THE
TRANSFORMATION

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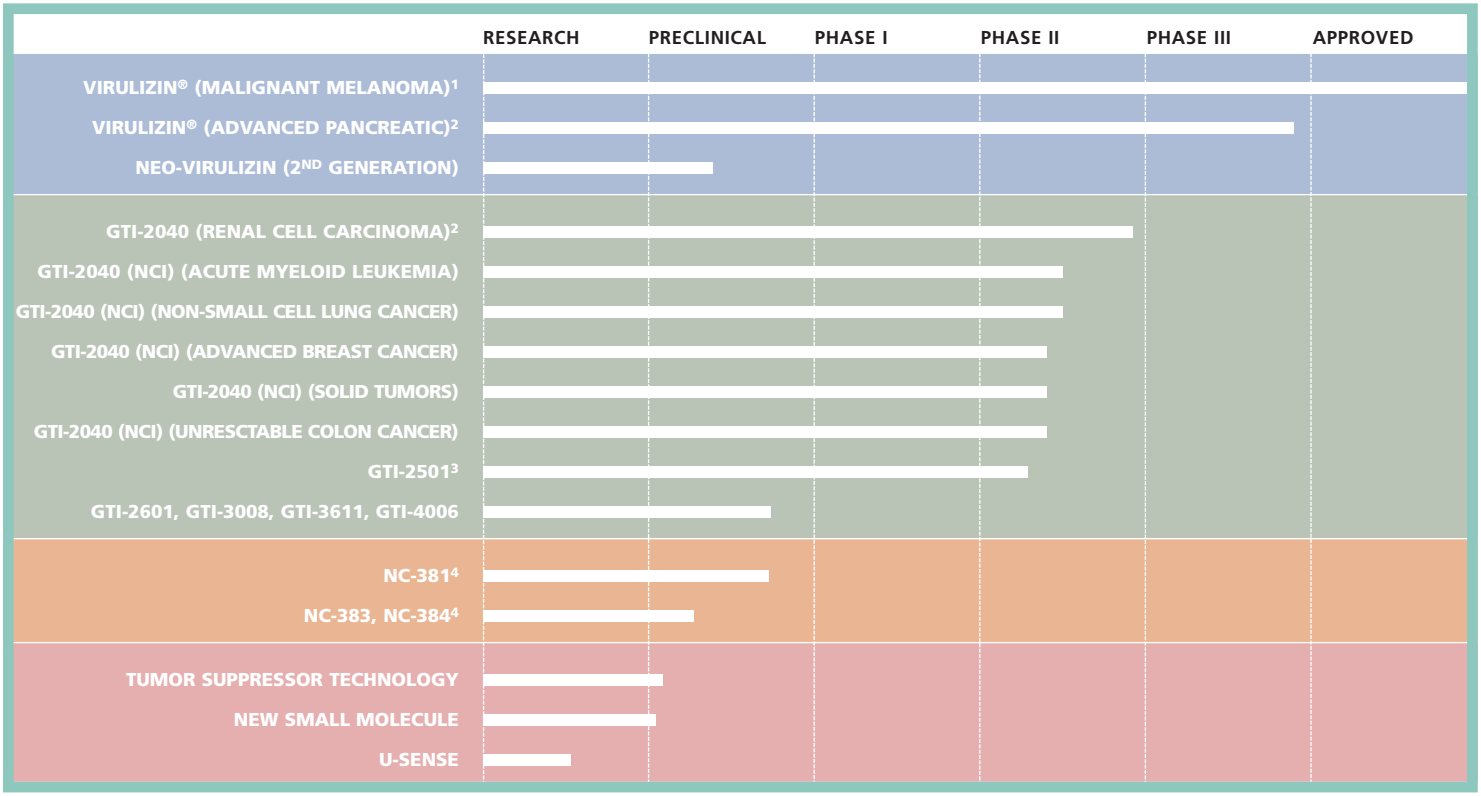
MISSION STATEMENT

Lorus Therapeutics Inc.'s mission is the discovery, research and development of well-tolerated therapies that successfully manage cancer and promote improved quality of life. Our uniquely diversified product pipeline provides multiple opportunities for clinical success and increased shareholder value.

PRODUCT DEVELOPMENT PIPELINE



- **Immunotherapy**
- **Antisense**
- **Small molecules**
- **Other**

1 Approved for sale in Mexico (private market) pursuant to the applicable regulatory process. We are not currently seeking approval for this indication in the United States or Canada.

2 Studies conducted under Investigational New Drug Applications filed with the FDA.

3 Combination chemotherapy study in hormone refractory prostate cancer at three study sites in Canada.

4 Pursuant to a worldwide exclusive out-licensing agreement, these products will be developed by Cyclacel Limited of U.K.

* The dotted lines indicate the commencement of the relevant phase of development.

TRANSFORMING OUR SCIENCE INTO PRODUCTS FOR THE MARKET

HIGHLIGHTS

- **In June 2004, completed full patient enrollment with over 400 patients in the pivotal Phase III FDA registration clinical trial of Lorus' lead immunotherapeutic drug Virulizin® for the treatment of advanced pancreatic cancer. The number of patients enrolled exceeded the target and enrollment was achieved ahead of schedule.**

- **On October 5, 2004, Lorus entered into an agreement to raise aggregate net proceeds of $14.4 million through the issuance of $15 million of secured convertible debentures. We received $4.4 million on October 5, 2004, and will receive $5.0 million on each of January 15, 2005 and April 15, 2005.**

- **Entered into a worldwide exclusive out-licensing agreement with Cyclacel Limited of the UK for NC381 and a library of clotrimazole analogs.**

- **Initiated five clinical trials in collaboration with the U.S. National Cancer Institute (NCI) for a Phase II clinical program of GTI-2040 in patients with Acute Myeloid Leukemia (AML), breast cancer, non-small cell lung cancer, solid tumors and advanced unresectable colon cancer.**

- **Initiated a Phase II clinical trial in hormone refractory prostate cancer patients with GTI-2501, one of the Company's lead antisense drug candidates at three prominent Canadian cancer centers.**

- **After three years of research, discovered novel low molecular weight compounds with anti-cancer and anti-bacterial activities. Lorus subsequently signed a collaboration agreement with the University of Toronto to provide further development of the compounds.**

- **Interim data were analyzed from the Phase II clinical trial of GTI-2040 in combination with capecitabine for patients with advanced end-stage renal cell carcinoma who had failed two or more prior therapies before entering the study, exhibited extensive metastases, and were representative of a population with very poor prognostic outcome. The data showed that more than half of the 21 evaluable patients in this study exhibited disease stabilization, ranging up to eight months. Tumor shrinkages of index tumors compared to baseline measurements were also observed in some patients.**

- **To increase Company exposure to U.S. investors, obtained approval to list on the American Stock Exchange and commenced trading on the exchange on February 23, 2004.**

LORUS' TRANSFORMATION ON THE ROAD TO COMMERCIALIZATION

Last year, I was pleased to report that 2003 was marked by our "getting the important things right" at Lorus. For a Company focused on the development of cancer therapies, that meant we moved forward in a number of important areas: in the clinical development of our diversified pipeline of products; in attracting ongoing support from investors; in attracting the right people to the Company, and in strengthening and establishing new relationships within the scientific community. Together, we had put in place the elements that are enabling us to control our destiny as a drug development company; the human, financial and scientific resources necessary to move forward.

We have added several new people to our senior management team during the past year and subsequent to our fiscal year end. Germaine Gross joined Lorus in May 2004, as our Director of Business Development from a Canadian based pharmaceutical company where she had spent the previous seven years in business development. Our new Director of Regulatory Affairs, Sue Fekete arrived in October 2003. Prior to Lorus, Sue was with the Canadian division of a large international pharmaceutical company. In December 2003, Hanif Sachedina started with Lorus as our Director of Compliance. Hanif had most recently been Director, Corporate Compliance with a Canadian pharmaceutical company. In September 2004, Paul Van Damme joined Lorus in the capacity of Chief Financial Officer. Paul is an experienced biotechnology executive whose presence on the senior management team at Lorus will have an immediate impact. Also in September 2004, Dr. Shafik Dharamshi began his duties as Lorus' Director of Medical Affairs. Dr. Dharamshi's previous experience includes positions as Director, Clinical Research and Director, Study Operations with clinical research organizations in Canada. Dr. Aiping Young was promoted to the position of Chief Operating Officer and Dr. Yoon Lee was promoted to Director of Research. Bruce Rowlands joined the management team in the role of Senior Vice President Planning & Public Affairs after having spent the previous year as a consultant to the company and prior to that as vice president and director of the Canadian operations of a U.S. investment banking firm.

In 2004, this foundation helped us build a strong and well-positioned company, an organization that we believe offers our investors the prospective financial rewards for their confidence in our business model and offers those afflicted with cancer hope for safer and more effective treatment options. Let me take this opportunity to recap why I feel we have continued to "get the important things right" and why we are "on the right track".

OUR PIPELINE

One clear sign that we are continuing on the right track is our extensive clinical and pre-clinical programs currently underway. Only 18 months ago, Lorus had two clinical studies underway: today we have eight clinical studies initiated representing two technology platforms: immunotherapy and antisense, and three products in clinical development; Virulizin®, GTI 2040 and GTI 2501. Additionally, our pipeline includes a number of novel pre-clinical drug candidates that we are assessing to determine development strategies for these assets either on our own or in collaboration with a development partner.

Virulizin®

Our most clinically advanced anti-cancer therapeutic is Virulizin®, a novel immunotherapy that has demonstrated strong anti-tumor efficacy with an excellent safety profile in clinical trials to date. Virulizin® stimulates a patient's innate immune system through the activation of macrophages and the infiltration of NK cells into tumors.

One of the critical clinical milestones we achieved was the completion of patient enrolment in our Virulizin® Phase III registration clinical trial, approximately six months ahead of our original schedule and with a larger patient population than originally contemplated. We have registered over 400 patients with locally advanced or metastatic pancreatic cancer in clinical study sites in North America, South America and Europe, comparing the efficacy and safety of Virulizin® when combined with gemcitabine versus a placebo combined with gemcitabine. We expect to receive the results of this important clinical trial in the second half of 2005.

With this pivotal registration clinical trial well advanced, we have also made good progress in expanding the awareness of Virulizin® within the scientific, medical and pharmaceutical communities. Representatives from the Company were present at the *American Society of Clinical Oncology (ASCO) Gastrointestinal Cancers Symposium* early in 2004, where our scientists made an oral presentation. In March, we presented a summary of the studies on the mechanism of action of Virulizin® at the annual meeting of the *American Association for Cancer Research (AACR)*, one of the largest gatherings of cancer specialists held each year. We also returned to the *Lustgarten Foundation Scientific Conference* this year, both as a sponsor and presenter on Virulizin®. This conference targets clinical researchers, oncologists, post-doctorate fellows and allied medical professionals worldwide. An international immunology conference held in Montreal this past summer also heard how Virulizin® elicits an expansion and activation of specialized immune cells, called NK cells, in the spleen, and in turn how that leads to increased NK cell infiltration into tumors. Data on Virulizin® published in *The International Journal of Oncology* added further to our peer presence and demonstrated how the drug inhibits tumor growth via stimulation of macrophages, important cells that play a key role in our immune system.

The presentations at these international cancer and immunology conferences in North America and Europe have significantly raised the profile of Virulizin®, precisely at the time when the clinical development process for this drug is nearing completion, and as we continue to explore marketing and distribution options with potential pharmaceutical partners.

At the same time, we strengthened our intellectual property position with Virulizin® this year by obtaining a new European patent that protects the composition and use of the drug for the treatment of cancer. It is the first Virulizin® patent that has been allowed in Europe and adds to the roster of countries that have already awarded Lorus similar patents, including the U.S., Canada, Mexico, Australia, South Africa, New Zealand, Korea and Singapore.

As our Phase III clinical program with Virulizin® proceeds, we continue to make the product available on a compassionate use basis to patients, primarily following failure of approved therapy This compassionate use data will further supplement our regulatory filings with additional safety data. And while efficacy data from this program is not directly usable in regulatory filings, it is encouraging to all of us at the Company to hear the anecdotal feedback from those who believe they have benefited from using Virulizin® as part of their treatment regiment.

GTI-2040

GTI-2501

Development of our antisense drugs, GTI-2040 and GTI-2501, also saw considerable progress in fiscal 2004, with seven Phase II studies with the two anti-cancer drugs currently underway. A common feature of a number of diseases like cancer is that the diseased cells produce increased amounts of important proteins that play key roles in the initiation and progression of the illness. Antisense technology provides an exciting opportunity to develop new drug treatment strategies to selectively prevent the production of disease-causing proteins, leading to the inhibition of further disease development. In contrast, conventional chemotherapy drugs usually work by binding directly to disease-causing proteins, but their lack of specificity often results in the binding to other proteins too, leading to unwanted side effects which can be very severe in patients with cancer. The specificity exhibited by the antisense approach provides the potential to design a novel class of drugs for the treatment of chronic illnesses such as cancer, while avoiding unwanted cytotoxic side effects. Our work in this field helped us cement a very valuable relationship with the U.S. National Cancer Institute (NCI).

The NCI is the American government's principal institute for research and training in cancer treatment. We entered into a clinical trials agreement with them in which the Institute is sponsoring a number of studies of GTI-2040, in a Phase II clinical trials program now underway in patients with acute myeloid leukemia (AML), breast cancer, non-small cell lung cancer, solid tumors and advanced unresectable colon cancer. We also saw encouraging interim data from the Phase II GTI-2040 trial in combination with capecitabine for patients with late-stage renal cell carcinoma. More than half of the 21 evaluable patients in the interim analysis of this study exhibited disease stabilization, ranging up to eight months. Tumor shrinkages of index tumors compared to baseline measurements were also observed in some patients, a particularly encouraging development given that those in the trial had failed two or more prior therapies before entering the clinical study, exhibited extensive metastases, and were representative of a population with a very poor prognostic outcome. In July, oncology investigators from our Phase II renal cell cancer clinical trial presented clinical findings at the *First International Congress on Kidney and Bladder Cancer*. These findings demonstrated that GTI-2040 is well tolerated in combination with capecitabine, with no reduction in the starting capecitabine dose required, up to and including the target GTI-2040 dose that was previously established as a monotherapy in a Phase I clinical investigation. These latter clinical results are important because they support our strategy of developing novel anti-cancer agents that show minimal additional toxicities when combined with traditional cytotoxic chemotherapies.

Another clinical program we initiated in the last year was a Phase II clinical trial in hormone refractory prostate cancer patients using GTI-2501, our second clinical antisense anti-cancer drug, at three prominent Canadian cancer centres. With prostate cancer second only to lung cancer in the number of deaths among men in North America, there is a real sense of urgency in providing new therapies for patients suffering from this disease. Our trial will investigate the safety and efficacy of GTI-2501 in combination with docetaxel, a widely used active chemotherapy in hormone refractory prostate cancer. And, as was the case with Virulizin®, we actively participated in international conferences to discuss our clinical work with researchers from around the world. We were invited to provide an update on our clinical and pre-clinical antisense program to leaders in the field of ogligonucleotide technology in April at the TIDES international conference in Las Vegas and earlier in the year at the Annual Antisense and siRNA Technologies Conference in London, England.

TOMORROW'S PROMISE

In addition to our well-developed clinical programs, our drug pipeline contains a number of other novel, proprietary drug candidates that hold great promise for Lorus and in which we made some very positive advances this past year.

Lorus' tumor suppressor/gene therapy discovery recently received patent protection in Europe, which follows previous patents issued by the U.S. patent office and the Australian patent office. These patents and others pending protect Lorus' discovery of a gene whose expression suppresses the growth of human tumors in pre-clinical models, and represents a considerable asset for the company with great potential. We are working diligently to determine how best this exciting discovery can be developed for the benefit of cancer patients.

After three years of in-house research, we were rewarded with the discovery of novel low molecular weight compounds with both anti-cancer and anti-bacterial activities. Lorus subsequently signed a collaboration agreement with the University of Toronto to provide further formulation development for the compounds using a cutting edge nanotechnology approach. This work is being supported by a grant from the Natural Sciences and Engineering Research Council of Canada. This type of technology along with such other assets as our gene therapy program represent the future of Lorus' drug development programs as Virulizin® and our antisense drugs emerge from the clinic as commercial products.

Through our subsidiary, NuChem Pharmaceuticals, we entered into a worldwide exclusive out-licensing agreement with Cyclacel Limited of the UK for a library of clotrimazole (CLT) analogs originally in-licenced by Lorus from the Medical School at Harvard University in 1997. CLT is an anti-fungal drug that has demonstrated anti-cancer activity, but its potential is limited by the presence of high liver toxicity. The goal in developing this library of drug candidates was to identify drugs like NC 381 with anti-cancer activity but with significantly reduced toxic effects. Pre-clinical data on NC 381 were recently published in both the *Journal of Pharmacology and Experimental Therapies and Bioorganic and Medicinal Chemistry Letters*. Further experimental studies demonstrated that in addition to NC 381, there were a number of other derivatives of CLT in the library of analogs that represent promising drug candidates with anti-cancer activity and low toxicity profiles. The agreement with Cyclacel provides Lorus with an upfront payment and the potential for approximately US$11.6 million in milestone payments, as well as a royalty on future sales for each compound commercialized from the CLT library of about 100 drug candidates. Cyclacel will also fund all future development work on this program, allowing Lorus to focus on its remaining pre-clinical technologies and on its more advanced clinical products.

Cancer progression is a complex process, which includes at least 100 different diseases; this is why the Company does not hold the view that a single drug will emerge as a cure. Instead, we believe that cancer will continue to be treated by combination therapy using many different drugs with a variety of mechanisms of action. Using this multi-mechanistic approach in the development of new cancer therapies essentially reduces the risk inherent in the drug development process, by ensuring we have multiple technologies and multiple products under development, and therefore avoiding the trap of being a "one product company."

OUR COMPANY

Much of our focus in 2004 has been on advancing our clinical programs for a number of our drug products. With significant progress having been made, we now foresee our priority in 2005 to focus on arrangements for the commercialization of Virulizin® and on partnerships and further development of our lead technologies. We have done much of the 'heavy lifting' in our drug development: bringing drugs to a late stage in the process. Now, "being on the right track" means putting in place the means to reap the rewards of this considerable investment.

It is our shareholders who allow us to continue our work in developing a broad portfolio of cancer therapies and we are committed to maximizing the value of the Company and its assets for the shareholders. Part of doing this, and another sign of "being on the right track," is the work we did over the last 12 months to raise the profile of the Company with key audiences.

Of paramount importance in this regard was our decision to seek a listing for our common shares in the world's biggest capital market. On February 23, shares of Lorus began trading for the first time on the American Stock Exchange under the symbol LRP. Providing exposure to U.S. investors is an important step in ensuring the Company will have access to additional capital in the future and to help us obtain maximum valuation for the milestones we are achieving.

Listing in the U.S. market in and of itself is not, however, sufficient to achieve these goals. We spent considerable time in fiscal 2004 meeting with many participants in the U.S. capital markets, introducing them to our Company and our portfolio of products. Participating in major international conferences such as BIO, BioPartnering Europe, Bio-Europe, BioContact and the Rodman & Renshaw Techvest Global Healthcare Conference helps achieve an ongoing objective of ensuring major global healthcare investors know the Company and are aware of our exciting prospects.

The pharmaceutical industry is poised for a transformation. The impetus for change can be seen on its business side, where an era of surging profits fuelled by blockbuster drugs grinds to a halt. Research pipelines at big pharmaceutical companies, directed at over-served therapeutic categories, are running dry, and the sector may be hitting the limit on growth through consolidation. We see, therefore, an industry that is looking for the kind of products that Lorus has been successfully developing: those that appear to be safe, efficacious, and address growing therapeutic opportunities. In short, we see a promising scenario unfolding for Lorus.

OUR COMMITMENT

In 2004, Lorus continued to create shareholder value as it achieved several significant milestones in the fight against cancer. Both the full enrolment in the expanded Virulizin® Phase III registration clinical trial earlier than anticipated and the expansion and initiation of the GTI-2040 and GTI-2501 Phase II clinical trials, demonstrate Lorus' commitment to bringing novel and effective cancer therapies with attractive safety profiles to a hard-to-treat patient population. But there is still much to do.

Based on the most recently available data from the American Cancer Society, more than 1,500 Americans die every day from cancer. In Canada, almost 400 new cases of cancer are diagnosed every day according to the National Cancer Institute of Canada.

The technology curve of medical science continues to advance with biotechnology at the forefront of discovery. The number of innovative biotechnology product opportunities continues to increase and successfully advance in clinical development. We are collectively getting better at our work in the field, providing promise to the thousands newly diagnosed with cancer. We believe Lorus is at the forefront in developing new therapies and we are proud of the many achievements that we made in the last year.

We would not have achieved our many successes and milestones in 2004 without the valuable contributions of so many. In the biotechnology field, human capital is the most critical resource and Lorus' employees, advisors and collaborators demonstrated that time and again. We have developed a number of partners in our history and their contributions in financial and intellectual capital have been of significant benefit to us. With eight clinical studies currently underway, I would also like to personally thank the many physicians and patients who are participating in these trials. We learn a considerable amount from both of these groups of front-line participants in the battle against cancer. And to our investors new and old, we thank you for having the faith in our technology, in our people and in our work. We are on the right track and that is good news for everyone who helped us get to this point. 2005 will be an important year as Lorus transforms itself from a pure research and development company into a significant commercial entity in Canada's maturing biopharmaceutical industry.

Dr. Jim Wright
President and Chief Executive Officer
Lorus Therapeutics
September 2004

The following discussion should be read in conjunction with the audited consolidated financial statements for the year ended May 31, 2004 and the accompanying notes (the "Financial Statements") set forth elsewhere in this report. The Financial Statements and all financial information discussed below have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Significant differences between Canadian and United States GAAP are identified in Note 14 to the Financial Statements. All amounts are expressed in Canadian dollars unless otherwise noted. In this Management's Discussion and Analysis, "Lorus", the "Company", "we", "us" and "our" each refers to Lorus Therapeutics Inc.

OVERVIEW

Lorus Therapeutics Inc. is a life sciences company focused on the research, development and commercialization of effective anti-cancer therapies with high safety. Lorus has worked diligently to establish a diverse, marketable anti-cancer product pipeline, with products in various stages of development ranging from preclinical to a global Phase III clinical trial which has reached full enrollment. This product pipeline is supported by a growing intellectual property portfolio.

Our success is dependent upon several factors, including establishing the efficacy and safety of our products in clinical trials, obtaining the necessary regulatory approvals to market our products and maintaining sufficient levels of funding through public and/or private financing. Lorus has not commercially marketed any product other than Virulizin®, which is being sold in the private market in Mexico.

We believe that the future of cancer treatment and management lies in drugs that are effective, safe and have minimal side effects and therefore improve a patient's quality of life. Many of the drugs currently approved for the treatment and management of cancer are toxic with severe side effects and we therefore believe that a product development plan based on effective and safe drugs could have broad applications in cancer treatment. Lorus' strategy is to continue the development of our product pipeline using several therapeutic approaches. Each therapeutic approach is dependent on different technologies, thereby mitigating the development risks associated with a single technology platform. We evaluate the merits of each product throughout the clinical trial process and consider commercialization. The most advanced anti-cancer drugs in our pipeline, each of which flow from different platform technologies, are: Immunotherapeutics (Virulizin®); Antisense (GTI compounds); small molecule and Tumor Suppressor Technology.

Our net loss for 2004 totaled $30.3 million ($0.18 per share) compared to a net loss of $16.6 million ($0.12 per share) in 2003. Research and development expenses in 2004 increased to $26.8 million from $12.6 million in 2003. The Virulizin® Phase III clinical trial expansion, that resulted in full enrollment in June 2004, increased manufacturing and compliance activities and the procurement of drug supply for the U.S. NCI-sponsored Phase II clinical trial programs for GTI-2040 contributed to the increase in net loss in 2004. We utilized cash of $28.1 million in our operating activities in 2004 compared with $11.9 million in 2003; the higher utilization was necessary to support our expanded research and development activities. At the end of 2004 we had cash and cash equivalents and short-term investments of $26.7 million compared to $25.1 million at the end of 2003.

As products progress through clinical trials, the size of the trials and cost of these development activities increase dramatically. The Company completed enrollment in its Virulizin® Phase III clinical trial shortly after the fiscal year end. A substantial amount of the costs of the trial were incurred in the year and particularly in the fourth quarter of fiscal 2004. We anticipate lower quarterly clinical trial costs in fiscal 2005.

CRITICAL ACCOUNTING POLICIES

The Company periodically reviews its financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and transparent information relative to the current economic and business environment. As part of this process, the Company has reviewed its selection, application and communication of critical accounting policies and financial disclosures. Management has discussed the development and selection of the critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosure relating to critical accounting policies in this Management's Discussion and Analysis. Other important accounting polices are described in Note 2 of the Financial Statements.

Drug Development Costs

We incur costs related to the research and development of pharmaceutical products and technologies for the management of cancer. These costs include internal and external costs for pre-clinical research and clinical trials, drug costs, regulatory compliance costs and patent application costs. All research costs are expensed as incurred as required under GAAP.

Development costs, including the cost of drugs for use in clinical trials, are expensed as incurred unless they meet the criteria under GAAP for deferral and amortization. The Company continually assesses its activities to determine when, if ever, development costs may qualify for capitalization. By expensing the research and development costs as required under GAAP, the value of the product portfolio is not reflected in the Company's Financial Statements.

RESULTS OF OPERATIONS

Revenues

Revenues for the year increased to $608 thousand, representing an increase of $542 thousand over 2003 sales of $66 thousand and nil in 2002. The increase results from a licensing agreement Lorus entered into during the year with Cyclacel Ltd. in connection with the out-licensing of our clotrimazole analog library of anti-cancer drug candidates. The agreement included an initial license fee of $546 thousand with the potential of additional license fees of up to $11.6 million that may be earned if Cyclacel achieves certain defined research and development milestones. We do not expect that any of these milestones will be achieved in the next 12 months. The balance of the revenue earned during 2004 relates to product and royalty revenues from the sale of Virulizin® to our distributor in the Mexican market, Mayne Pharma. The Company processed a change in the formulation of Virulizin® for sale in Mexico in order to increase the shelf life of the product, however, as this change in formulation was not approved by the Mexican Minister of Health until subsequent to year end, there were no sales of Virulizin® in Mexico during the last five months of the fiscal year. We do not anticipate product revenue in fiscal 2005 from any of our other anti-cancer drugs currently under development.

Research and Development

Research and development expenditures totaled $26.8 million in 2004 compared to $12.6 million in 2003 and $8.7 million in 2002. The significant increase in 2004 expenditures is primarily the result of two factors. First, we incurred increased costs associated with the expanded pivotal Phase III global clinical trial of Virulizin® for the treatment of advanced pancreatic cancer, including personnel, drug manufacturing and testing, combination drug purchases and contract research organization costs. Second, we incurred expenditures related to the upfront procurement of the GTI-2040 drug for the five U.S. National Cancer Institute ("NCI") sponsored Phase II clinical trials initiated during 2004 for patients with Acute Myeloid Leukemia ("AML"), breast cancer, non-small cell lung cancer, solid tumors and advanced unresectable colon cancer. Research and development costs in 2003 were higher than 2002 primarily due to: (i) the initial expansion of the Phase III Virulizin® clinical trial; (ii) the expansion of the Phase II clinical trial of GTI-2040 in renal cell carcinoma to more than 8 major oncology centres in the U.S.; and (iii) the preparation for the National Cancer Institute sponsored GTI-2040 Phase II clinical trial programs.

Of the total research and development expenditures incurred during the year, Virulizin® accounted for $19.9 million or 74% of total spending. As discussed above, our lead drug Virulizin® is undergoing a Phase III clinical trial for which full enrollment was reached shortly after year end. During fiscal 2005 we expect our research and development costs to decrease, as no further start-up costs associated with this trial will be incurred.

General and Administrative

General and administrative expenses totaled $4.9 million in 2004 compared to $4.3 million in 2003 and $4.9 million in 2002. The increase in 2004 of $600 thousand compared to 2003 is due to higher professional and filing fees related to regulatory changes and changes to the option plan, as well as a one time non-cash charge of $245 thousand to write-off financing costs no longer deemed to have future value. The decrease in 2003 compared to 2002 resulted mainly from lower legal and advisory service fees.

Depreciation and Amortization

Depreciation and amortization expenses totaled $420 thousand in 2004 compared to $1.0 million in 2003 and $2.0 million in 2002. The decrease in 2004 over 2003 is due primarily to the amortization of stock-based compensation that was a recovery of $43 thousand in 2004 and an expense of $700 thousand in 2003 due to a decline in Lorus' use of the compensation tool during 2004. The decrease in 2003 over 2002 is related primarily to the adoption of the new accounting pronouncement for goodwill and other intangible assets whereby the Company ceased amortizing goodwill on June 1, 2002 upon adoption of CICA Handbook section 3062 "Goodwill and other intangible assets". Amortization of goodwill totaled $1.5 million in 2002.

Amortization of stock-based compensation in 2003 totaled $700 thousand as compared to $300 thousand in 2002.

Interest and Other Income

Interest income totaled $1.2 million in 2004 and in 2003 and $2.0 million in 2002. Interest income was unchanged between 2004 and 2003 despite higher average cash and short-term investment balances in 2004 because of lower market interest rates in 2004 compared with 2003. The decrease in 2003 interest income compared to 2002 was due to a lower average cash and short-term investment balance in 2003 and the general decline in market interest rates.

Loss for the Period

The loss for the year totaled $30.3 million or $0.18 per share in 2004 compared to $16.6 million or $0.12 per share in 2003 and $13.5 million or $0.09 per share in 2002. The increase in net loss in 2004 compared to 2003 is primarily due to the significant increase in clinical trial activities to support the expanded Phase III Virulizin® clinical trial. The increase in net loss in 2003 compared to 2002 relates primarily to increased clinical trial activities, which was partially offset by lower administrative costs and the discontinuance of amortization of goodwill in accordance with the adoption of the new CICA accounting pronouncement described above. On a comparative basis, the loss for the year ended May 31, 2002 would have been $12.0 million or $0.08 per share after adjustment to remove the amortization of goodwill.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity financing, the exercise of warrants and stock options, and interest income on funds held for future investment. We expect to continue to finance the costs of the global Virulizin® Phase III clinical trial from internal resources until its anticipated completion in Q1 of fiscal 2006. The costs of the five GTI-2040 Phase II clinical trials will continue to be borne by the NCI in the United States. We believe that our available cash, cash equivalents and short-term investments, and the interest earned thereon, together with the post year-end convertible debenture financing discussed below, will be sufficient to finance our operations and capital needs for at least the next 12 months.

Financing

On June 11, 2003, Lorus raised net proceeds of $29.9 million by way of a public offering of 26,220,000 units at a price of $1.25 per unit, each unit consisting of one common share and one-half of one share purchase warrant. In addition during fiscal 2004, Lorus issued common shares on the exercise of stock options for proceeds of $200 thousand. In 2003, Lorus issued common shares on the exercise of stock options for proceeds of $700 thousand. In 2002, Lorus issued common shares on the exercise of warrants and stock options for proceeds of $1.4 million.

On October 5, 2004, subsequent to the 2004 fiscal year-end, we entered into an agreement to raise aggregate net proceeds of $14.4 million through the issuance of $15 million of secured convertible debentures. The debentures are secured by a first charge over all of the assets of the Company. We received $4.4 million on October 5, 2004, and will receive $5.0 million on January 15, 2005 and on April 15, 2005. The debentures will expire on October 1, 2009 and interest will accrue and be paid monthly at a rate of prime + 1% until the Company's share price reaches $1.75 for 60 consecutive trading days, at which time interest will no longer accrue. Interest is to be payable in common shares of Lorus until such shares trade at a price of $1.00 or more after which interest will be payable in cash or common shares at the option of the debenture holder. Common shares issued in payment of interest will be issued at a price equal to the weighted average trading price of such shares for the ten trading days immediately preceding their

issue in respect of each interest payment. The $5.0 million principal amount of debentures issued on October 5, 2004 is convertible at the holder's option into common shares of the Company with an exercise price per share of $1.00. The $10.0 million principal amount of debentures issued thereafter is convertible at an exercise price per share equal to the greater of $1.00 and the weighted average trading price of our common shares for the twenty trading days prior to the investment of the funds, less any discount permitted by the Toronto Stock Exchange. The agreement also provides for the issuance of up to 4 million warrants, with a life of five years, to buy common shares at a price per share of $1.00.

Use of Proceeds

In our prospectus dated June 3, 2003 we indicated that the proceeds to be received from that financing would be used as follows: $12.0 million for the product development of our immunotherapy platform, $11 million for the product development of our antisense platform and $2.0 million for pre-clinical and discovery programs. It was anticipated that the balance of funding would be used for working capital and general purposes. During fiscal 2004 we incurred $19.9 million in research and development expenses on our immunotherapy platform, $6.7 million on our antisense platform, and $200 thousand on pre-clinical and discovery programs. The additional spending on our immunotherapy platform was funded through cash and short-term investments held by the Company prior to the 2003 offering and is the direct result of the expansion of the Virulizin® Phase III clinical trial. The spending anticipated in the 2003 prospectus on our antisense platform and pre-clinical and discovery programs was to be incurred over a number of years, not solely in 2004. We have sufficient funds available at the end of 2004 to fund the remaining $4.3 million to be spent on our antisense platform and $1.8 million to be spent on pre-clinical and discovery programs.

Operating Cash Requirements

Lorus utilized cash in operating activities of $28.1 million in 2004 compared to $11.9 million in 2003 and in 2002. The cash used in operating activities in 2004 is higher than the prior year due to higher expenditures throughout the year to support the Virulizin® Phase III clinical trial. The cash used in operating activities in 2003 was comparable with that experienced in 2002 despite a higher net loss in 2003 due primarily to changes in the timing of payments of accounts payable and accrued liabilities.

We expect the cash used in operating activities to decrease in 2005 from the amount experienced in 2004 as our major clinical trial with Virulizin® will be underway and no further initiation costs associated with this trial will be incurred in 2005.

Cash Position

At May 31, 2004, Lorus had cash and cash equivalents and short-term investments totaling $26.7 million compared to $25.1 million at the end of 2003. The Company invests in highly rated and liquid debt instruments. Investment decisions are made in accordance with an established investment policy administered by senior management and overseen by the Board of Directors. Working capital (representing primarily cash and cash equivalents and short-term investments) at May 31, 2004 was $22.6 million as compared to $20.9 million in 2003. As discussed above, subsequent to the year-end, we entered into an agreement to issue $15 million in convertible debentures for net proceeds of $14.4 million. Cash and short-term investments will therefore increase by $14.4 million (gross proceeds of issuance net of issuance costs). The Company does not expect to generate a positive cash flow from operations for the next few years due to substantial additional research and development costs, including costs related to drug discovery, pre-clinical testing, clinical trials, manufacturing costs and operating expenses associated with supporting these activities. Negative cash flow will continue until such time, if ever, that we receive regulatory approval to commercialize any of our products under development and revenue from any such products exceeds expenses.

We may seek to access the public or private equity markets from time to time, even if we do not have an immediate need for additional capital at that time. Lorus intends to use its resources to fund its existing drug development programs and develop new programs from its portfolio of pre-clinical research technologies. The amounts actually expended for research and drug development activities and the timing of such expenditures will depend on many factors, including the progress of the Company's research and drug development programs, the results of pre-clinical and clinical trials, the timing of regulatory submissions and approvals, the impact of any internally developed licenses or acquired technologies, the impact from technological advances, determinations as to the commercial potential of the Company's compounds and the timing and development status of competitive products.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET FINANCING

At May 31, 2004, we had contractual obligations requiring annual payments as follows:

(amounts in 000's)	Less than 1 year	1-3 years	4-5 years	5+ years	Total
Operating leases	110	–	–	–	110
Contract Research Organizations[1]	2,585	2,213	–	–	4,798

Off-balance sheet financing arrangements are limited to operating lease contracts in respect of office equipment, and a building lease.

[1] Contract Research Organization expenditures relate to our Phase III Virulizin® clinical trial

OUTSTANDING SHARE DATA

As at August 30, 2004 the Company had 171,804,989 common shares issued and outstanding. In addition, the Company had 8,235,998 stock options issued and outstanding, 1,835,400 compensation options issued and outstanding with an exercise price of $1.27 and warrants to purchase 13,110,000 common shares of Lorus at an exercise price of $1.75 per share.

SELECTED ANNUAL FINANCIAL DATA

The following selected consolidated financial data has been derived from, and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended May 31, 2004 which are prepared in accordance with Canadian GAAP.

Consolidated Statements of Loss and Deficit

(amounts in 000's except for per common share data) (Canadian dollars)	Years Ended May 31		
	2004	2003	2002
Revenues	$ 608	$ 66	$ –
Operating expenses			
Cost of sales	28	55	–
Research and development	26,785	12,550	8,659
General and administrative	4,915	4,290	4,867
Depreciation and amortization	420	960	1,956
Operating loss	31,540	17,789	15,482
Interest and other income	(1,239)	(1,155)	(1,995)
Loss for the year	30,301	16,634	13,487
Basic and fully diluted loss per common share	$ 0.18	$ 0.12	$ 0.09
Total assets	34,424	34,255	47,572

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth certain unaudited consolidated statements of operations data for each of the eight most recent fiscal quarters that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained elsewhere in this annual report and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information presented.

During Q3 2003, we began selling Virulizin® for the treatment of malignant melanoma through our distributor, Mayne Pharma, in the Mexican private market. Sales continued to Q2 2004 when Lorus filed a change in formulation with the Mexican Minister of Health which was not approved until subsequent to year end. Sales through Mayne Pharma include both product sales and royalty revenue. Revenue increased significantly in Q2 2004 due to the initial license fee from Cyclacel Ltd. discussed above.

Research and development expenses increased significantly throughout 2004 in comparison to 2003 due

to the expansion of the Phase III Virulizin® clinical trial. Research and development payments fluctuated during 2004 primarily due to the timing of milestone payments to our Contract Research Organizations, as well as the manufacturing of our study drugs (Virulizin® and GTI-2040) and the purchase of the study combination drug.

	Fiscal 2004 Quarter Ended				Fiscal 2003 Quarter Ended			
	Aug 31 2003	Nov 30 2003	Feb 29 2004	May 31 2004	Aug 31 2002	Nov 30 2002	Feb 28 2003	May 31 2003
Revenue	$ 29	$ 575	$ 2	$ 2	$ –	$ –	$ 27	$ 39
Cost of Sales	–	26	1	1	–	–	27	28
Research and development	7,263	5,586	7,340	6,596	3,047	3,323	2,876	3,304
General and administrative	1,231	1,176	1,010	1,498	1,304	796	960	1,230
Depreciation and amortization	99	99	108	114	95	164	224	477
Operating loss	8,564	6,312	8,457	8,207	4,446	4,283	4,060	5,000
Interest and other income	(393)	(314)	(298)	(234)	(370)	(314)	(258)	(213)
Loss for the period	8,171	5,998	8,159	7,973	4,076	3,969	3,802	4,787
Basic and fully diluted loss per common share	$ 0.05	$ 0.03	$ 0.05	$ 0.05	$ 0.03	$ 0.03	$ 0.02	$ 0.04

RISKS AND UNCERTAINTIES

Lorus has not produced or commercially marketed any product other than Virulizin®, which has been approved for sale and is being sold in the private market in Mexico. Although we have commenced commercial sales of Virulizin®, there can be no assurance that the Company will realize future revenues from the product. In addition, there can be no assurance that we will ever realize revenues from any of our products in development, or that we will ever be profitable.

Lorus' products are in various stages of development. There can be no assurance that we will have funds available to permit the successful commercialization of our products. The Company's funding needs may vary depending on many factors including: the progress and number of research and drug development programs; costs associated with clinical trials and the regulatory process; costs related to maintaining drug manufacturing sources; costs of prosecuting or enforcing patent claims and other intellectual property rights; collaborative and license agreements with third parties; and opportunities to in-license or acquire new products.

In order to commercialize our products, we must obtain regulatory approvals. Regulatory approvals can take a number of years and involve substantial expenditures. There can be no assurance that the Company will ever obtain necessary approvals or licenses for any of its products; that the Company will not encounter difficulties or excessive costs in its efforts to secure necessary approvals and licenses; or that the Company will be able to obtain sufficient funds to meet the necessary expenditures associated with obtaining regulatory approvals.

Even if our product candidates receive all necessary regulatory approvals and clearances, they may not gain market acceptance. Physicians, patients, third party payors and the medical community may not accept or utilize our products, and if our products do not achieve significant market acceptance our business and financial condition will be materially adversely affected. In addition, market acceptance is affected by the extent to which reimbursement for the cost of such products will be available from government health administration authorities, private health coverage insurers and other organizations.

Lorus relies upon third parties to provide certain key services, including contract manufacturers to manufacture its products and independent investigators and contract research organizations to assist it in conducting its clinical trials. These third parties may encounter difficulties in meeting regulatory requirements and in maintaining quality control and quality assurance to meet Lorus' clinical development needs. If these third party service providers are unable to meet regulatory requirements or maintain quality control and quality assurance, or we are unable to retain such suppliers or obtain new third party suppliers, we may not be able to effectively conduct clinical trials or ultimately commercialize our products.

We currently hold licenses from third parties for certain technologies, including in respect of our antisense platform. We cannot assure you that these licenses will not terminate or that they will remain in good standing.

Our strategy is to enter into various arrangements with corporate and academic collaborators, licensors, licensees and others for the research, development, clinical testing, manufacturing, marketing and commercialization of our products. There can be no assurance, however, that we will be able to establish such additional collaborations on favourable terms, if at all, or that our current or future collaborative arrangements will be successful or may not be terminated by our partners. We do not have any sales, marketing or distribution capabilities. In order to commercialize our products, if any are approved, we must either acquire or internally develop sales, marketing and distribution capabilities or make arrangements with third parties to perform these services for us. The inability to market our products could have a material adverse effect on our business and financial condition.

The sale and use of the products we develop could carry the risk of product liability proceedings. While we currently maintain limited product liability insurance, we cannot assure you that product liability insurance will continue to be available to us on commercially reasonable terms. Product liability claims might also exceed the amounts of such coverage.

Our discovery and development processes involve the controlled use of hazardous and radioactive materials. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by local laws and regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed our resources.

Our interest income is subject to fluctuations of interest rates in our investment portfolio of debt securities. Investments are held to maturity and have staggered maturities to minimize interest rate risk. There can be no assurance that interest income fluctuations will not have an adverse impact on Lorus' financial condition. The Company maintains its accounts in Canadian dollars, but its revenues and a portion of its expenditures are in foreign currencies. Lorus does not currently engage in hedging its foreign currency requirements to reduce exchange rate risk.

Our success depends in part on our ability to obtain patents, maintain trade secret protection and operate without infringing the proprietary rights of third parties. We cannot assure that our pending patent applications will result in patents being granted, that we will be able to develop additional proprietary products that are patentable, that patents already granted to us will provide us with any competitive advantage, or that patents of others will not have an adverse effect on our ability to do business.

Our success depends in large part upon our ability to attract and retain highly qualified scientific and management personnel. We face competition for such personnel from other companies, academic institutions, government entities and other organizations. We cannot assure you that we will retain our current personnel and will be able to continue to attract qualified personnel.

RECENT ACCOUNTING PRONOUNCEMENTS

Effective June 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ["FAS 143"]. The standard requires us to estimate and accrue for the present value of our obligations to restore leased premises at the end of the lease. At lease inception, the present value of this obligation would be recognized as other long-term liabilities with a corresponding amount recognized in fixed assets. The fixed asset amount would be amortized, and the liability amount would be accreted, over the period from lease inception to the time the Company expects to vacate the premises resulting in both depreciation and interest charges in the consolidated statements of income. There is no material impact on the consolidated financial statements resulting from the adoption of FAS 143 either in the current or prior years presented.

In December 2003, the Financial Accounting Standards Board ["FASB"] amended Interpretation No. 46, "Consolidation of Variable Interest Entities" ["FIN 46R"]. FIN 46R requires that a variable interest entity ["VIE"] be consolidated by a company if that company is subject to a majority of the risk of loss from the VIE's activ-

ities and/or is entitled to receive a majority of the VIE's residual returns. For the Company, the requirements of FIN 46R apply in 2003 for all VIE's created after January 31, 2003. For VIE's created before January 31, 2003, the requirements of FIN 46R apply as of May 31, 2005 for a VIE that does not meet the definition of a special-purpose entity ["SPE"] and as of June 1, 2004 for a VIE that is an SPE. The application of this Interpretation will not have an effect on our consolidated financial statements.

In September 2003, the Canadian Institute of Chartered Accountants ["CICA"] revised Section 3870 'Stock-Based Compensation and Other Stock-Based Payments' to require that, effective June 1, 2004, the fair value method of accounting for stock options be recognized in the consolidated financial statements. The Company intends to apply these provisions retroactively without restatement for the year commencing June 1, 2004. The cumulative compensation cost of options on common shares of the Company, using the Black-Scholes option pricing model, will be charged to deficit with a corresponding increase to contributed surplus at June 1, 2004.

In November 2003, the CICA issued Accounting Guideline AcG-15, "Consolidation of Variable Interest Entities", to provide guidance for applying the principles in Handbook Section 1590, "Subsidiaries", to certain entities. Although the CICA is contemplating amendments to the Guideline, it is effective for fiscal years beginning on or after November 1, 2004. Although the Company is currently reviewing AcG-15, the impact of the Guideline, if any, on the Company's consolidated financial statements has not been determined.

In March 2003, the CICA issued Handbook Section 3110, "Asset Retirement Obligations", which establishes standards for the recognition, measurement and disclosure of asset retirement obligations and the related asset retirement costs. This new Section is effective June 1, 2004 for the Company and harmonizes Canadian requirements with existing United States GAAP. There will be no material impact on the consolidated financial statements resulting from the adoption of Section 3110 either in the current or prior years presented.

FORWARD LOOKING STATEMENTS

Statements contained herein that are not based on historical fact, including without limitation statements containing the words "believes," "may," "likely," "plans," "will," "estimate," "continue," "anticipates," "intends," "expects" and similar expressions, constitute "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995.

Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, events or developments to be materially different from any future results, events or developments expressed or implied by such forward-looking statements. Such factors include, without limitation, changing market conditions, our ability to obtain patent protection and protect our intellectual property rights, commercialization limitations imposed by intellectual property rights owned or controlled by third parties, intellectual property liability rights and liability claims asserted against us, the successful and timely completion of clinical studies, the impact of competitive products and pricing, new product development, uncertainties related to the regulatory approval process, product development delays, our ability to attract and retain business partners and key personnel, future levels of government funding, our ability to obtain the capital required for research, operations and marketing and other risks detailed from time-to-time in the Company's ongoing quarterly filings, annual information forms and annual reports.

ADDITIONAL INFORMATION

Additional information relating to Lorus, including Lorus' annual information form and other disclosure documents, is available on SEDAR at www.sedar.com.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements and all information in this annual report have been prepared by management and have been approved by the Board of Directors of the Company.

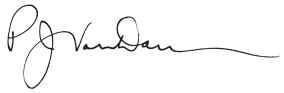
The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include amounts that are based on the best estimates and judgments of management. Financial information presented in accordance with Canadian generally accepted accounting principles elsewhere in the annual report is consistent with that in the financial statements.

In discharging its responsibility for the integrity and fairness of the financial statements, management maintains a system of internal controls designed to provide reasonable assurance that transactions are authorized, assets are safeguarded and proper records are maintained. Management believes that the internal controls provide reasonable assurance that financial records are reliable and form a proper basis for the preparation of the consolidated financial statements, and that assets are properly accounted for and safeguarded. The internal control process includes management's communication to employees of policies that govern ethical business conduct.

The Board of Directors, through an Audit Committee, oversees management's responsibilities for financial reporting. This committee, which consists of three independent directors, reviews the audited consolidated financial statements, and recommends the financial statements to the Board for approval. Other key responsibilities of the Audit Committee include reviewing the adequacy of the Company's existing internal controls, audit process and financial reporting with management and the external auditors.

These financial statements have been audited by KPMG LLP, who are independent auditors appointed by the shareholders of the Company upon the recommendation of the Audit Committee. Their report follows. The independent auditors have free and full access to the Audit Committee with respect to their findings concerning the fairness of financial reporting and the adequacy of internal controls

Jim A. Wright, Chief Executive Officer
July 16, 2004



Paul Van Damme, Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

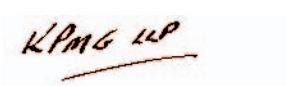
We have audited the consolidated balance sheets of Lorus Therapeutics Inc. as at May 31, 2004 and 2003 and the consolidated statements of loss and deficit and cash flows for each of the years in the three-year period ended May 31, 2004 and the related consolidated statements of loss and deficit and cash flows for the period from inception on September 5, 1986 to May 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2004 and 2003 and the results of its operations and its cash flows for each of the years in the three-year period ended May 31, 2004 and for the period from inception on September 5, 1986 to May 31, 2004 in accordance with Canadian generally accepted accounting principles.

Canadian generally accepted accounting principles vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 14 to the consolidated financial statements.

We did not audit the consolidated financial statements of Lorus Therapeutics Inc. for the period from inception on September 5, 1986 to May 31, 1994. Those consolidated financial statements were audited by other auditors who issued a report without reservation on July 8, 1994.



Chartered Accountants, Toronto, Canada
July 16, 2004, except as to note 13 which is as of October 5, 2004

As at May 31	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,071	$ 905
Short-term investments	25,657	24,219
Prepaid expenses and amounts receivable	1,697	1,104
Total current assets	28,425	26,228
Fixed assets (note 3)	1,471	1,507
Goodwill	606	606
Acquired research and development (note 4)	3,922	5,669
Deferred financing costs	–	245
	$ 34,424	$ 34,255
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 2,429	$ 1,318
Accrued liabilities	3,396	4,042
Total current liabilities	5,825	5,360
Shareholders' equity		
Share capital (note 5)		
Common shares		
Authorized: unlimited number of shares;		
Issued and outstanding (000's):		
May 31, 2004 – 171,794		
May 31, 2003 – 145,285	144,673	120,441
Warrants	4,325	–
Compensation options (note 5(d))	1,405	–
Deferred stock-based compensation	–	(43)
Deficit accumulated during development stage	(121,804)	(91,503)
Total shareholders' equity	28,599	28,895
	$ 34,424	$ 34,255

Commitments and Guarantees (note 9)
Subsequent event (note 13)
Canada and United States accounting policy differences (note 14)
See accompanying notes to consolidated financial statements

On behalf of the Board:

Director Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

(amounts in 000's except for per common share data) (Canadian dollars)

	Years Ended May 31			Period from inception Sept. 5, 1986 to
	2004	2003	2002	May 31, 2004
Revenue (note 12)	$ 608	$ 66	$ –	$ 674
Operating expenses				
Cost of sales	28	55	–	83
Research and development (note 7)	26,785	12,550	8,659	85,844
General and administrative	4,915	4,290	4,867	37,793
Depreciation and amortization	420	960	1,956	8,781
Operating expenses	32,148	17,855	15,482	132,501
Interest and other income	(1,239)	(1,155)	(1,995)	(10,023)
Loss for the period	30,301	16,634	13,487	121,804
Deficit, beginning of period	91,503	74,869	61,382	–
Deficit, end of period	$ 121,804	$ 91,503	$ 74,869	$ 121,804
Basic and diluted loss per common share (note 2)	$ 0.18	$ 0.12	$ 0.09	
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share	171,628	144,590	143,480	

See accompanying notes to consolidated financial statements

(amounts in 000's) (Canadian dollars)

	Years Ended May 31			Period from inception Sept. 5, 1986 to
	2004	2003	2002	May 31, 2004
OPERATING ACTIVITIES				
Loss for the period	$ (30,301)	$ (16,634)	$ (13,487)	$(121,804)
Add items not requiring a current outlay of cash:				
Depreciation and amortization	2,166	2,033	3,407	16,127
Stock-based compensation	(43)	674	296	1,293
Other	245	–	–	745
Net change in non-cash working capital balances related to operations (note 8)	(129)	2,019	(2,124)	3,220
Cash used in operating activities	(28,062)	(11,908)	(11,908)	(100,419)
INVESTING ACTIVITIES				
Sale (purchase) of short-term investments, net	(1,438)	12,438	9,378	(25,657)
Acquisition, net of cash received	–	–	–	(539)
Acquired research and development	–	–	–	(715)
Additions to fixed assets	(383)	(1,260)	(477)	(5,375)
Cash proceeds on sale of fixed assets	–	–	–	348
Cash provided by (used in) investing activities	(1,821)	11,178	8,901	(31,938)
FINANCING ACTIVITIES				
Issuance of warrants	4,537	–	–	36,414
Issuance of common shares	25,512	715	1,389	97,259
Additions to deferred financing costs	–	(245)	–	(245)
Cash provided by financing activities	30,049	470	1,389	133,428
Increase (decrease) in cash and cash equivalents during the period	166	(260)	(1,618)	1,071
Cash and cash equivalents, beginning of period	905	1,165	2,783	–
Cash and cash equivalents, end of period	$ 1,071	$ 905	$ 1,165	$ 1,071

See accompanying notes to consolidated financial statements

1. DESCRIPTION OF BUSINESS

Lorus Therapeutics Inc. ("Lorus" or "the Company") is a biopharmaceutical company specializing in the research, development and commercialization of pharmaceutical products and technologies for the management of cancer. With products in all stages of evaluation, from pre-clinical through to Phase III trials, Lorus develops therapeutics that seek to manage cancer with efficacious low-toxicity compounds that improve patients' quality of life.

The Company has not earned substantial revenues from its drug candidates and is therefore considered to be in the development stage.

The continuation of the Company's research and development activities and the commercialization of the targeted therapeutic products is dependent upon the Company's ability to successfully complete its research and development programs and finance its cash requirements through a combination of equity financing and payments from strategic partners. The Company's current level of cash and short-term investments and the additional funds available under a convertible debenture entered into on October 1, 2004 (note 13) is sufficient to execute the Company's current planned expenditures for the next twelve months.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of Lorus, its 80% owned subsidiary NuChem Pharmaceuticals Inc. ("NuChem"), and its wholly-owned subsidiary GeneSense Technologies Inc. ("GeneSense"). The results of operations for acquisitions are included in these consolidated financial statements from the date of acquisition. All significant intercompany balances and transactions have been eliminated on consolidation.

The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and comply in all material respects with accounting principles generally accepted in the United States, except as disclosed in note 14 "Canada and United States Accounting Policy Differences."

Revenue Recognition

Revenue includes product sales revenue, license revenue and royalty revenue.

The Company recognizes revenue from product sales when title has passed and collection is reasonably assured, which typically is upon delivery to the distributor.

License fees are comprised of initial fees and milestone payments derived from a worldwide exclusive license agreement. Non-refundable license fees are recognized when the Company has no further involvement or obligation to perform under the arrangement, the fee is fixed and determinable and collection of the amount is deemed probable. Future non-refundable milestone payments receivable upon the achievement of third party performance are recognized upon the achievement of specified milestones when the milestone payment is substantive in nature, the achievement of the milestone was not reasonably assured at the inception of the agreement and the Company has no further significant involvement or obligation to perform under the arrangement.

The Company earns royalties from its distributor. Royalties from the distribution agreement are recognized when the amounts are reasonably determinable and collection is reasonably assured.

Cash Equivalents and Short-Term Investments

Lorus invests in high quality fixed income government (2004 – $3,811,000, 2003 – $4,214,000) and corporate (2004 – $21,846,000, 2003 – $20,005,000) instruments with low credit risk. Cash equivalents consist of highly liquid investments with a maturity of three months or less at the time of purchase.

Short-term investments, which consist of fixed income securities with a maturity of three months or more, are recorded at their accreted value as they are held to maturity instruments.

Inventory

The Company purchases drugs for resale and for research and clinical development. Drugs purchased for use in research and clinical development are expensed as purchased. Drugs purchased for resale are recorded as inventory and valued at the lower of cost and net realizable value.

Fixed Assets

Fixed assets are recorded at cost less accumulated depreciation and amortization. The Company records depreciation and amortization at rates which are expected to charge operations with the cost of the assets over their estimated useful lives as follows:

Furniture and equipment	straight-line over three to five years
Leasehold improvements	straight-line over the lease term

Research and Development

Research costs are charged to expense as incurred. Development costs, including the cost of drugs for use in clinical trials, are expensed as incurred unless they meet the criteria under generally accepted accounting principles for deferral and amortization. No development costs have been deferred to date.

Goodwill and Intangible Assets

Goodwill is not amortized but tested for impairment at least annually. Intangible assets with finite lives acquired in a business combination or other transaction are amortized over their estimated useful lives which have been assessed as seven years.

Goodwill represents the excess of the purchase price over the fair value of net identifiable assets acquired in the GeneSense business combination. Goodwill acquired in a business combination is tested for impairment on an annual basis and at any other time if an event occurs or circumstances change that would indicate that an impairment may exist. When the carrying value of a reporting unit's goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to the excess.

The Company capitalized the cost of acquired research and development assets, comprised of patents and licences, on the acquisitions of GeneSense and the NuChem compounds. The nature of this asset is such that it is categorized as an intangible asset with a finite life. The carrying value of acquired research and development assets does not necessarily reflect its present or future value. The amount recoverable is dependent upon the continued advancement of the drugs through research, clinical trials and ultimately to commercialization. It is not possible to predict the outcome of future research and development programs.

No impairment relating to goodwill and intangible assets has been identified by the Company for 2004 and 2003.

Impairment of Long-Lived Assets

Effective June 1, 2003, the Company adopted the new standard in CICA Handbook Section 3063, "Impairment or Disposal of Long-Lived Assets." Under the new standard the Company performs an impairment assessment of long-lived assets held for use whenever events or changes in circumstances indicated that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount, it is considered to be impaired. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value, which is estimated as the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset. Prior to June 1, 2003 the Company periodically assessed and measured impairment by comparing the carrying amount to the undiscounted future cash flows the long-lived assets were expected to generate.

Stock-Based Compensation

Stock options granted to employees are accounted for using the intrinsic value method. Under the intrinsic value method, compensation cost is recorded if, on the measurement date of the grant, the fair value of an underlying common share exceeds the exercise price per share. For options with contingent vesting criteria, the option is treated as a variable award and is revalued, using the intrinsic value method of accounting, at the end of each reporting period until the final measurement date. Deferred stock-based compensation is recognized as an expense over the vesting period of the option.

Options issued to consultants and other non-employees are accounted for using the fair value method and are recognized as an expense over the period which the services are performed or options earned using the Black-Scholes option pricing model.

The Company also has a deferred share unit plan that provides directors the alternative to receive payment for their current services in the form of share units rather than common shares or cash. Share units entitle the holder to receive, in the future, either an equivalent number of common shares or the cash equivalent of the shares at the date the units are exercised. As the award entitles the holder to settle the award through the receipt of cash, the value of the share units are recorded as a liability and the share units are revalued each reporting date with any increase or decrease in value being recorded in the consolidated statements of loss.

Investment Tax Credits

The Company is entitled to Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible research and development expenditures incurred in each taxation year. Investment tax credits are accounted for as a reduction of the related expenditure for items of a current nature and a reduction of the related asset cost for items of a long-term nature, provided that the Company has reasonable assurance that the tax credits will be realized.

Income Taxes

Income taxes are reported using the asset and liability method. Under this method future tax assets and liabilities are recorded for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of assets and liabilities and their respective tax bases, and operating loss and research and development expenditure carry forwards. Future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply when the asset is realized or the liability is settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. A valuation allowance is recorded for the portion of the future tax assets where the realization of any value is uncertain.

Loss Per Share

Basic net loss per common share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted net loss per common share is calculated by dividing the net loss by the sum of the weighted average number of common shares outstanding and the dilutive common equivalent shares outstanding during the year. Common equivalent shares consist of the shares issuable upon exercise of stock options and warrants calculated using the treasury stock method. Common equivalent shares are not included in the calculation of the weighted average number of shares outstanding for diluted net loss per common share when the effect would be anti-dilutive.

Segmented Information

The Company is organized and operates as one operating segment, the research and development of cancer therapies. Substantially all of the Company's identifiable assets as at May 31, 2004 and 2003 are located in Canada.

Foreign Currency Translation

Foreign currency transactions are translated into Canadian dollars at rates prevailing on the transaction dates. Monetary assets and liabilities are translated into Canadian dollars at the rates on the balance sheet dates. Gains or losses resulting from these transactions are accounted for in the loss for the period and are not significant.

Use of Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the years. Actual results could differ from those estimates.

Recent Canadian Accounting Pronouncements

In September 2003, the Canadian Institute of Chartered Accountants ["CICA"] revised Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments" to require that, effective June 1, 2004, the fair value method of accounting for stock options be recognized in the consolidated financial statements. The Company intends to apply these provisions retroactively without restatement for the year commencing June 1, 2004. The cumulative compensation cost of options on common shares of the Company, using the Black-Scholes option pricing model, will be charged to deficit with a corresponding increase to contributed surplus at June 1, 2004.

In November 2003, the CICA issued Accounting Guideline AcG-15, "Consolidation of Variable Interest Entities", to provide guidance for applying the principles in Handbook Section 1590, "Subsidiaries", to certain entities. Although the CICA is contemplating amendments to the Guideline, it is effective for the fiscal years beginning on or after November 1, 2004. Although the Company is currently reviewing AcG-15, the impact of the Guideline, if any, on the Company's consolidated financial statements has not been determined.

In March 2003, the CICA issued Handbook Section 3110, "Asset Retirement Obligations", which establishes standards for the recognition, measurement and disclosure of asset retirement obligations and the related asset retirement costs. This new Section is effective for June 1, 2004 for the Company and harmonizes Canadian requirements with existing United States GAAP. There will be no material impact on the consolidated financial statements resulting from the adoption of Section 3110 either in the current or prior years presented.

3. FIXED ASSETS

As at May 31 (amounts in 000's)	2004	2003
Furniture and equipment	$ 1,977	$ 1,603
Leasehold improvements	907	898
	2,884	2,501
Accumulated depreciation and amortization	(1,413)	(994)
	$ 1,471	$ 1,507

4. ACQUIRED RESEARCH AND DEVELOPMENT

As at May 31 (amounts in 000's)	2004	2003
Cost	$ 12,228	$ 12,228
Accumulated amortization	(8,306)	(6,559)
	$ 3,922	$ 5,669

5. SHARE CAPITAL

(a) Continuity of common shares and warrants

(amounts and units in 000's)		Common Shares		Warrants	
		Number	Amount	Number	Amount
Balance at May 31, 2001		142,411	$ 117,150	1,242	$ 729
Exercise of compensation warrants	(b)	476	265	(476)	(70)
Expiry of compensation warrants		–	659	(766)	(659)
Exercise of stock options	(e)	1,525	1,194	–	–
Stock-based compensation	(f)	–	(100)	–	–
Balance at May 31, 2002		144,412	119,168	–	–
Exercise of stock options	(e)	873	715	–	–
Stock-based compensation	(f)	–	558	–	–
Balance at May 31, 2003		145,285	$ 120,441	–	$ –
Share issuance	(d)	26,220	24,121	13,110	4,325
Exercise of stock options	(e)	289	171	–	–
Stock-based compensation	(f)	–	(88)	–	–
Other		–	28	–	–
Balance at May 31, 2004		171,794	$ 144,673	13,110	$ 4,325

(b) October 1999 Private Placement of Special Warrants

In connection with the October 27, 1999 special warrants offering the Company issued 2,824,849 compensation warrants (stated capital $0.147 per warrant) for services in connection with the completion of the offering. Each compensation warrant entitles the holder to acquire one common share for $0.41 at any time prior to October 27, 2001. During fiscal year 2002, 475,700 compensation warrants were exercised.

(c) Alternate Compensation Plans

In 2000, the Company established a compensation plan for directors and officers, which allows the Company, in certain circumstances, to issue common shares to pay directors' fees or performance bonuses of officers in lieu of cash. The number of common shares reserved for issuance under this plan is 2,500,000. Since inception, 71,000 shares have been issued under this plan.

The Company also established a deferred share unit plan that provides directors the option of receiving payment for their services in the form of share units rather than common shares or cash. Share units entitle the director to elect to receive, on termination of their services to the Company, an equivalent number of common shares, or the cash equivalent of the market value of the common shares at that future date. The share units are granted based on the market value of the common shares on the date of issue. As of May 31, 2004, 68,183 deferred share units have been issued (2003 – 45,964, 2002 – 83,057), with a cash value of $57,000 (2003 – $58,000, 2002 – $62,000) being recorded in accrued liabilities.

(d) Share Issuance

On June 11, 2003, the Company raised gross proceeds of $32,775,000 by way of a public offering of 26,220,000 units at a price of $1.25 per unit. Each unit consists of one common share and one-half of one purchase warrant. Each whole warrant entitles the holder to purchase a common share at a price of $1.75 at any time on or before December 10, 2004. In addition, the Company issued 1,835,400 compensation options with a fair value of $1,468,000 for services in connection with the completion of the offering. Each compensation option entitles the holder to acquire one unit for $1.27 at any time on or before December 10, 2004. The Company incurred expenses of $4,392,000 for the issuance, which include the non-cash charge of $1,468,000 being the fair value of the compensation option. The Company allocated $4,325,000 of the net proceeds to the warrants, $1,405,000 to the compensation option and $24,121,000 to share capital.

(e) Stock Option Plan

Under the Company's stock option plan, options may be granted to directors, officers, employees and consultants of the Company to purchase up to 20,582,081 common shares. Options are granted at the fair market value of the common shares on the date of grant. Options vest at various rates and have a term of five years to ten years. Stock option transactions for the three years ended May 31, 2004 are summarized as follows:

	2004		2003		2002	
	Options (000's)	Weighted-average exercise price	Options (000's)	Weighted-average exercise price	Options (000's)	Weighted-average exercise price
Outstanding at beginning of year	5,378	$ 1.05	5,425	$ 1.17	4,144	$ 1.19
Granted	2,629	$ 1.16	2,613	$ 0.72	3,188	$ 0.98
Exercised	(289)	$ 0.59	(873)	$ 0.83	(1,525)	$ 0.78
Forfeited	(1,346)	$ 1.29	(1,787)	$ 1.01	(382)	$ 1.39
Outstanding at end of year	6,372	$ 1.05	5,378	$ 1.05	5,425	$ 1.17
Exercisable at end of year	3,542	$ 1.01	2,921	$ 1.26	2,183	$ 1.32

The following table summarizes information about stock options outstanding at May 31, 2004:

	Options outstanding			Options exercisable	
Range of Exercise prices	Options outstanding (000's)	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Options exercisable (000's)	Weighted-average exercise price
$0.33 to $0.49	552	1.01	$ 0.39	552	$ 0.39
$0.50 to $0.99	2,767	2.79	$ 0.80	2,085	$ 0.79
$1.00 to $1.99	2,588	5.04	$ 1.21	440	$ 1.37
$2.00 to $3.63	465	1.44	$ 2.41	465	$ 2.41
	6,372	3.45	$ 1.05	3,542	$ 1.00

(f) Deferred Stock-based Compensation

The Company issues performance based options to employees which give rise to stock option expense based on the intrinsic value of the option on the date the performance is met. The Company also issues options to non-employees for services which are fair valued and expensed over the performance period.

The Company recorded a deferred stock-based compensation recovery relating to options issued under the Company's stock option plan amounting to $88,000 for the year ended May 31, 2004 (2003 – charge $558,000 and 2002 – recovery $100,000). Amortization of deferred stock-based compensation was a recovery of $43,000 for the year ended May 31, 2004 (2003 – charge of $674,000 and 2002 – charge of $296,000).

(g) Pro forma disclosure for Employee Stock Based Compensation

The Company accounts for its stock options granted to employees using the intrinsic value method. CICA Section 3870 requires companies not using the fair value method to disclose pro forma net earnings and earnings per share information as if the company had accounted for employee stock options under the fair value method. The Company has elected to disclose pro forma net loss and pro forma net loss per share as if the Company had accounted for its options since 1995 under the fair value method.

A summary of the pro forma impact on the statement of loss is presented in the table below.

(amounts in 000's)	2004	2003	2002
Loss for the year	$ 30,301	$ 16,634	$ 13,487
Compensation expenses related to the fair value of stock options	1,580	1,929	1,574
Employee stock-based compensation expense as recorded	43	(511)	(296)
Pro forma loss for the period	$ 31,924	$ 18,052	$ 14,765
Pro forma basic and diluted loss per common share	$ 0.19	$ 0.12	$ 0.10

The fair value of each option granted or modified has been estimated at the date of grant or modification using the Black-Scholes option pricing model with the following assumptions used for options granted in the years ended May 31, 2004, 2003 and 2002: (i) dividend yield of 0%; (ii) expected volatility of 89% (2003 – 110%, 2002 – 80%) (iii) risk free interest rates ranging from 2.25% to 3.05% (2003 – 3.2-3.5%, 2002 – 3.6%) and (iv) expected lives of 5 years. The Company has assumed no forfeiture rate as adjustments for actual forfeitures are made in the year they occur. The weighted–average grant date fair values of options issued in the years ended May 31, 2004, 2003 and 2002 were $0.74, $0.75 and $0.71 respectively.

6. INCOME TAXES

Income tax recoveries attributable to losses from operations differ from the amounts computed by applying the combined Canadian federal and provincial income tax rates to pretax income from operations primarily as a result of the provision of a valuation allowance on net future income tax benefits.

Significant components of the Company's future tax assets are as follows:

As at May 31 (amounts in 000's)	2004	2003
Non-capital loss carryforwards	$ 19,746	$ 9,824
Research and development expenditures	17,613	12,905
Book over tax depreciation	1,307	1,576
Other	1,345	492
Future tax assets	40,011	24,797
Valuation allowance	40,011	24,797
	$ –	$ –

In assessing the realizable benefit from future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income, uncertainties related to the industry in which the Company operates, and tax planning strategies in making this assessment. Due to the Company's stage of development and operations, and uncertainties related to the industry in which the Company operates, the tax benefit of the above amounts has been completely offset by a valuation allowance.

Research and development expenditures can be carried forward indefinitely. To the extent that the non-capital loss carryforwards are not used, they expire as follows:

Year of expiry (amounts in 000's)	Non-capital losses
2005	$ 2,159
2006	3,468
2007	4,626
2008	4,985
2009	6,525
2010	8,248
2011	1,028
2012	–
2013	–
2014	22,206
	$ 53,245

7. RESEARCH AND DEVELOPMENT PROGRAMS

The Company's cancer drug research and development programs focus primarily on the following technology platforms:

(a) Immunotherapy

This clinical approach stimulates the body's natural defenses against cancer. The Company's lead drug Virulizin® is currently in a Phase III clinical trial for the treatment of pancreatic cancer and has been sold in the private market in Mexico for malignant melanoma.

(b) Antisense

Antisense drugs are genetic molecules that inhibit the production of disease-causing proteins. GTI-2040 and GTI-2501, the Company's lead antisense drugs, have shown pre-clinical anti-cancer activity across a broad range of cancers and are currently in a total of seven different Phase II clinical trials.

(c) Small Molecules

Anti-cancer activity was discovered with an anti-fungal agent Clotrimazole ("CLT"). Based on the structural feature found to be responsible for the anti-cancer effect of CLT, chemical analogues of CLT have been designed and tested. Our library of clotrimazole analogs has been licensed to Cyclacel Limited as described in note 12.

Lorus scientists discovered novel low molecular weight compounds with anti-cancer and anti-bacterial activity in pre-clinical investigations. Of particular interest were compounds that inhibit the growth of human tumor cell lines including hepatocellular carcinoma, pancreatic carcinoma, ovarian carcinoma, breast adenocarcinoma and metastatic melanoma. These compounds also demonstrated activity against multi-drug resistant bacteria which are responsible for a number of life-threatening infections.

In addition to the above Lorus has a number of other technologies under pre-clinical development including a tumor suppressor or gene therapy approach to inhibiting the growth of tumors.

(amounts in 000's)	Years ended May 31			Period from inception Sept. 5, 1986 to
Research and Development	**2004**	2003	2002	May 31, 2004
Immunotherapy				
Expensed	$ 19,944	$ 7,433	$ 4,612	$ 56,865
Acquired	–	–	–	–
Antisense				
Expensed	6,666	4,911	3,410	24,875
Acquired	–	–	–	11,000
Small Molecules				
Expensed	175	206	637	4,104
Acquired	–	–	–	1,228
Total expensed	$ 26,785	$ 12,550	$ 8,659	$ 85,844
Total acquired	$ –	$ –	$ –	$ 12,228

8. SUPPLEMENTARY CASH FLOW INFORMATION

Changes in non-cash working capital balances for each of the periods ended are summarized as follows:

(amounts in 000's)	Years ended May 31			Period from inception Sept. 5, 1986 to
	2004	2003	2002	May 31, 2004
(Increase) decrease				
Prepaid expenses and amounts receivable	$ (593)	$ 91	$ 309	$ (1,120)
Increase (decrease)				
Accounts payable	1,111	876	(2,686)	1,185
Accrued liabilities	(647)	1,052	253	3,155
	$ (129)	$ 2,019	$ (2,124)	$ 3,220

During the year ended May 31, 2004, the Company received interest of $1,151,000 (2003 – $1,679,000 and 2002 – $2,488,000).

9. COMMITMENTS AND GUARANTEES

(a) Operating lease commitments

The Company has entered into operating leases for premises and office equipment under which it is obligated to make minimum annual payments of approximately $110,000 in 2005.

During the year ended May 31, 2004, operating lease expenses were $141,000 (2003 – $122,000 and 2002 – $118,000).

(b) Other contractual commitments

In December 1997, the Company acquired certain patent rights and a sub-license to develop and commercialize the anti-cancer application of certain compounds in exchange for:

(i) A 20% share interest in NuChem;

(ii) A payment of US$350,000 in shares of Lorus, and

(iii) Up to US$3,500,000 in cash.

To date the Company has made cash payments of US$500,000. The remaining balance of up to US$3,000,000 remains payable upon the achievement of certain milestones based on the commencement and completion of clinical trials. Additional amounts paid will be classified as acquired research and development and will be amortized over the estimated useful life of the licensed asset.

The Company holds an exclusive world-wide license from the University of Manitoba (the "University") and Cancer Care Manitoba ("CCM") to certain patent rights to develop and sub-license certain oligonucleotide technologies. In consideration for the exclusive license of the patent rights, the University and CCM are entitled to an aggregate of 1.67% of the net sales received by the Company from the sale of products or processes derived from the patent rights and 1.67% of all monies received by the Company from sub-licenses of the patent rights. Any and all improvements to any of the patent rights derived in whole or in part by the Company after the date of the license agreement, being June 20, 1997, are not included within the scope of the agreement and do not trigger any payment of royalties. To date the Company has not paid any royalties pursuant to the license agreement.

(c) Guarantees

The Company entered into various contracts whereby contractors perform certain services for the Company. The Company indemnifies the contractors against costs, charges and expenses in respect of legal actions or proceedings against the contractors in their capacity of servicing the Company. The maximum amounts payable from these guarantees cannot be reasonably estimated. Historically, the Company has not made significant payments related to these guarantees.

The Company contracts with Clinical Research Organizations to facilitate some of our clinical trials. These contracts may be terminated upon sixty days written notice.

10. RELATED PARTY TRANSACTIONS

During the year ended May 31, 2004, consulting fees of nil were paid to a company which is controlled by a director of the Company (2003 – $48,874 and 2002 – $68,000). These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties.

The amount payable to related parties as at May 31, 2004 was nil (2003 – nil and 2002 – $46,000).

11. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, short-term investments, amounts receivable, accounts payable and accrued liabilities approximate their fair values due to the short-term nature of these instruments.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Financial instruments potentially exposing the Company to a concentration of credit risk consist principally of cash equivalents and short-term investments. The Company mitigates this risk by investing in high grade fixed income securities.

12 REVENUE

During the year, the Company recorded license revenue of $546,000 (2003 – nil, 2002 – nil) in connection with a world-wide exclusive license agreement entered into with Cyclacel Limited in the United Kingdom for the out-licensing of

the Company's library of clotrimazole analogs. Additional license fees of up to $11.6 million may be earned if Cyclacel achieves certain defined research and development milestones. Under the agreement the Company will also receive royalties on the sale of any products.

Revenue also includes product and royalty revenue from the sale of Virulizin® to Mayne Pharma, the Company's distribution partner for the Mexico market.

13 SUBSEQUENT EVENT

On October 5, 2004, subsequent to the 2004 fiscal year-end, we entered into an agreement to raise aggregate net proceeds of $14.4 million through the issuance of $15 million of secured convertible debentures. The debentures are secured by a first charge over all of the assets of the Company. We received $4.4 million on October 5, 2004, and will receive $5.0 million on January 15, 2005 and on April 15, 2005. The debentures will expire on October 1, 2009 and interest will accrue and be paid monthly at a rate of prime + 1% until the Company's share price reaches $1.75 for 60 consecutive trading days, at which time interest will no longer accrue. Interest is to be payable in common shares of Lorus until such shares trade at a price of $1.00 or more after which interest will be payable in cash or common shares at the option of the debenture holder. Common shares issued in payment of interest will be issued at a price equal to the weighted average trading price of such shares for the ten trading days immediately preceding their issue in respect of each interest payment. The $5.0 million principal amount of debentures issued on October 5, 2004 is convertible at the holder's option into common shares of the Company with an exercise price per share of $1.00. The $10.0 million principal amount of debentures issued thereafter is convertible at an exercise price per share equal to the greater of $1.00 and the weighted average trading price of our common shares for the twenty trading days prior to the investment of the funds, less any discount permitted by the Toronto Stock Exchange. The agreement also provides for the issuance of up to 4 million warrants, with a life of five years, to buy common shares at a price per share of $1.00.

14 CANADA AND UNITED STATES ACCOUNTING POLICY DIFFERENCES

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles as applied in Canada ("Canadian GAAP"). In certain respects, generally accepted accounting principles as applied in the United States ("United States GAAP") differ from those applied in Canada. There are no material measurement differences between Canadian GAAP and United States GAAP that apply to the consolidated financial statements.

(a) SFAS 130 Reporting Comprehensive Income

SFAS No. 130 establishes standards for reporting and presentation of comprehensive income. This standard defines comprehensive income as the changes in equity of an enterprise except those resulting from shareholder transactions. Comprehensive loss for the periods presented in these consolidated financial statements equaled the loss for the period.

(b) Recent United States Accounting Pronouncements

United States GAAP, Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ["FAS 143"], was adopted by the Company effective June 1, 2003. The standard requires the Company to estimate and accrue for the present value of its obligations to restore leased premises at the end of the lease. At lease inception, the present value of this obligation would be recognized as other long-term liabilities with a corresponding amount recognized in fixed assets. The fixed asset amount would be amortized, and the liability amount would be accreted, over the period from lease inception to the time the Company expects to vacate the premises resulting in both depreciation and interest charges in the consolidated statements of income. There is no material impact on the consolidated financial statements resulting from the adoption of FAS 143 either in the current or prior years presented.

In December 2003, the Financial Accounting Standards Board ["FASB"] amended Interpretation No. 46, "Consolidation of Variable Interest Entities" ["FIN 46R"]. FIN 46R requires that a variable interest entity ["VIE"] be consolidated by a company if that company is subject to a majority of the risk of loss from the VIE's activities and/or is entitled to receive a majority of the VIE's residual returns. For the Company, the requirements of FIN 46R apply in 2003 for all VIE's created after January 31, 2003. For VIE's created before January 31, 2003, the requirements of FIN 46 apply as of May 31, 2005 for a VIE that does not meet the definition of a special-purpose entity ["SPE"] and as of June 1, 2004 for a VIE that is an SPE. The application of this Interpretation will not have an effect on the Company's financial statements.

DIRECTORS AND OFFICERS

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President and
Chief Executive Officer

Aiping Young, M.D., Ph.D.
Chief Operating Officer

Paul Van Damme
Chief Financial Officer

Bruce Rowlands
Senior Vice President, Planning and Public Affairs

Shane Ellis
Vice President, Legal Affairs and Corporate Secretary

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Lorus Therapeutics Inc.,
Toronto, ON

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Sunnybrook and Women's College Health Sciences Centre,
Toronto, Ontario

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Director General,
National Cancer Institute,
Mexico City, Mexico

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Co-Director,
Investigational New Drug Program,
National Cancer Institute of Canada,
Kingston, Ontario

Dr. Bishnu Sanwal, Ph.D., DSC, FRSC
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Department of Biochemistry,
University of Western Ontario,
London, Ontario

Dr. George R. Stark, Ph.D., FRS
Distinguished Scientist,
Lerner Research Institute,
The Cleveland Clinic Foundation,
Cleveland, Ohio

Dr. L. Siminovitch, Ph.D., DSC, CC, FRS, FRSC
Chairman,
Lorus Therapeutics Inc.'s MSAB
Director Emeritus, Samuel Lunenfeld Research Institute,
Toronto, Ontario

CORPORATE INFORMATION

Corporate Counsel
Torys, Toronto and New York
Marusyk Miller & Swain, Ottawa

AUDITORS

KPMG LLP
Yonge Corporate Centre
4100 Yonge Street, Suite 200,
North York, Ontario M2P 2H3

TRANSFER AGENT AND REGISTRAR

Inquiries regarding transfer requirements, lost certificates and changes of address should be directed to the transfer agent.

Computershare Trust Company of Canada
100 University Avenue, 11th Floor,
Toronto, Ontario M5J 2Y1
Tel: 416 981 9500

INQUIRIES, ANNUAL AND QUARTERLY REPORTS

Shareholders and prospective shareholders are invited to call or e-mail us with questions or requests for additional information.
Tel: 416 798 1200
Fax: 416 798 2200
e-mail: ir@lorusthera.com
website: www.lorusthera.com

ANNUAL MEETING

The 2004 Annual Meeting of Shareholders will be held on Thursday November 18, 2004 at 4 p.m. at:

TSX Conference Centre
The Exchange Tower
130 King Street West,
Toronto, Ontario M5X 1J2

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lorus therapeutics inc.
2 Meridian Road, Toronto, Ontario, Canada M9W 4Z7
T 416 798 1200 **F** 416 798 2200
www.lorusthera.com