as to their presentation in the financial statements; however, they are subject to the terms and conditions of the various agreements and the continuing support of the government agencies. It is not possible to guarantee that the terms and conditions will not be changed or interpreted in a different manner that could have a material impact on the financial position of the Company. One such program, which provides material financial assistance to the Company's research and development program, is currently subject to a government audit.

## **FORWARD-LOOKING STATEMENTS**

This discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events predicted in this document to differ materially from actual results or events. No assurance can be given that results, performance, or achievement expressed in, or implied by, forward-looking statements within this disclosure will occur, or, if they do, that any benefit may be derived from them.

Additional information relating to the Company, including the Annual Information Form (AIF), is available on SEDAR at [www.sedar.com](http://www.sedar.com).



Patrick Montpetit, CA  
Vice-President, and Chief Financial Officer  
May 5, 2005

**Bioniche Life Sciences Inc.**  
Amalgamated under the laws of Ontario

## CONSOLIDATED BALANCE SHEETS

	<i>Unaudited</i> As at Mar. 31 2005 \$	<i>Unaudited</i> As at Mar. 31 2004 \$	<i>Unaudited</i> As at June 30 2004 \$
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents	8,425,861	9,187,512	8,245,118
Accounts receivable	13,039,199	10,694,281	16,582,146
Inventories	11,970,413	13,436,299	11,059,212
Prepaid expenses and deposits	995,797	575,236	590,028
	34,431,270	33,893,328	36,476,504
<b>Long-term</b>			
Capital assets	34,267,618	18,669,238	23,548,199
Goodwill	5,553,798	5,553,798	5,553,798
Intangible assets, net	11,002,800	12,029,654	11,672,718
Deferred financing fees, net	1,246,930	1,415,916	1,485,624
Other assets – deferred costs	576,000	—	576,000
	87,078,416	71,561,934	79,312,843
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current</b>			
Accounts payable and accrued liabilities	11,960,785	13,085,851	15,063,137
Deferred revenue	185,353	—	—
Income taxes payable	955,620	950,680	833,443
Current portion of senior and other long-term debt [note 4]	2,357,279	1,112,178	1,510,666
	15,459,037	15,148,709	17,407,246
<b>Long-term</b>			
Senior debt [note 4]	14,213,251	3,407,128	6,933,854
Other long-term debt	22,673,015	19,905,801	22,339,900
Deferred revenue	602,397	—	—
Deferred government incentives	6,295,706	3,287,605	4,131,237
Future income taxes	387,000	374,000	387,000
	59,630,406	42,123,243	51,199,237
Non-controlling interest	3,055,611	3,935,882	3,079,640
<b>Commitments and contingencies</b> [note 5]			
<b>Shareholders' equity</b>			
Share capital [note 2]	70,153,530	57,346,346	57,666,956
Other paid-in capital [note 2]	3,536,398	2,729,631	3,310,345
Deficit	(50,252,470)	(35,653,945)	(37,123,268)
Cumulative translation amount	954,941	1,080,777	1,179,933
	24,392,399	25,502,809	25,033,966
	87,078,416	71,561,934	79,312,843

See accompanying notes

Bioniche Life Sciences Inc.

**CONSOLIDATED STATEMENTS OF LOSS**

For the three and nine months ended March 31

	<i>Unaudited Current Quarter 2005 \$</i>	<i>Unaudited Last Year Quarter 2004 \$</i>	<i>Unaudited Current Year to Date 2005 \$</i>	<i>Unaudited Last Year Year to Date 2004 \$</i>
<b>REVENUE</b>				
Sales	12,823,456	13,301,424	33,187,726	36,575,147
Cost of sales	5,289,611	5,064,278	14,448,150	15,388,081
<b>Gross profit</b>	7,533,845	8,237,146	18,739,576	21,187,066
<b>OPERATING EXPENSES</b>				
Administration	2,454,061	1,710,146	6,709,903	5,831,302
Marketing and selling	2,505,751	2,236,992	7,026,250	6,217,549
Quality assurance	900,144	1,024,868	2,760,990	2,656,690
Interest	650,407	696,032	1,890,945	2,069,460
Imputed interest expense on convertible debentures	210,900	158,288	678,985	674,742
Share ownership and bonus – operating	85,439	145,622	515,462	514,190
Amortization	809,112	654,160	2,280,117	1,995,595
Gain on debt settlement	—	—	—	(1,744,835)
Foreign exchange (gain) loss	(114,793)	13,798	723,411	406,609
	7,501,021	6,639,906	22,586,063	18,621,302
<b>Income (loss) before research and development</b>	32,824	1,597,240	(3,846,487)	2,565,764
Research and development expenses, gross	(3,600,008)	(3,801,570)	(10,051,733)	(9,629,874)
Less government incentives	307,495	307,033	998,172	1,249,363
<b>Loss before income taxes</b>	(3,259,689)	(1,897,297)	(12,900,048)	(5,814,747)
Income tax (expense) recovery				
Current	(268,153)	(165,125)	(253,183)	(553,825)
Future	—	—	—	25,000
	(268,153)	(165,125)	(253,183)	(528,825)
	(3,527,842)	(2,062,422)	(13,153,231)	(6,343,572)
Non-controlling interest	(23,125)	—	24,029	—
<b>Net loss for the period</b>	(3,550,967)	(2,062,422)	(13,129,202)	(6,343,572)
<b>Basic and fully diluted net loss per share</b>	(0.10)	(0.06)	(0.36)	(0.20)

See accompanying notes

**Bioniche Life Sciences Inc.**

**CONSOLIDATED STATEMENTS OF DEFICIT**

For the three and nine months ended March 31

	<i>Unaudited Current Quarter 2005 \$</i>	<i>Unaudited Last Year Quarter 2004 \$</i>	<i>Unaudited Current Year to Date 2005 \$</i>	<i>Unaudited Last Year Year to Date 2004 \$</i>
<b>Balance, beginning of period</b>	(46,701,503)	(33,591,523)	(37,123,268)	(30,936,563)
Settlement of convertible debentures	—	—	—	1,626,190
Net loss for the period	(3,550,967)	(2,062,422)	(13,129,202)	(6,343,572)
<b>Balance, end of period</b>	(50,252,470)	(35,653,945)	(50,252,470)	(35,653,945)

See accompanying notes

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three and nine months ended March 31

	<i>Unaudited Current Quarter 2005 \$</i>	<i>Unaudited Last Year Quarter 2004 \$</i>	<i>Unaudited Current Year to Date 2005 \$</i>	<i>Unaudited Last Year Year to Date 2004 \$</i>
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	(3,550,967)	(2,062,422)	(13,129,202)	(6,343,572)
Add (deduct) non-cash items:				
Amortization	809,112	654,160	2,280,117	1,995,595
Non-cash interest expense	210,900	158,288	678,985	674,742
Foreign exchange	—	149,931	—	137,907
Share and option compensation	38,893	—	171,729	110,000
Non-controlling interest	23,125	—	(24,029)	—
Non-cash bonus	(235,104)	250,000	437,896	910,482
Employee share ownership plan	148,183	143,574	428,150	376,519
Dividends on preferred shares	20,319	8,253	65,122	23,967
(Gain) loss on disposal of capital assets	—	(4,408)	—	(4,408)
Gain on debt settlement	—	—	—	(1,744,835)
Future tax recovery	—	—	—	(25,000)
<b>Cash flow used in operations</b>	<b>(2,535,539)</b>	<b>(702,624)</b>	<b>(9,091,232)</b>	<b>(3,888,603)</b>
Net changes in non-cash working capital balances related to operations	(884,756)	(2,440,280)	1,111,269	(1,398,673)
<b>Cash used in operating activities</b>	<b>(3,420,295)</b>	<b>(3,142,904)</b>	<b>(7,979,963)</b>	<b>(5,287,276)</b>
<b>INVESTMENT ACTIVITIES</b>				
Acquisition of net assets	—	(102,559)	—	(147,709)
Payment on balance of acquisitions	(58,620)	—	(1,077,783)	—
Government incentives received on account of capital assets	—	—	6,458	18,462
Disposal of capital assets	—	4,408	—	4,408
Purchase of capital assets	(3,440,046)	(1,450,571)	(12,498,399)	(3,907,448)
<b>Cash used in investing activities</b>	<b>(3,498,666)</b>	<b>(1,548,722)</b>	<b>(13,569,724)</b>	<b>(4,032,287)</b>

Bioniche Life Sciences Inc.

**CONSOLIDATED STATEMENTS OF CASH FLOWS** *CONTINUED*

	<i>Unaudited Current Quarter 2005 \$</i>	<i>Unaudited Last Year Quarter 2004 \$</i>	<i>Unaudited Current Year to Date 2005 \$</i>	<i>Unaudited Last Year Year to Date 2004 \$</i>
<b>FINANCING ACTIVITIES</b>				
Proceeds of senior debt	2,196,979	—	8,817,443	298,495
Common shares issued, net	—	9,245,000	—	9,227,266
Preferred shares issued, net	—	—	11,674,854	—
Financing fees – debt	—	10,000	(20,968)	(229,376)
Proceeds on debenture loans	—	—	—	9,450,000
Increase in deferred government incentives	338,016	465,928	2,292,462	798,039
Repayment of long-term debt	(234,575)	(342,192)	(729,576)	(11,274,726)
<b>Cash provided by (used in) financing activities</b>	2,300,420	9,378,736	22,034,215	8,269,698
Effect of foreign currency translation	(353,252)	(83,264)	(303,785)	388,967
Net increase (decrease) in cash during the period	(4,971,793)	4,603,846	180,743	(660,898)
Cash, beginning of period	13,397,654	4,583,666	8,245,118	9,848,410
<b>Cash, end of period</b>	8,425,861	9,187,512	8,425,861	9,187,512

See accompanying notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited — March 31, 2005

### 1. SIGNIFICANT ACCOUNTING POLICIES

These interim financial statements do not contain all disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, these financial statements should be read in conjunction with the most recently prepared annual financial statements for the year ended June 30, 2004. These unaudited interim consolidated financial statements follow the same accounting policies and methods of their application as outlined in the most recent annual consolidated financial statements.

Business is typically stronger in the last quarter of the Company's fiscal year. Consequently, due to the seasonality of the business, the results of operations for the three and nine months ended March 31, 2005 are not necessarily indicative of annual results.

To date, the Company has financed its cash requirements primarily through issuances of securities, investment tax credits, revenues, government grants, long-term debt, and interest income. The success of the Company is dependent upon its ability to continue generating revenue, to establish the technological feasibility of its products, to bring its products to market, to obtain regulatory approvals when necessary, and to achieve future profitable operations. It may be necessary for the Company to raise additional funds for the continuing development and marketing of its products.

### 2. SHARE CAPITAL AND OTHER PAID-IN CAPITAL

Issued share capital consists of:

	March 2005 \$	March 2004 \$	June 2004 \$
Preferred shares — Series 1 – 167 [March 2004 – 167, June 2004 – 167]	161,000	161,000	161,000
Preferred shares — Series 2 [c] — 12,000,000 [March 2004 – Nil, June 2004 – Nil]	11,674,854	—	—
Common shares — 36,195,938 [March 2004 – 35,458,809, June 2004 – 35,681,029]	58,317,676	57,185,346	57,505,956
	70,153,530	57,346,346	57,666,956

At March 31, 2005 the Company has issued 278,742 shares under the employee share ownership plan in the current fiscal year valued at \$425,598, of which \$45,450 relates to the accrued balance at June 30, 2004 included in Other paid-in capital. In addition, the Company has issued 49,413 shares to directors in lieu of payment of fees, valued at \$84,000 and issued 186,754 shares under the share bonus plan (a).

Other paid-in capital consists of:

	March 2005	March 2004	June 2004
	\$	\$	\$
Accrued share bonus [a]	556,953	1,085,053	421,181
Accrued employee share ownership plan	48,002	45,864	45,450
Warrants	1,570,714	1,570,714	1,570,714
Accrued warrants	1,200,000	—	1,200,000
Options [b]	160,729	28,000	73,000
	3,536,398	2,729,631	3,310,345

#### (a) Share Bonus

The Company has accrued an estimated bonus of \$555,678 in the current fiscal year for all of its eligible employees which is expected to be settled by issuing the Company's common shares subsequent to the year end. At March 31, 2005 the Company issued 183,382 shares in settlement of last years bonus, valued at \$297,661. The balance of the share bonus at June 30, 2004 was settled in cash. In addition, 3,372 shares were issued under the salary sacrifice program in Ireland.

#### (b) Options

During the current fiscal year, 420,000 stock options were granted at \$1.58 per share, 954,500 stock options were granted at \$4.40 per share and 15,000 stock options were granted at \$1.68 per share to employees and directors. Under the Company's share option plan, options may be granted with an exercise price not less than the market price on the date of the grant. The fair value of these 1,389,500 stock options, determined using the fair value method, was \$742,125. These options will be expensed over the vesting period. The amount of compensation expense in the current quarter is \$38,893 [2004 – nil] and year to date is \$87,729 [2004 – \$28,000].

The following weighted average assumptions were used to determine the fair value of these options: risk-free interest rate of 3.75%, expected dividend yield of 0%, average expected volatility of 0.566 and expected option life of three and five years resulting in a weighted fair value per option of \$0.534. The Company uses the Black-Scholes model to calculate the fair value of options awarded.

### **(c) Preferred Shares – Series 2**

On November 3, 2004 the Company issued 12,000,000 shares of Series 2 convertible preferred stock for gross consideration of \$12,000,000. The proceeds are to be used for the Phase III clinical trial with MCC for the treatment of bladder cancer, MCC for animal health applications, and the *E. coli* O157:H7 vaccine development. The Series 2 preferred shares are convertible at the option of the holder into common shares for five years plus one day at a conversion ratio which is obtained by dividing the fully-accreted value by the applicable conversion price as follows: 25% at \$1.45; 50% at \$2.50; and 25% at \$3.75. The fully-accreted value is calculated as the aggregate subscription price of the preferred shares plus 6% per annum until the earlier of conversion or five years from the date of issuance. Costs of completion for this private placement, estimated at approximately \$325,000, were netted against the share capital of the Series 2 preferred shares.

After the initial five-year plus one-day term, any Series 2 preferred shares outstanding are convertible, at the option of the holder, into common shares at the fully accreted value divided by the average market price of the common shares less the greater of 5% or the maximum discount permitted by the Toronto Stock Exchange (subject to the issuance of a maximum of 8,910,000 common shares in the aggregate on conversion of all Series 2 preferred shares).

If the trading price of the common shares exceeds \$13.50 for 60 consecutive days, the Company may require the holders to convert the preferred shares into common shares at the conversion ratio applicable on the date of conversion.

The preferred shares have voting rights on the basis of the number of common shares that the holder would have if the preferred shares were converted into common shares on the date of the applicable shareholders' meeting.

### **3. SEGMENTED FINANCIAL INFORMATION**

The Company's four reportable segments: Pharma, Animal Health, Therapeutics, and Food Safety are strategic business units that offer different products and require different technology and marketing strategies. The manufacturing operations for both the Pharma and Therapeutics segments are carried out at the plant in Galway, Ireland.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies in note 2 of the annual consolidated financial statements for the year ended June 30, 2004. The Company accounts for inter-segment sales on a cost plus basis.

The Company evaluates performance and allocates resources based on profit or loss from operations before interest, income taxes, depreciation, and amortization.

Current Quarter – March, 2005

	Human		Animal	Food	Total
	Pharma	Therapeutics	Health	Safety	
<b>Sales</b>	5,461,242	898,734	6,463,480	—	12,823,456
Cost of sales	2,345,696	41,302	2,902,613	—	5,289,611
Operating expenses	2,365,449	772,866	2,807,080	—	5,945,395
<b>EBITDA before Research and Development</b>	750,097	84,566	753,787	—	1,588,450
Research and Development expenses	182,971	2,093,185	806,073	517,779	3,600,008
Less Government Incentives	—	(248,401)	—	(59,094)	(307,495)
<b>Net Research and Development expenses</b>	182,971	1,844,784	806,073	458,685	3,292,513
Interest expense, net	347,561	396,301	117,445	—	861,307
Amortization expense	226,540	296,063	278,844	7,665	809,112
Foreign exchange (gain)					(114,793)
Gain on settlement of debt					—
<b>Segment (loss) before taxes and non-controlling interest</b>	(6,975)	(2,452,582)	(448,575)	(466,350)	(3,259,689)
Inter-segment sales	995,823	—	—	—	995,823

Last Year Third Quarter – March, 2004

	Human		Animal	Food	Total
	Pharma	Therapeutics	Health	Safety	
<b>Sales</b>	5,816,562	932,627	6,552,235	—	13,301,424
Cost of sales	2,466,786	93,263	2,504,229	—	5,064,278
Operating expenses	2,709,681	200,692	2,207,255	—	5,117,628
<b>EBITDA before Research and Development</b>	640,095	638,672	1,840,751	—	3,119,518
Research and Development expenses	438,728	2,376,536	629,061	357,245	3,801,570
Less Government Incentives	(3,183)	(237,364)	—	(66,486)	(307,033)
<b>Net Research and Development expenses</b>	435,545	2,139,172	629,061	290,759	3,494,537
Interest expense, net	306,455	445,566	102,299	—	854,320
Amortization expense	196,233	307,420	147,745	2,762	654,160
Foreign exchange loss					13,798
Gain on settlement of debt					—
<b>Segment (loss) before taxes and non-controlling interest</b>	(298,138)	(2,253,486)	961,646	(293,521)	(1,897,297)
Inter-segment sales	1,057,541	—	24,664	—	1,082,205

Current Year to Date March, 2005

	Human		Animal	Food	Total
	Pharma	Therapeutics	Health	Safety	
<b>Sales</b>	12,387,691	2,840,509	17,959,526	—	33,187,726
Cost of sales	6,285,167	235,480	7,927,503	—	14,448,150
Operating expenses	7,567,401	1,411,996	8,033,208	—	17,012,605
<b>EBITDA before Research and Development</b>	(1,464,877)	1,193,033	1,998,815	—	1,726,971
Research and					
Development expenses	611,608	6,122,760	2,116,701	1,200,664	10,051,733
Less Government Incentives	—	(770,383)	(31,684)	(196,105)	(998,172)
<b>Net Research and Development expenses</b>	611,608	5,352,377	2,085,017	1,004,559	9,053,561
Interest expense, net	1,102,989	1,153,191	313,750	—	2,569,930
Amortization expense	679,929	883,281	698,822	18,085	2,280,117
Foreign exchange loss					723,411
Gain on settlement of debt					—
<b>Segment (loss) before taxes and non-controlling interest</b>	(3,859,403)	(6,195,816)	(1,098,774)	(1,022,644)	(12,900,048)
Inter-segment sales	2,579,497	1,132	—	—	2,580,629

Last Year to Date March, 2004

	Human		Animal	Food	Total
	Pharma	Therapeutics	Health	Safety	
<b>Sales</b>	15,820,887	1,977,906	18,776,354	—	36,575,147
Cost of sales	6,776,170	197,791	8,414,120	—	15,388,081
Operating expenses	7,518,324	651,563	7,049,844	—	15,219,731
<b>EBITDA before Research and Development</b>	1,526,393	1,128,552	3,312,390	—	5,967,335
Research and					
Development expenses	1,162,289	6,151,836	1,759,512	556,237	9,629,874
Less Government Incentives	(193,283)	(835,883)	(12,796)	(207,401)	(1,249,363)
<b>Net Research and Development expenses</b>	969,006	5,315,953	1,746,716	348,836	8,380,511
Interest expense, net	866,702	1,494,752	382,748	—	2,744,202
Amortization expense	696,033	888,032	403,244	8,286	1,995,595
Foreign exchange loss					406,609
Gain on settlement of debt					(1,744,835)
<b>Segment income (loss) before taxes and non-controlling interest</b>	(1,005,348)	(6,570,185)	779,682	(357,122)	(5,814,747)
Inter-segment sales	3,002,237	—	28,322	—	3,030,559

#### 4. SENIOR DEBT

The Company's affiliate, Bioniche Pharma Group Limited, entered into an interest rate swap agreement with the Bank of Ireland as contemplated in Facility 3 of their agreement in order to reduce the impact of fluctuating interest rates on this debt. Under the terms of this agreement, the Company is required within a reasonable period of time to exchange at least one-half of the outstanding floating rate debt under Facilities 1 and 2 of the loan agreement to a notional fixed interest rate of 5.315%. The swap agreement requires the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The balance of this loan facility not subject to the swap agreement will be subject to a floating interest rate of Euribor plus 1.825% and 1.75% covering Facility 1 and 2 respectively.

The Company designates its interest rate swap agreements as hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps. At March 31, 2005, the Company had a notional principal amount of 3,099,333 Euro (\$4,882,999 CDN) outstanding on the interest rate swap with a negative fair value of 75,580 Euro (\$119,076 CDN).

During the quarter, the Company drew 1,532,999 Euro (\$2,415,240 CDN) against Facilities 1 and 2 with the Bank of Ireland, bringing the total drawn at March 31, 2005 to 8,199,999 Euro (\$12,919,098 CDN). These facilities are for the purchase and building of an expanded facility in Galway, Ireland. Interest capitalized during the current fiscal year totals 222,943 Euro (\$351,247 CDN).

In addition, the Company's affiliate in Australia agreed to repayment terms pursuant to a mortgage arrangement in regards to the \$547,185 AUS (\$514,792 CDN) loan facility. It will be repaid over a 15-year term with monthly principal and interest payments of \$5,295 AUS (\$4,981 CDN). Interest is variable and is calculated at the mortgage index rate as published by the bank.

#### 5. COMMITMENTS AND CONTINGENCIES

On July 2, 2004, the Company initiated, as planned, the funding of the Industrial Research Chairs after the Vaccine & Infectious Disease Organization (VIDO), jointly with Natural Science and Engineering Research Canada (NSERC), confirmed two appointments for this role. Under this agreement, the Company receives the first commercial rights to new food safety vaccines to fight infectious diseases of animals, including Salmonella enteritidis, Campylobacter and Cryptosporidium parvum. The Company's financial commitment is \$200,000, payable at the beginning of each six-month period commencing July, 2004 and ending June, 2009. At the end of March, 2005, the Company has expensed \$300,000 in Research and Development.

The Company participates in research and development funding arrangements, some of which, based on management's best estimates, are recorded as a reduction in the related cost and some as a deferred government incentives obligation. The funding arrangements are subject to audit by the contributors and, accordingly, the Company was notified that it would be audited under the terms of one of their funding arrangements subsequent to the end of the second quarter. Any adjustments, if necessary, which could be material, will be made in the period in which they are known.

#### 6. COMPARATIVE AMOUNTS

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

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