deliver > < promise

Mission for Life

Enhancing the quality of life of cancer patients through the development of efficacious and well-tolerated drugs stands behind every activity undertaken at Lorus. Our commitment to our shareholders is a lifelong commitment, one that ensures we deliver products with the potential to be used alone or in combination chemotherapy to manage cancer. Our capable and experienced team of professionals remains focused on this mission.

the right track >

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committed to quality for life > < promise

mission

> Lorus Therapeutics Inc. is a biopharmaceutical company specializing in the development and commercialization of pharmaceutical products and technologies for the management of cancer. Lorus carries out basic drug discovery research and clinical development, but also seeks to reduce the risks associated with the drug development process by acquiring promising new technologies from research institutions and other companies.

> The focus of Lorus is on the development of well-tolerated cancer therapy drugs. Since cancer progression is a complex process involving the accumulation of multiple genetic alterations leading to changes in many specialized cell functions, Lorus does not hold the view that a single drug will emerge as a cure for all cancers. Instead, Lorus believes that cancer will continue to be treated by many different drugs with a variety of mechanisms of action. Since Lorus takes a multi-mechanistic approach for the treatment of cancer, the Company concentrates on the discovery and the development of different classes of anticancer compounds.

> All of the drugs being developed by the research team at Lorus have one similar characteristic: they are designed with the goal of being well-tolerated by patients. For successful drug candidates, this may contribute to an improved quality of life for cancer patients, and may also make Lorus' drugs more commercially attractive as they could more easily be investigated in combination with other leading therapies without significantly adding to the current side effect profiles of existing drugs.

PLATFORM TECHNOLOGIES

The Company focuses on three therapeutic areas, and in addition has a number of promising preclinical technologies that we believe will continue to expand the product pipeline.

The lead areas of research and development include:

Immunotherapy

Lead Product	– Virulizin®
Major Accomplishment in Fiscal 2005	– Completion of pivotal Phase III clinical study of Virulizin® in combination with GEMZAR®
Pending Milestones	– Release of clinical trial results – Application for marketing approval

Antisense

Lead Products	– GTI-2040 and GTI-2501
Major Accomplishments in Fiscal 2005	– Eight Phase II clinical trials underway for a variety of cancer indications, six of which are sponsored and funded by the U.S. National Cancer Institute
Pending Milestones	– Advancement of GTI-2040 in all its clinical development programs

Anticancer Small Molecules

Lead Products	– ML-133, ML-220 and LT-253
Major Accomplishments in Fiscal 2005	– Identification of lead compounds after being included in screening program of the U.S. National Cancer Institute
Pending Milestones	– Advancement of the Company's first small molecule drug candidate into clinical study

our work > < global

Lorus Therapeutics is developing a broad and diverse portfolio of compounds in the battle against cancer. Knowing that this is a disease without a singular cause, it will be necessary to offer a number of treatment options in this battle. For our part, we have three products representing two classes of drugs currently in clinical development and plan to move the first candidate of our third class of drugs into the clinic this fiscal year.

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product pipeline > < promise

IN THE CLINIC

Immunotherapy

Major advances in cancer therapy have been made in the past two decades. One of the most significant advances has been the emergence of immunotherapy; which is a class of therapies that work against disease by attempting to produce active or passive immunity.

Our lead immunotherapy is Virulizin®. At the center of the Virulizin® mechanism of action are macrophages, which are white blood cells that play an important role in the recognition and destruction of tumor cells. Virulizin® induces macrophages to produce a variety of molecules that kill tumor cells directly, as well as indirectly through activation of Natural Killer (NK) cells.

Antisense Technology

Antisense therapy represents a powerful means to selectively decrease expression of disease-causing genes, providing the potential of reducing malignancy while avoiding adverse side effects associated with inhibition of multiple targets common with other forms of therapy.

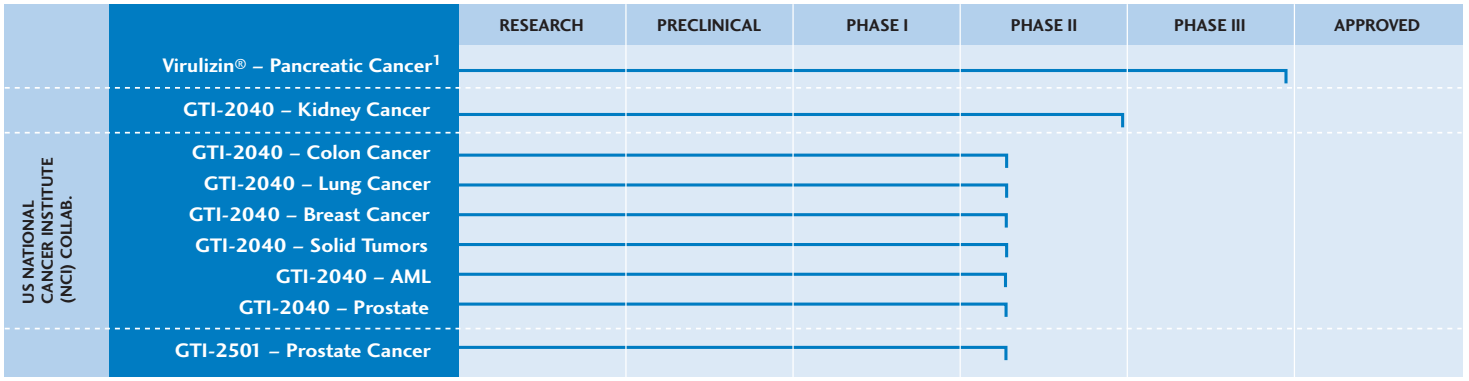
We had further evidence of the safety and clinical efficacy of our antisense drugs GTI-2040 and GTI-2501. These oligonucleotides comprise our lead clinical antisense platform, based on inhibition of expression of ribonucleotide reductase (RNR). We have shown that RNR is important in cancer malignancy and is elevated in a wide range of tumors.

PRECLINICAL

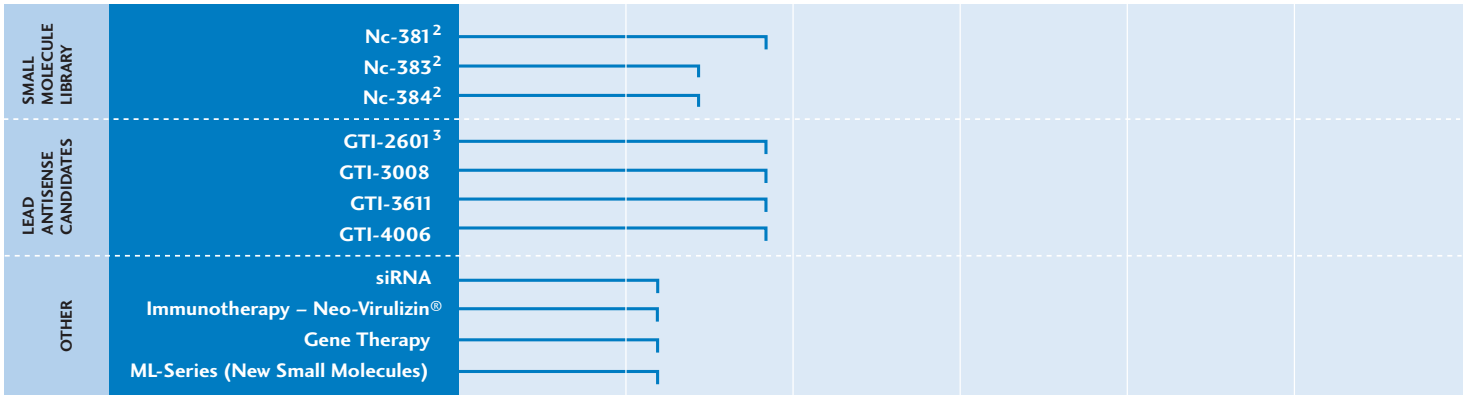
Small Molecule Program

The Company has several very interesting preclinical technologies under development with the Small Molecule Program as one of the most advanced. Currently we are focused on the development of the ML-Series of compounds, particularly ML133 and its derivatives, which appear to be an extremely potent inhibitor of cancer cell growth for a number of different cancers.

Clinical Development Pipeline



Preclinical Development Pipeline



1 Approved in Mexico for the treatment of malignant melanoma

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

3 Developing in collaboration with Sumitomo Pharmaceuticals Co. Ltd. and Koken Co. Ltd.

letter to shareholders > < promise

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Dear fellow shareholders:

We are almost there! As you know, we have been building a biopharmaceutical company with a broad and diverse portfolio of well-tolerated, efficacious, anticancer drugs. We have made steady, consistent, important progress in the development of our multiple anticancer platform technologies with a variety of clinical and preclinical studies underway, including our now complete global Phase III clinical trial with Virulizin® for the treatment of pancreatic cancer. We have developed the internal expertise to repeat our successes in the future and to mitigate the pitfalls in the challenging biotechnology industry. We have ridden the volatile stock market through its cycles of highs and lows, partially buffered by our fundamentals, but not exempt from its considerable influence.

The result of these initiatives is a Company poised for multiple successes, starting with our lead anticancer drug, Virulizin®.

Persistence, perseverance and a degree of patience have all played their part in the development of Virulizin®, but planning has been the most important factor in reaching this point. We have achieved a series of key milestones this past year in all of our programs, notably:

- the completion of the Virulizin® Phase III clinical registration trial with results anticipated by late 2005;
- BioVectra, our recently selected contract manufacturer, successfully scaled-up production of Virulizin® to commercial batches;
- the U.S. FDA approval of a "rolling submission" for our New Drug Application for Virulizin®, potentially expediting the approval process;
- the granting of Orphan Drug Status for Virulizin® by the European Medicines Agency (something we already have from the FDA), which provides for 10 years of market exclusivity and enables Lorus to seek out expedited approval processes;
- completing a Phase II trial of GTI-2040 in combination with capecitabine in patients with advanced and metastatic renal cell carcinoma;
- commencing a Phase II clinical trial in hormone refractory prostate cancer using GTI-2040, marking the sixth clinical trial study sponsored and funded by the U.S. National Cancer Institute;
- entering into a collaboration agreement with Sumitomo Pharmaceuticals Co. of Japan.

There may never be a "silver bullet" for the treatment of cancer. Rather, combating and managing the disease will require a wide range of therapies and treatments. We are contributing to this battle by developing a number of technology platforms from which we hope to be able

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to offer a range of well-tolerated therapeutic interventions. This report reviews the considerable progress we have made on advancing our broad portfolio of anticancer drug candidates. The breadth of our pipeline speaks to our commitment to become a leading global cancer company with a well diversified clinical and preclinical pipeline of novel therapies. We expect low toxicity products will be welcomed by patients, while developing a diversified portfolio represents prudent risk management for our investors.

We have also developed internal expertise in many aspects of drug development. We expanded our management team this past year to prepare the Company as we plan for commercialization. We continue to develop and expand upon our collaborative and strategic relationships with a broad cross-section of industry players: from academic institutions such as the University of Toronto, to the National Cancer Institute in the U.S., Sumitomo Pharmaceuticals of Japan, Cyclacel Ltd. of the U.K. and BioVectra in Canada. We will continue to be focused and opportunistic in our efforts to create shareholder value.

Since our merger in October 1999 with GeneSense Technologies, we have consistently moved forward on a number of fronts. We fully expect solid progress in the year ahead but likely none will equal the excitement of the results of our Phase III clinical trial for Virulizin® for the treatment of pancreatic cancer.

We own 100% of Virulizin®, our novel anticancer drug which has completed a pivotal Phase III clinical trial. We have a variety of other drug candidates in all phases of preclinical and clinical development and expect to advance at least one of our preclinical programs into the clinic in 2006. We have a strong and independent board of directors representing our shareholders and guiding the Corporation. It has been a difficult year for many within the life sciences sector, but our perseverance and planning at Lorus have put us in an enviable position for 2006 and beyond.

Our shareholders deserve special credit at this important juncture in our history. Thanks to all of you who have had the patience and the confidence to support our efforts. We look forward to great things.

Sincerely,

Dr. Jim Wright
President and Chief Executive Officer
Lorus Therapeutics

technology overview > < promise

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Lorus is developing innovative therapies with high safety profiles for the management of cancer, and is achieving this goal through a broad diversified technology base. Examples are described below.

Virulizin®

This has been an exciting year for our most advanced oncology product Virulizin®, a novel immunotherapy. One of our most significant milestones was the successful completion of our pivotal Phase III clinical study of Virulizin® in combination with GEMZAR® for the treatment of pancreatic cancer. The Phase III clinical registration study had been underway since early 2002, and enrolled 436 patients at over 100 clinical sites in North America and Europe. Last patient visit, which occurred in July 2005, will be followed by database lock later this summer. According to the study protocol requirements for follow-up, database lock and data analysis, the results of the study are anticipated for late 2005.

The Phase III clinical study compares the efficacy and safety of Virulizin® when combined with GEMZAR®, versus a placebo combined with GEMZAR® in patients with locally advanced or metastatic pancreatic cancer. The primary efficacy endpoint is overall survival, while secondary endpoints include progression of symptoms of pain, deterioration of performance status and weight loss.

We continued to receive promising news in support of regulatory approval and, ultimately, commercialization of Virulizin®. Prior to completion of the Phase III trial, we received a favorable review from the Data Safety Monitoring Board and a positive outcome of the pharmacokinetic portion of the trial. In June, the U.S. Food and Drug Administration accepted our proposal for a rolling submission for the Company's New Drug Application (NDA) for Virulizin®. That same month we announced that our contract manufacturer, BioVectra, had successfully scaled up the manufacturing process of Virulizin® to the commercial batch size of 800 liters, representing an eight-fold increase over the clinical manufacturing process. Virulizin® was also approved as an orphan medicinal product in the European Union for the treatment of pancreatic cancer.

During this past year we also made several key advances towards the understanding of the mechanism of action of Virulizin®, the findings of which we presented at international cancer conferences and published in two articles in the journal *Cancer Immunology, Immunotherapy*. At the center of the Virulizin® mechanism of action are macrophages, which are white blood cells that play an important role in the recognition and destruction of tumor cells. Virulizin® induces macrophages to produce a variety of molecules that kill tumor cells directly, as well as indirectly through activation of Natural Killer (NK) cells. We expanded on these findings at the annual meeting of the American Association for Cancer Research (AACR) in April, with in vivo data demonstrating that a link between macrophage activation and NK-cell antitumor activity was the cytokine IL-12. In May, at the American Society of Clinical Oncology (ASCO), we revealed an entirely novel aspect of Virulizin® antitumor function.

GTI-2040 and GTI-2501

This past year we had further evidence of the safety and clinical efficacy of our antisense drugs GTI-2040 and GTI-2501. These oligonucleotides comprise our lead clinical antisense platform, based on inhibition of expression of ribonucleotide reductase (RNR). We have shown that RNR is important in cancer malignancy and is elevated in a wide range of tumors. Antisense therapy represents a powerful means to selectively decrease expression of disease-causing genes, with the potential in cancer of reducing malignancy while avoiding adverse side effects associated with inhibition of multiple targets common with other forms of therapy. We continue to be encouraged by the progress of our clinical program for GTI-2040 and GTI-2501, which comprises eight Phase II trials for a variety of cancer indications.

Last November we initiated a Phase II clinical trial in hormone refractory prostate cancer using GTI-2040 in combination with docetaxel and prednisone. This is the Company's sixth clinical trial study sponsored and funded by the U.S. National Cancer Institute (NCI). Other ongoing GTI-2040 clinical trials involving different combinations with chemotherapies conducted under the NCI program include studies in non-small cell lung cancer (NSCLC), breast cancer, colorectal cancer, acute myeloid leukemia (AML), and solid tumors. In May a steering committee meeting was held with Lorus and Principal Investigators from our NCI-sponsored trials to review the ongoing program. We are pleased to report that the program is continuing as planned.

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This past April we completed a Phase II trial of GTI-2040 in combination with capecitabine in patients with advanced and metastatic renal cell carcinoma. More than half (52%) of the patients on the recommended dose exhibited disease stabilization or better, including one confirmed partial response with duration of eight months. Durable tumor reductions observed at the recommended dose included a 23 per cent reduction of tumor burden in a patient with a disease stabilization of 10 months' duration, while other disease stabilizations of four to nine months duration were also observed.

Other important milestones were achieved for GTI-2040 this year. The U.S. FDA awarded orphan drug status to GTI-2040 for the treatment of AML. In April, Lorus and clinical investigators from the University of Chicago published the results of a Phase I trial of GTI-2040 in solid tumors in the journal *Annals of Oncology*. The findings from this trial confirmed the favorable toxicity profile of GTI-2040, and provided a dose level for subsequent Phase II trials. Preliminary results of a Phase II study of GTI-2040 plus docetaxel as second-line treatment in NSCLC were presented at this year's ASCO meeting. The investigators reported that no dose limiting toxicities were observed in the first cycle of combination treatment with GTI-2040 and docetaxel, which is an established cytotoxic agent for second-line treatment of NSCLC. Early efficacy data showed disease stabilization activity in 10 of 18 patients, with some patients still on treatment in this ongoing trial. These encouraging results indicate the safe use of GTI-2040 plus docetaxel in advanced NSCLC, with early evidence of activity.

Earlier this year Lorus entered into an important partnership agreement with one of Japan's leading pharmaceutical companies, Sumitomo Pharmaceuticals Co. Ltd., and collagen manufacturer Koken Co. Ltd., to formulate one of our promising preclinical antisense oligonucleotides, GTI-2601. Unlike our lead antisense molecules, which target RNR, GTI-2601 specifically downregulates expression of thioredoxin, which is a protein that is elevated in multiple cancer types, and is widely implicated in tumor formation, metastasis, and resistance to chemotherapeutic agents. Sumitomo and Koken have developed an advanced delivery system based on collagen that, when complexed with antisense oligonucleotides, can improve antitumor efficacy compared to naked or uncomplexed oligonucleotides. This delivery technology holds much promise from efficacy, safety, manufacturing and commercial perspectives.

In addition, Lorus is developing the potential of RNA interference to control gene expression through the use of small interfering RNA (siRNA). siRNA selectively decreases mRNA and protein levels in the cell by an antisense like mechanism that differs from that of antisense gene regulation by compounds like GTI-2040, GTI-2501 and GTI-2601.

Anticancer Small Molecules: The ML-Series

Last year we announced the discovery of novel low molecular weight compounds with anticancer activity. Since then we have made progress in the development of these molecules, which we have called the ML-Series. A group of selected compounds from the ML-Series were included in the in vitro anticancer screening program of the National Cancer Institute (USA), a screening program utilizing 60 human cancer cell lines. Two of the most active compounds, ML-133 and ML-220, passed acute toxicity tests in mice, and showed significant tumor inhibition activity in vivo in xenograft models of several human cancer types. The U.S. NCI subsequently selected ML-133 for further in vivo evaluation due to its potent anticancer activity and novel chemical structure.

In this past year we presented results of studies on the efficacy and mechanism of action of ML-220 at the 9th Annual World Congress Drug Discovery Technology in Boston. We showed that ML-220 potently suppressed the growth of most cancer cell types. The mechanism of action of ML-220 involves the inhibition of kinases, which are enzymes that are often associated with abnormal cell growth and development of tumors. Targeting cancer-related kinase activity presents novel opportunities for the development of new cancer therapies designed to be less toxic than conventional chemotherapeutic drugs. Currently we are focused on the development of our lead compound ML-133, which appears to be an extremely potent inhibitor of cancer cell growth for a number of different cancers.

We believe the unique mode of action and novel structures make this group of compounds promising drug candidates for the development of novel anticancer agents with minimal or no cross resistance with existing drugs.

management's discussion and analysis >

AUGUST 11, 2005

The following discussion should be read in conjunction with the audited consolidated financial statements for the year ended May 31, 2005 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 16 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 anticancer therapies with high safety. Lorus has worked diligently to establish a diverse, marketable anticancer product pipeline, with products in various stages of development ranging from preclinical to multiple Phase II clinical trials, and a global Phase III trial which recently completed last patient visit. A growing intellectual property portfolio supports our diverse product pipeline.

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.

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 cancer 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 as appropriate. The most advanced anticancer 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 2005 totalled $22.1 million ($0.13 per share) compared to a net loss of $30.3 million ($0.18 per share) in 2004. Research and development expenses in 2005 decreased to $14.4 million from $26.8 million in 2004. The wind down of the Virulizin® Phase III clinical trial during 2004 and the procurement of drug supply for the U.S. NCI-sponsored Phase II clinical trial programs for GTI-2040 as well as GTI-2501 for our Phase I/II clinical trial in 2004 for which we continue to have sufficient supply on hand contributed to the decrease over 2004. We utilized cash of $18.7 million in our operating activities in 2005 compared with $28.1 million in 2004; the lower utilization is consistent with lower research and development activities, offset by lower revenue and interest income during the year. At the end of 2005 we had cash and cash equivalents and short-term investments of $21.5 million compared to $26.7 million at the end of 2004.

RESULTS OF OPERATIONS

Revenues

Revenues for the year decreased to $6 thousand compared with 2004 revenue of $608 thousand and $66 thousand in 2003. The decrease over 2004 results from a licensing agreement Lorus entered into during 2004 with Cyclacel Ltd. in connection with the out-licensing of our Clotrimazole analog library of anticancer drug candidates. The agreement included an initial license fee of $546 thousand received in 2004 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 and 2003 relates to product and royalty revenues from the sale of our lead drug Virulizin® to our distributor in the Mexican market,

Mayne Pharma. As of July 31, 2005, Lorus' contract with Mayne Pharma to distribute Virulizin® in Mexico was terminated as a result of Mayne Pharma ceasing operations in Mexico and Brazil. Lorus is currently investigating alternatives to continue our presence in the Mexican market. We do not anticipate product revenue in fiscal 2006 from any of our other anticancer drugs currently under development.

Research and Development

Research and development expenses totalled $14.4 million in 2005 compared to $26.8 million in 2004 and $12.6 million in 2003. The significant decrease in spending compared with 2004 is primarily the result of two factors. First, in 2004 our Phase III global clinical trial of Virulizin® for the treatment of advanced pancreatic cancer was progressing through a heavy enrollment period resulting in many up front costs, including personnel, drug manufacturing and testing, combination drug purchases and contract research organization costs. In 2005 the study and the associated costs have wound down to the point of last patient visit on July 5, 2005. Second, we incurred expenditures in 2004 related to the upfront procurement of the GTI-2040 drug for the five U.S. National Cancer Institute ("NCI") sponsored Phase II clinical trials as well as the GTI-2501 drug for our Phase I/II prostate trial. We have had, and continue to have, a sufficient drug supply on hand such that no additional costs were incurred during 2005. Research and development costs in 2004 were higher than 2003 primarily due to the reasons discussed above.

Of the total research and development expenditures incurred during the year, Virulizin® accounted for $11.9 million or 83% of the total spending. As discussed above Virulizin® recently completed a Phase III clinical trial, and we are preparing for a New Drug Application (NDA) filing, both of which have required a majority of the Company's time and resources during the year.

General and Administrative

General and administrative expenses totalled $5.3 million in 2005 compared to $4.9 million in 2004 and $4.3 million in 2003. The increase in 2005 of $400 thousand compared with 2004 is primarily due to additional administrative personnel as we gear up for commercialization. The 2004 increase 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.

Stock-Based Compensation

Effective June 1, 2004 the retroactive application of Canadian Institute of Chartered Accountants (CICA) revised Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments" (Section 3870) with respect to the recognition of stock-based compensation expense for the cumulative effects of the fair value of stock-based awards for 2003 and 2004 fiscal years resulted in a $2.8 million charge to the deficit and credit to the stock options account on June 1, 2004. Prior periods were not restated.

Stock-based compensation expense increased to $1.5 million in 2005 compared with $(43) thousand in 2004 and $674 thousand in 2003. The 2005 expense represents the amortization of the estimated fair value of stock options granted since June 1, 2002 applicable to the current service period as well as a charge of $208 thousand recorded in the second quarter of 2005 representing the increase in value attributed to the November 18, 2004 shareholder approved amendment to the stock option plan to extend the contractual life of all options outstanding from five-years to 10-years. Stock compensation expense recorded prior to June 1, 2004 represents the cost of awarding performance-based stock options to employees. These options have contingent vesting criteria, and as such they were treated as a variable award and revalued using the intrinsic method at the end of each reporting period until the final measurement date. In 2003 there was a large expense due to the significant increase in our share price during the year. The negative adjustment in 2004 was due to a general decline in our share price during the year.

Depreciation and Amortization

Depreciation and amortization expenses totalled $564 thousand in 2005 compared to $463 thousand in 2004 and $286 thousand in 2003. The increase in expense over 2004 is due to the acquisition of additional capital related to the scale up of our manufacturing process, as well as a write-down of $75 thousand taken on certain equipment whose carrying value was deemed to be unrecoverable and in excess of the estimated future undiscounted cash flows of the underlying assets. The increase in 2004 over 2003 is due to the completion of leasehold improvements for which amortization started in late 2003.

Interest Expense

We recognized non-cash interest expense of $300 thousand in 2005, representing interest at a rate of prime +1% on the $15 million convertible debentures. Interest has accrued based on the cash advanced beginning October 6, 2004 when the first tranche of $5 million was advanced through to May 31, 2005 when the entire $15 million had been advanced. The interest accrued on the debentures during the year was paid in common shares of the Company.

Accretion in Carrying Value of Secured Convertible Debentures

Accretion in the carrying value of the convertible debentures amounted to $426 thousand in 2005. This amount reflects the accretion charge from the date of issue (October 6, 2004) to the end of the year. This accretion charge arises as, under Canadian GAAP, we have allocated the proceeds from each tranche of the convertible debentures to the debt and equity instruments issued on a relative fair value basis resulting in the $15.0 million convertible debentures having an initial carrying value of $9.8 million as of their dates of issuance. Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be the face value of $15.0 million.

Amortization of Deferred Financing Charges

Amortization of deferred financing charges for 2005 increased to $84 thousand compared to nil in 2004. The deferred financing charges relate to the convertible debenture transaction and will be amortized over the five-year life of the debt commencing October 6, 2004.

Interest and Other Income

Interest income totalled $524 thousand in 2005 compared to $1.2 million in both 2004 and 2003. The decrease is due to a lower average cash and short-term investment balance in 2005. 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.

Loss for the Year

Net loss for the year decreased 27% to $22.1 million or $0.13 per share in 2005 compared to $30.3 million or $0.18 per share in 2004 and $16.6 million or $0.12 per share in 2003. The decrease in net loss over the prior year is primarily due to lower research and development costs resulting from the wind down of the Phase III Virulizin® clinical trial, as well as no GTI-2040 or GTI-2501 drug production in the current year, offset by lower interest revenue and non-cash expenses associated with stock-based compensation expense, and charges related to the convertible debentures including accretion, interest and amortization of deferred financing charges. Net loss was higher in 2004 compared with 2003 primarily due to the significant increase in clinical trial activities to support the expanded Phase III Virulizin® clinical trial, and the cost of procuring GTI-2040 and GTI-2501 drugs to support our ongoing clinical trials.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity and debt financing, the exercise of warrants and stock options, and interest income on funds held for future investment. We expect to continue to finance the remaining costs of the Virulizin® Phase III clinical trial and the GTI-2501 Phase I/II clinical trial from internal resources until their anticipated completion. The ongoing costs of the six GTI-2040 Phase II clinical trials will continue to be borne by the NCI in the United States with Lorus continuing to be responsible for any additional GTI-2040 manufacturing costs.

We have not earned substantial revenues from our drug candidates and are therefore considered to be in the development stage. The continuation of our research and development activities and the commercialization of the targeted therapeutic products are dependent upon our ability to successfully finance and complete our research and developments programs.

Our future operations are highly dependent upon the outcome of the Phase III trial of our lead product, Virulizin®. Should the trial prove successful, we will pursue regulatory approval and subsequent commercialization of Virulizin®. Lorus' commercialization efforts are dependent upon our ability to raise additional financing through a combination of equity or debt financing, or payments from strategic partners. Should our ability to raise additional financial support be delayed, we believe that our current level of cash and cash equivalents and short-term investments are sufficient to fund planned expenditures for the next twelve months.

In the event the result of the Phase III trial does not warrant efforts to commercialize Virulizin® at the present time, we will be required to re-evaluate our business operations and to reduce expenditures. Should commercialization not be pursued, we believe that our current level of cash and cash equivalents and short-term investments is sufficient to fund the planned expenditures for the next twelve months.

Operating Cash Requirements

Lorus utilized cash in operating activities of $18.7 million in 2005 compared to $28.1 million in 2004 and $11.9 million in 2003. The significant decrease in cash used in operating activities in 2005 compared with 2004 is due to lower research and development expenses, as described above, offset by lower interest income and a negative change in non-cash working capital due to a reduction in the accounts payable and accrued liabilities balances at the end of the year. The increase in cash used in operating activities in 2004 compared with 2003 was due to higher research and development activities as well as a negative change in non-cash working capital compared with a positive change in 2003.

Cash Position

At May 31, 2005, Lorus had cash and cash equivalents and short-term investments totalling $21.5 million compared to $26.7 million at the end of 2004. 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, 2005 was $18.5 million as compared to $22.6 million at May 31, 2004. The Company does not expect to generate positive cash flow from operations in the next several years due to additional research and development costs, including costs related to drug discovery, preclinical testing, clinical trials, manufacturing costs and operating expenses associated with supporting these activities, as well as the costs associated with filing an NDA with the FDA and bringing a drug to market. 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 preclinical 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 preclinical and clinical trials, the timing of regulatory submissions and approvals, the impact of any internally developed, licensed 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.

Financing

On October 6, 2004, we entered into an agreement to raise aggregate net proceeds of $13.9 million through the issuance of secured convertible debentures and warrants. The debentures are secured by a first charge over all of the assets of the Company. We received $4.4 million on October 6, 2004 (representing a $5.0 million debenture less an investor fee representing 4% of the $15.0 million to be received under the Agreement), and $5.0 million on each of January 14 and April 15, 2005. All debentures issued under this Agreement are due on October 6, 2009 and are subject to interest payable monthly at a rate of prime +1% until such time as the Company's share price reaches $1.75 for 60 consecutive trading days, at which time, interest will no longer be charged. Interest is payable in common shares of Lorus until Lorus' 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. To May 31, 2005, the Company has issued 421,000 shares in settlement of $300 thousand in interest.

The $15.0 million principal amount of debentures issued on October 6, 2004, January 14 and April 15, 2005 is convertible at the holder's option at any time into common shares of the Company with a conversion price per share of $1.00.

With the issuance of each $5.0 million debenture, the Company issued to the debt holder 1,000,000 warrants expiring October 6, 2009 to buy common shares of the Company at a price per share equal to $1.00.

In addition, in 2005 Lorus issued common shares on the exercise of stock options for proceeds of $112 thousand.

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 purchase warrant. In 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 $715 thousand.

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 million for the product development of our immunotherapy platform, $11 million for the product development of our antisense platform and $2 million for preclinical and discovery programs. It was anticipated that the balance of funding would be used for working capital and general purposes. Since the date of the prospectus, we have incurred $31.8 million in research and development expenses on our immunotherapy platform, $9.1 million on our antisense platform, and $300 thousand on preclinical 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, as well as the October 6, 2004 $15 million convertible debenture financing, 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 preclinical and discovery programs was to be incurred over a number of years, including 2004 and 2005. We have sufficient funds available at the end of 2005 to fund the remaining $1.9 million to be spent on our antisense platform and $1.7 million to be spent on preclinical and discovery programs.

CONTRACTUAL OBLIGATIONS

At May 31, 2005, 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	136	235	–	–	371
Contract Research Organizations[1]	2,160	–	–	–	2,160
Convertible Debenture[2]	–	–	15,000	–	15,000
Total	**2,296**	**235**	**15,000**	**–**	**17,531**

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

[2] The convertible debentures as described above may be converted into common shares of Lorus at a conversion price of $1.00. In the event that the holder does not convert the shares, Lorus has an obligation to repay the $15 million in cash.

OFF-BALANCE SHEET ARRANGEMENTS

As at May 31, 2005, we have not entered into any off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

In 2005, we did not enter into any transactions with related parties. In order to effectively execute our business strategy, we expect to continue outsourcing various functions to the expertise of third-parties such as contract manufacturing organizations, contract research organizations, and other research organizations. These relationships are with non-related third-parties and occur at arm's length and on normal commercial terms.

RISK FACTORS

Before making an investment decision with respect to our common shares, you should carefully consider the following Risk Factors, in addition to the other information included or incorporated by reference into this report. The risks set out below are not the only risks we face. If any of the following risks occur, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common shares could decline and you may lose all or part of the money you paid to buy our common shares.

We have a history of operating losses. We expect to incur net losses and we may never achieve or maintain profitability.

We have not been profitable since our inception in 1986. We reported net losses of $22.1 million; $30.3 million and $16.6 million for the years ended May 31, 2005, 2004 and 2003, respectively. As of May 31, 2005, we had an accumulated deficit of $146.6 million.

To date we have only generated nominal revenues from the sale of Virulizin® in Mexico. We have not generated any other revenue from product sales to date and it is possible that we will never have sufficient product sales revenue to achieve profitability. We expect to continue to incur losses for at least the next several years as we or our collaborators and licensees pursue clinical trials and research and development efforts. To become profitable, we, either alone or with our collaborators and licensees, must successfully develop, manufacture and market our current product candidates, particularly Virulizin® and

GTI-2040, as well as continue to identify, develop, manufacture and market new product candidates. It is possible that we will never have significant product sales revenue or receive significant royalties on our licensed product candidates. If funding is insufficient at any time in the future, we may not be able to develop or commercialize our products, take advantage of business opportunities or respond to competitive pressures.

Our current and anticipated operations, particularly our product development and potential commercialization programs for Virulizin®, require substantial capital. We expect that our existing cash and cash equivalents will sufficiently fund our current and planned operations through at least the next twelve months. However, our future capital needs will depend on many factors, including the extent to which we enter into collaboration agreements with respect to any of our proprietary product candidates, receive royalty and milestone payments from our possible collaborators and make progress in our internally funded research, development and commercialization activities.

Our capital requirements will also depend on the magnitude and scope of these activities, our ability to maintain existing and establish new collaborations, the terms of those collaborations, the success of our collaborators in developing and marketing products under their respective collaborations with us, the success of our contract manufacturers in producing clinical and commercial supplies of our product candidates on a timely basis and in sufficient quantities to meet our requirements, competing technological and market developments, the time and cost of obtaining regulatory approvals, the extent to which we choose to commercialize our future products through our own sales and marketing capabilities, the cost of preparing, filing, prosecuting, maintaining and enforcing patent and other rights and our success in acquiring and integrating complementary products, technologies or companies. We do not have committed external sources of funding and we cannot assure you that we will be able to obtain additional funds on acceptable terms, if at all. If adequate funds are not available, we may be required to:

- engage in equity financings that would be dilutive to current shareholders;
- delay, reduce the scope of or eliminate one or more of our development programs;
- obtain funds through arrangements with collaborators or others that may require us to relinquish rights to technologies, product candidates or products that we would otherwise seek to develop or commercialize ourselves; or license rights to technologies, product candidates or products on terms that are less favorable to us than might otherwise be available.

We expect to announce results for an ongoing Phase III clinical trial of Virulizin® in patients with pancreatic cancer in late 2005. Our share price could decline significantly if those clinical results are not favorable, are delayed or are perceived negatively.

We expect to announce the results of our Phase III clinical trial of Virulizin® in late 2005. These results may not be favorable or viewed favorably by us or third-parties, including investors, equity research analysts and potential collaborators. Share prices for biotechnology companies have declined significantly in certain instances where clinical results were not favorable, were perceived negatively or otherwise did not meet expectations. Unfavorable results or negative perceptions regarding the results of the trial could cause our share price to decline significantly.

We do not yet have all the required approvals to market our product candidates and our clinical trials may not yield results that will enable us to obtain regulatory approval.

We have not completed the development of any products and there can be no assurance that any products will be successfully developed. None of our products has received regulatory approval for commercial use and sale in North America. We cannot market a pharmaceutical product in any jurisdiction until it has completed thorough preclinical testing and clinical trials in addition to that jurisdiction's extensive regulatory approval process. In general, significant research and development and clinical studies are required to demonstrate the safety and effectiveness of our products before we can submit any regulatory applications. We may never obtain the required regulatory approvals for any of our products in North America or elsewhere in the world. Our product candidates will require additional research and development efforts prior to regulatory approval and potential commercialization in North America or other jurisdictions. However, there can be no assurance that the results of all required clinical trials will demonstrate that these product candidates are safe and effective or, even if the results of the clinical trials are considered successful by us, that the FDA will not require us to conduct additional large-scale clinical trials before it will consider approving such product candidates for commercial use. Approval or consent by the FDA or other regulatory authorities to commence a clinical trial does not indicate that the drug or treatment being studied can or will be approved. Preparing, submitting and advancing applications for regulatory approval is complex, expensive and time intensive and entails significant uncertainty. The results of our completed preclinical studies and clinical trials may not be indicative of future clinical trial results. A commitment of substantial resources to conduct time-consuming research, preclinical studies and clinical trials will be required if we are to complete development of our products. Clinical trials of our products require that we identify and enroll a large number of

patients with the illness under investigation. We may not be able to enroll a sufficient number of appropriate patients to complete our clinical trials in a timely manner particularly in smaller indications such as Acute Myeloid Leukemia and solid tumors. If we experience difficulty in enrolling a sufficient number of patients to conduct our clinical trials, we may need to delay or terminate ongoing clinical trials and will not accomplish objectives material to our success that could affect the price of our common shares. Delays in planned patient enrollment or lower than anticipated event rates in our current clinical trials or future clinical trials may result in increased costs, program delays, or both. There can be no assurance that unacceptable toxicities or adverse side effects will not occur at any time in the course of preclinical studies or human clinical trials or, if any products are successfully developed and approved for marketing, during commercial use of our products. The appearance of any such unacceptable toxicities or adverse side effects could interrupt, limit, delay or abort the development of any of our products or, if previously approved, necessitate their withdrawal from the market. Furthermore, there can be no assurance that disease resistance or other unforeseen factors will not limit the effectiveness of our potential products. We cannot guarantee that any products resulting from our programs will be successfully developed or made commercially available in the near term or at all.

We may never develop any commercial drugs or other products that generate revenues.

Our product candidates will require significant additional development, clinical trials, regulatory clearances and additional investment before they can be commercialized. Our product development efforts may not lead to commercial drugs for a number of reasons, including the failure of our product candidates to be safe and effective in clinical trials or because we have inadequate financial or other resources to pursue the programs through the clinical trial process.

Because of the uncertainty of pharmaceutical pricing, reimbursement and healthcare reform measures, we may be unable to sell our products profitably.

The availability of reimbursement by governmental and other third-party payors affects the market for any pharmaceutical product. These third-party payors continually attempt to contain or reduce the costs of healthcare. There have been a number of legislative and regulatory proposals to change the healthcare system and further proposals are likely. Significant uncertainty exists with respect to the reimbursement status of newly approved healthcare products. In addition, third-party payors are increasingly challenging the price and cost-effectiveness of medical products and services. We might not be able to sell our products profitably or recoup the value of our investment in product development if reimbursement is unavailable or limited in scope.

We may be unable to obtain patents to protect our technologies from other companies with competitive products, and patents of other companies could prevent us from manufacturing, developing or marketing our products.

The patent positions of pharmaceutical and biotechnology companies are uncertain and involve complex legal and factual questions. The United States (U.S.) Patent and Trademark Office has not established a consistent policy regarding the breadth of claims that it will allow in biotechnology patents. If it allows broad claims, the number and cost of patent interference proceedings in the U.S. and the risk of infringement litigation may increase. If it allows narrow claims, the risk of infringement may decrease, but the value of our rights under our patents, licenses and patent applications may also decrease. In addition, the scope of the claims in a patent application can be significantly modified during prosecution before the patent is issued. Consequently, we cannot know whether our pending applications will result in the issuance of patents or, if any patents are issued, whether they will provide us with significant proprietary protection or will be circumvented, invalidated or found to be unenforceable. Until recently, patent applications in the U.S. were maintained in secrecy until the patents issued, and publication of discoveries in scientific or patent literature often lags behind actual discoveries. Patent applications filed in the United States after November 2000 generally will be published 18 months after the filing date unless the applicant certifies that the invention will not be the subject of a foreign patent application. We cannot assure you that, even if published, we will be aware of all such literature. Accordingly, we cannot be certain that the named inventors of our products and processes were the first to invent that product or process or that we were the first to pursue patent coverage for our inventions.

Our commercial success depends in part on our ability to maintain and enforce our proprietary rights. If third-parties engage in activities that infringe our proprietary rights, our management's focus will be diverted and we may incur significant costs in asserting our rights. We may not be successful in asserting our proprietary rights, which could result in our patents being held invalid or a court holding that the third-party is not infringing, either of which would harm our competitive position. In addition, we cannot assure you that others will not design around our patented technology. Moreover, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office or other analogous proceedings in other parts of the world to determine priority of invention and the validity of patent rights granted or applied for, which could result in substantial cost and delay, even if the eventual outcome is favorable to us. We cannot assure you that our pending patent applications, if issued, would be held valid or enforceable. Additionally, many of our foreign patent applications have been published as part of the patent prosecution process in such countries.

Protection of the rights revealed in published patent applications can be complex, costly and uncertain. In order to protect goodwill associated with our company and product names, we rely on trademark protection for our marks. We registered the Virulizin® trademark with the U.S. Patent and Trademark Office. A third-party may assert a claim that the Virulizin® mark is confusingly similar to its mark and such claims or the failure to timely register the Virulizin® mark or objections by the FDA could force us to select a new name for Virulizin®, which could cause us to incur additional expense or delay its introduction to market. We also rely on trade secrets, know-how and confidentiality provisions in our agreements with our collaborators, employees and consultants to protect our intellectual property. However, these and other parties may not comply with the terms of their agreements with us, and we might be unable to adequately enforce our rights against these people or obtain adequate compensation for the damages caused by their unauthorized disclosure or use. Our trade secrets or those of our collaborators may become known or may be independently discovered by others.

We are subject to extensive government regulations that may cause us to cancel or delay the introduction of our products to market.

Our research and development activities and the clinical investigation, manufacture, distribution and marketing of drug products are subject to extensive regulation by governmental authorities in the U.S. and other countries. Prior to marketing in the U.S., a drug must undergo rigorous testing and an extensive regulatory approval process implemented by the FDA under federal law, including the Federal Food, Drug and Cosmetic Act. To receive approval, we or our collaborators must, among other things, demonstrate, with substantial evidence from well-controlled clinical trials, that the product is both safe and effective for each indication where approval is sought. Depending upon the type, complexity and novelty of the product and the nature of the disease or disorder to be treated, that approval process can take several years and require substantial expenditures. Data obtained from testing are susceptible to varying interpretations that could delay, limit or prevent regulatory approvals of our products. Drug testing is subject to complex FDA rules and regulations, including the requirement to conduct human testing on a large number of test subjects. We, our collaborators or the FDA may suspend human trials at any time if a party believes that the test subjects are exposed to unacceptable health risks. We cannot assure you that any of our product candidates will be safe for human use. Other countries also have extensive requirements regarding clinical trials, market authorization and pricing. These regulatory schemes vary widely from country to country, but, in general, are subject to all of the risks associated with U.S. approvals. If any of our products receive regulatory approval, the approval will be limited to those disease states and conditions for which the product is safe and effective, as demonstrated through clinical trials. In addition, results of preclinical studies and clinical trials with respect to our products could subject us to adverse product labeling requirements, which could harm the sale of such products. Even if regulatory approval is obtained, later discovery of previously unknown problems may result in restrictions of the product, including withdrawal of the product from the market. Further, governmental approval may subject us to ongoing requirements for post-marketing studies. Even if we obtain governmental approval, a marketed product, its respective manufacturer and its manufacturing facilities are subject to unannounced inspections by the FDA and must comply with the FDA's cGMP and other regulations. These regulations govern all areas of production, record keeping, personnel and quality control. If a manufacturer fails to comply with any of the manufacturing regulations, it may be subject to, among other things, product seizures, recalls, fines, injunctions, suspensions or revocations of marketing licenses, operating restrictions and criminal prosecution. Other countries also impose similar manufacturing requirements.

If we fail to attract and retain key employees, the development and commercialization of our products may be adversely affected.

We depend heavily on the principal members of our scientific and management staff. If we lose any of these persons, our ability to develop products and become profitable could suffer. The risk of being unable to retain key personnel may be increased by the fact that we have not executed long-term employment contracts with our employees, except for our senior executives. Our future success will also depend in large part on our ability to attract and retain other highly qualified scientific and management personnel. We face competition for personnel from other companies, academic institutions, government entities and other organizations.

If product liability claims are brought against us or we are unable to obtain or maintain product liability insurance, we may incur substantial liabilities that could reduce our financial resources.

The clinical testing and commercial use of pharmaceutical products involves significant exposure to product liability claims. We have obtained limited product liability insurance coverage for our clinical trials on humans; however, our insurance coverage may be insufficient to protect us against all product liability damages. Further, liability insurance coverage is becoming increasingly expensive and we might not be able to obtain or maintain product liability insurance in the future on acceptable terms or in sufficient amounts to protect us against product liability damages. Regardless of merit or eventual outcome, liability claims may result in decreased demand for a future product, injury to reputation, withdrawal of clinical

trial volunteers, loss of revenue, costs of litigation, distraction of management and substantial monetary awards to plaintiffs. Additionally, if we are required to pay a product liability claim, we may not have sufficient financial resources to complete development or commercialization of any of our product candidates and our business and results of operations will be adversely affected.

Our operations involve hazardous materials and we must comply with environmental laws and regulations, which can be expensive and restrict how we do business.

Our research and development activities involve the controlled use of hazardous materials, radioactive compounds and other potentially dangerous chemicals and biological agents. Although we believe our safety procedures for these materials comply with governmental standards, we cannot entirely eliminate the risk of accidental contamination or injury from these materials. We currently have insurance, in amounts and on terms typical for companies in businesses that are similarly situated, that could cover all or a portion of a damage claim arising from our use of hazardous and other materials. However, if an accident or environmental discharge occurs, and we are held liable for any resulting damages, the associated liability could exceed our insurance coverage and our financial resources.

We have no manufacturing capabilities. We depend on third-parties, including a number of sole suppliers, for manufacturing and storage of our product candidates used in our clinical trials. Product introductions may be delayed or suspended if the manufacture of our products is interrupted or discontinued.

We do not have manufacturing facilities to produce supplies of Virulizin®, GTI-2040, GTI-2501 or any of our other product candidates to support clinical trials or commercial launch of these products, if they are approved. We are dependent on third-parties for manufacturing and storage of our product candidates. If we are unable to contract for a sufficient supply of our product candidates on acceptable terms, or if we encounter delays or difficulties in the manufacturing process or our relationships with our manufacturers, we may not have sufficient product to conduct or complete our clinical trials or support preparations for the commercial launch of our product candidates, if approved.

We have entered into a sole supplier agreement with a contract manufacturer, Diagnostic Chemicals Limited operating as BioVectra dcl (BioVectra) to manufacture commercial supplies of Virulizin®. This contract manufacturer is our only source for the commercial production of Virulizin®. To date, this contract manufacturer has produced only small quantities of Virulizin® relative to those needed for commercialization. However, this supplier is contractually required to set up an alternate independent manufacturing facility within their organization. In addition, we rely upon a sole supplier for the filling portion of the manufacturing process, Draxis Pharma (a division of Draxis Specialty Pharmaceuticals Inc.) (Draxis). In terms of the components of Virulizin®, we currently rely upon only one type of charcoal as produced by Norit Americas Inc. (Norit), in the event that this specific type of charcoal was no longer available, we would need to perform further research and development procedures to demonstrate to the FDA that an alternative would be acceptable. The technology transfer process at BioVectra has been completed and commercial scale-up of the manufacturing run successfully completed. We expect BioVectra to be able to produce sufficient drug supplies of Virulizin® on a timely basis. Due to the sole supplier status of our relationship with BioVectra, Draxis and our reliance on Norit charcoal, we are subject to the risk that disruptions in their operations would result in delays in Virulizin® regulatory approvals and commercial introduction. If BioVectra or Draxis were unable to produce finished supplies of Virulizin® in required quantities, on a timely basis or at all, we could ultimately be forced to establish a secondary manufacturing site, which would require additional regulatory approvals and delay. Any disruption or termination of our relationship with BioVectra would materially harm our business and financial condition and cause our share price to decline.

We will be required to establish comparability between the finished drug product used in the conduct of our clinical trials and the commercial supplies of the finished drug product manufactured by BioVectra. Additionally, FDA and comparable foreign regulatory approvals may also be required.

We also have arrangements with contract manufacturers for clinical supplies of GTI-2040 and GTI-2501. If clinical supplies of these drugs are disrupted, exhausted, or fail to arrive when needed, we will have to substantially curtail or postpone initiation of planned clinical trials with those product candidates.

Dependence on contract manufacturers for commercial production involves a number of risks, many of which are outside our control. These risks include potential delays in transferring technology, and the inability of our contract manufacturer to scale production on a timely basis, to manufacture commercial quantities at reasonable costs, to comply with cGMP and to implement procedures that result in the production of drugs that meet our specifications and regulatory requirements.

Our reliance on contract manufacturers exposes us to additional risks, including:

- there may be delays in scale-up to quantities needed for clinical trials and commercial launch or failure to manufacture such quantities to our specifications, or to deliver such quantities on the dates we require;

- our current and future manufacturers are subject to ongoing, periodic, unannounced inspection by the FDA and corresponding Canadian and international regulatory authorities for compliance with strictly enforced cGMP regulations and similar standards, and we do not have control over our contract manufacturers' compliance with these regulations and standards;
- our current and future manufacturers may not be able to comply with applicable regulatory requirements, which would prohibit them from manufacturing products for us;
- if we need to change to other commercial manufacturing contractors, the FDA and comparable foreign regulators must approve these contractors prior to our use, which would require new testing and compliance inspections, and the new manufacturers would have to be educated in, or themselves develop substantially equivalent processes necessary for the production or our products; and
- our manufacturers might not be able to fulfill our commercial needs, which would require us to seek new manufacturing arrangements and may result in substantial delays in meeting market demand.

Any of these factors could cause us to delay or suspend clinical trials, regulatory submission, required approvals or commercialization of our products under development, entail higher costs and result in our being unable to effectively commercialize our products. We do not currently intend to manufacture any of our product candidates, although we may choose to do so in the future. If we decide to manufacture our products, we would be subject to the regulatory risks and requirements described above. We would also be subject to similar risks regarding delays or difficulties encountered in manufacturing our pharmaceutical products and we would require additional facilities and substantial additional capital. We cannot assure you that we would be able to manufacture any of our products successfully in accordance with regulatory requirements and in a cost-effective manner.

Our products and product candidates may infringe the intellectual property rights of others, which could increase our costs and negatively affect our profitability.

Our success also depends on avoiding infringement of the proprietary technologies of others. In particular, there may be certain issued patents and patent applications claiming subject matter which we or our collaborators may be required to license in order to research, develop or commercialize at least some of our product candidates, including Virulizin®, GTI-2040, GTI-2501 and GTI-2601. In addition, third-parties may assert infringement or other intellectual property claims against us based on our patents or other intellectual property rights. An adverse outcome in these proceedings could subject us to significant liabilities to third-parties, require disputed rights to be licensed from third-parties or require us to cease or modify our use of the technology. If we are required to license such technology, we cannot assure you that a license under such patents and patent applications will be available on acceptable terms or at all. Further, we may incur substantial costs defending ourselves in lawsuits against charges of patent infringement or other unlawful use of another's proprietary technology.

We have limited sales, marketing and distribution experience.

We have very limited experience in the sales, marketing and distribution of pharmaceutical products. There can be no assurance that we will be able to establish sales, marketing, and distribution capabilities or make arrangements with our collaborators, licensees or others to perform such activities or that such efforts will be successful. If we decide to market any of our products directly, we must either acquire or internally develop a marketing and sales force with technical expertise and with supporting distribution capabilities. The acquisition or development of a sales and distribution infrastructure would require substantial resources, which may divert the attention of our management and key personnel and have a negative impact on our product development efforts. If we contract with third-parties for the sales and marketing of our products, our revenues will be dependent on the efforts of these third-parties, whose efforts may not be successful. If we fail to establish successful marketing and sales capabilities or to make arrangements with third-parties, our business, financial condition and results of operations will be materially adversely affected.

Clinical trials are long, expensive and uncertain processes and the FDA may ultimately not approve any of our product candidates. We cannot assure you that data collected from preclinical studies and clinical trials of our product candidates will be sufficient to support approval by the FDA, the failure of which could delay our profitability and adversely affect our share price.

Many of our research and development programs are currently in the Phase II and Phase III clinical stage. Clinical trials are long, expensive and uncertain processes. Clinical trials may not be commenced or completed on schedule, and the FDA may not ultimately approve our product candidates for commercial sale. Further, even if the results of our preclinical studies or clinical trials are initially positive, it is possible that we will obtain different results in the later stages of drug development or that results seen in clinical trials will not continue with longer-term treatment. Drugs in late stages of clinical development

may fail to show the desired safety and efficacy traits despite having progressed through initial clinical testing. For example, positive results in early Phase I or Phase II clinical trials may not be repeated in larger Phase II or Phase III clinical trials. All of our potential drug candidates are prone to the risks of failure inherent in drug development. The clinical trials of any of our drug candidates, including Virulizin® could be unsuccessful, which would prevent us from commercializing or partnering the drug. Our failure to develop safe, commercially viable drugs would substantially impair our ability to generate revenues and sustain our operations and would materially harm our business and adversely affect our share price.

We rely on third-parties for a variety of functions and we may enter into future collaborations. We may not receive the benefits that we expect from these arrangements.

Our strategy for the research, development and commercialization of our products requires entering into various arrangements with corporate collaborators, licensors, licensees and others, and our commercial success is dependent upon these outside parties performing their respective contractual responsibilities. The amount and timing of resources that such third-parties will devote to these activities may not be within our control. There can be no assurance that such parties will perform their obligations as expected. There can be no assurance that our collaborators will devote adequate resources to our programs. In addition, we could become involved in disputes with our collaborators, which could result in a delay or termination of the related development programs or result in litigation. We intend to seek additional collaborative arrangements to develop and commercialize some of our products. There can be no assurance that we will be able to negotiate collaborative arrangements on favorable terms, or at all, in the future, or that our current or future collaborative arrangements will be successful.

As a result of intense competition and technological change in the pharmaceutical industry, the marketplace may not accept our products, and we may not be able to compete successfully against other companies in our industry and achieve profitability.

Many of our competitors have drug products that have already been approved or are in development, and operate large, well-funded research and development programs in these fields. For example, OSI's Tarceva may become a direct competitor of Virulizin®. Many of our competitors have substantially greater financial and management resources, superior intellectual property positions and greater manufacturing, marketing and sales capabilities, areas in which we have limited or no experience. In addition, many of our competitors have significantly greater experience than we do in undertaking preclinical testing and clinical trials of new or improved pharmaceutical products and obtaining required regulatory approvals. Consequently, our competitors may obtain FDA and other regulatory approvals for product candidates sooner and may be more successful in manufacturing and marketing their products than we or our collaborators are. Existing and future products, therapies and technological approaches will compete directly with the products we seek to develop. Current and prospective competing products may provide greater therapeutic benefits for a specific problem or may offer easier delivery or comparable performance at a lower cost. Any product candidate that we develop and that obtains regulatory approval must then compete for market acceptance and market share. Our product candidates may not gain market acceptance among physicians, patients, healthcare payors and the medical community. Further, any products we develop may become obsolete before we recover any expenses we incurred in connection with the development of these products. As a result, we may never achieve profitability.

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 our financial condition. We maintain all our accounts in Canadian dollars, but our revenues and a portion of our expenditures are in foreign currencies. We do not currently engage in hedging our foreign currency requirements to reduce exchange rate risk.

RISKS RELATED TO OUR COMMON SHARES AND CONVERTIBLE DEBENTURES

Our share price has been and may continue to be volatile and an investment in our common shares could suffer a decline in value.

You should consider an investment in our common shares as risky and invest only if you can withstand a significant loss and wide fluctuations in the market value of your investment. We receive only limited attention by securities analysts and frequently experience an imbalance between supply and demand for our common shares. The market price of our common shares has been highly volatile and is likely to continue to be volatile. Factors affecting our common share price include:

- fluctuations in our operating results
- announcements of technological innovations or new commercial products by us, our collaborators or our competitors;

- published reports by securities analysts;
- the progress of our and our collaborators' clinical trials, including our and our collaborators' ability to produce clinical supplies of our product candidates on a timely basis and in sufficient quantities to meet our clinical trial requirements;
- governmental regulation and changes in medical and pharmaceutical product reimbursement policies;
- developments in patent or other intellectual property rights;
- publicity concerning discovery and development activities by our licensees;
- public concern as to the safety and efficacy of drugs that we and our competitors develop; and
- general market conditions.

Future sales of our common shares by us or by our existing shareholders could cause our share price to fall.
Additional equity financings or other share issuances by us could adversely affect the market price of our common shares. Sales by existing shareholders of a large number of shares of our common stock in the public market and the sale of shares issued in connection with strategic alliances, or the perception that such additional sales could occur, could cause the market price of our common shares to drop.

Our cash flow may not be sufficient to cover interest payments on the secured convertible debentures or to repay the debentures at maturity.
Our ability to make interest payments, if required to be paid in cash, and to repay at maturity or refinance our prime +1% convertible debentures due in 2009 will depend on our ability to generate sufficient cash or refinance them. We have never generated positive annual cash flow from our operating activities, and we may not generate or sustain positive cash flows from operations in the future. Our ability to generate sufficient cash flow will depend on our ability, or the ability of our strategic partners, to successfully develop and obtain regulatory approval for new products and to successfully market these products, as well as the results of our research and development efforts and other factors, including general economic, financial, competitive, legislative and regulatory conditions, many of which are outside of our control.

Conversion of the secured convertible debentures will dilute the ownership interest of existing shareholders.
The conversion of some or all of the convertible debentures will dilute the ownership interests of existing shareholders. Any sales in the public market of the common shares issuable upon such conversion could adversely affect prevailing market prices of our common shares. In addition, the existence of the secured convertible debentures may encourage short selling by market participants.

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 preclinical 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 on the Company's Financial Statements.

Stock-Based Compensation

In December 2003, the amended CICA Handbook, Section 3870 – Stock-Based Compensation and Other Stock-Based Payments required companies to measure and expense all equity instruments awarded to employees. We adopted the new recommendation effective June 1, 2004 retroactively, without restatement. As such, we have applied the fair value based method to expense stock options awarded since June 1, 2002 using the Black-Scholes option-pricing model as allowed under Section 3870. The model estimates the fair value of fully transferable options, without vesting restrictions, which significantly differs from the stock option awards issued by Lorus. The model also requires four highly subjective assumptions including future stock price volatility and expected time until exercise, which greatly affect the calculated values. The increase or decrease of one of these assumptions could materially increase or decrease the fair value of stock options issued and the associated expense.

Valuation Allowance for Future Tax Assets

We have a net tax benefit resulting from non-capital losses carried forward, and scientific research and experimental development expenditures. In light of the recent net losses and uncertainty regarding our future ability to generate taxable income, management is of the opinion that it not more likely than not that these tax assets will be realized in the foreseeable future and hence, a full valuation allowance has been recorded against these income tax assets. Consequently, no future income tax assets or liabilities are recorded on the balance sheets. The generation of future taxable income could result in the recognition of some portion or all of these benefits which could result in a material improvement in our results of operations through the recovery of future income taxes.

Valuation of Long-Lived Assets

We periodically review the useful lives and the carrying values of our long-lived assets. We review for impairment in long-lived assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted 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.

ACCOUNTING POLICY CHANGES

Stock-Based Compensation

Effective June 1, 2004, the Company adopted the fair value method of accounting for stock options granted to employees on or after June 1, 2002 as required by the CICA Section 3870. The change was adopted retroactively without restatement as permitted under the revised section.

Under the fair value method, the estimated fair value of stock options granted is recognized over the service period, that is, the applicable vesting period, as a charge to stock compensation expense and a credit to stock options. When options granted on or after June 1, 2002 are exercised, the proceeds received and the related amounts in stock options are credited to share capital. For options granted prior to June 1, 2002, the Company continues to provide pro forma disclosure of the effect of the fair value method on the net loss and net loss per share. When options granted prior to June 1, 2002 are exercised, the proceeds are credited to share capital. The impact to the financial statements arising from adoption of the fair value method was an increase to the deficit and stock option balances of $2.8 million at June 1, 2004.

We use the Black-Scholes option pricing model to calculate the fair value of the stock options granted, modified, or settled. Any changes in the underlying assumptions used in the Black-Scholes option pricing model could impact earnings.

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.

The carrying values of the convertible debentures approximate their fair values. The interest rate fluctuates as prime fluctuates and the carrying values are being accreted to face value over the term of the convertible debentures such that they will be recorded at their full value if and when they become due and payable.

RECENT ACCOUNTING PRONOUNCEMENTS

Variable Interest Entities

In July 2004, the CICA amended Accounting Guideline AcG-15, "Consolidation of Variable Interest Entities", to provide guidance for applying the principles in Handbook Section 1590, "Subsidiaries", to certain entities. It is effective for fiscal years beginning on or after November 1, 2004.

The Company has determined that adoption of this standard will not have a material effect on its consolidated financial position, results of operations or cash flows.

Financial Instruments – Disclosure and Presentation

In November 2003, CICA Handbook Section 3860, Financial Instruments – Disclosure and Presentation, was amended to require that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The amendments to Section 3860 are effective for fiscal years beginning on or after November 1, 2004.

The Company has determined that adoption of this standard will not have a material effect on its consolidated financial position, results of operations or cash flows.

Financial Instruments – Recognition and Measurement

In January 2005, the CICA released new Handbook Section 3855, Financial Instruments – Recognition and Measurement, effective for annual and interim periods beginning on or after October 1, 2006. This new section prescribes when a financial instrument is to be recognized on the balance sheet and at what amount, sometimes using fair value and other times using cost-based measures. It also specifies how financial instrument gains and losses are to be presented and defines financial instruments to include accounts receivable and payable, loans, investments in debt and equity securities, and derivative contracts.

The Company has not yet determined the impact of the adoption of this standard on the consolidated results of operations or financial position.

Comprehensive Income and Equity

In January 2005, the CICA released new Handbook Section 1530, Comprehensive Income, and Section 3251, Equity, effective for annual and interim periods beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. The section does not address issues of recognition or measurement for comprehensive income and its components. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in this section are in addition to Section 1530.

The Company has not yet determined the impact of the adoption of this standard on the presentation of the consolidated results of operations or financial position.

Non-Monetary Transactions

In June 2005, the CICA released a new Handbook Section 3831, *Non-monetary Transactions*, effective for fiscal periods beginning on or after January 1, 2006. This standard requires all non-monetary transactions to be measured at fair value unless they meet one of four very specific criteria.

Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. Commercial substance is a function of the cash flows expected by the reporting entity.

The Company has determined that this standard will not have any impact to the Company's consolidated financial statements.

SELECTED ANNUAL FINANCIAL DATA

The following selected consolidated financial data have been derived from, and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended May 31, 2005 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		
	2005	2004	2003
REVENUE	**$ 6**	$ 608	$ 66
EXPENSES			
Cost of sales	**1**	28	55
Research and development	**14,394**	26,785	12,550
General and administrative	**5,348**	4,915	4,290
Stock-based compensation	**1,475**	(43)	674
Depreciation and amortization of fixed assets	**564**	463	286
Operating expenses	**21,782**	32,148	17,855
Interest expense	**300**	–	–
Accretion in carrying value of secured convertible debentures	**426**	–	–
Amortization of deferred financing charges	**84**	–	–
Interest income	**(524)**	(1,239)	(1,155)
Loss for the period	**22,062**	30,301	16,634
Basic and diluted loss per common share	**$ 0.13**	$ 0.18	$ 0.12
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share	**172,112**	171,628	144,590
Total Assets	**$ 27,566**	$ 34,424	$ 34,255
Total Long-term liabilities	**$ 10,212**	$ –	$ –

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 the second quarter ended November 30, 2003 we recognized revenue from a licensing agreement Lorus entered into with Cyclacel Ltd. in connection with the out-licensing of our Clotrimazole analog library of anticancer 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.

Research and development expenses have decreased since February 29, 2004 due to the wind down of our Phase III Virulizin® clinical trial which reached full enrollment in the three months ended August 31, 2004 and achieved last patient visit in July 2005. In addition, during 2004 we incurred procurement costs for the manufacture of GTI-2040 and GTI-2501 for which we continue to have a sufficient supply on hand.

Interest income has continued to decline in line with our lower cash and short-term investment balance.

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

	Fiscal 2005 Quarter Ended				Fiscal 2004 Quarter Ended			
	May 31 2005	Feb 28 2005	Nov 30 2004	Aug 31 2004	May 31 2004	Feb 29 2004	Nov 30 2003	Aug 31 2003
Revenue	$ –	$ 3	$ 1	$ 2	$ 2	$ 2	$ 575	$ 29
Research and Development	2,332	3,175	3,838	5,049	6,596	7,340	5,586	7,263
General and Administrative	1,506	1,484	1,333	1,025	1,498	1,010	1,176	1,231
Interest income	127	116	136	145	234	298	314	393
Net loss	(4,598)	(5,274)	(5,945)	(6,245)	(7,973)	(8,159)	(5,998)	(8,171)
Basic and diluted net loss per share	**$ (0.03)**	**$ (0.03)**	**$ (0.03)**	**$ (0.04)**	**$ (0.05)**	**$ (0.05)**	**$ (0.03)**	**$ (0.05)**

OUTSTANDING SHARE DATA

As at August 11, 2005, the Company had 172,622,386 common shares issued and outstanding. In addition, the Company had issued and outstanding, 9,689,208 stock options to purchase an equal number of common shares, 3,000,000 warrants to purchase an equal number of common shares of Lorus at an exercise price of $1.00 per share and a $15 million convertible debenture convertible into common shares of Lorus at $1.00 per share.

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' 2005 annual information form and other disclosure documents, is available on SEDAR at www.sedar.com.

management's responsibility for financial reporting >

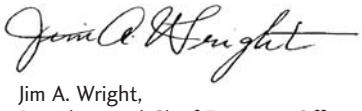
The accompanying consolidated financial statements and all information in this annual report have been prepared by management and have been approved by the Board of Directors of the Company.

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.

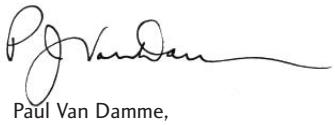
In discharging its responsibility for the integrity and fairness of the financial statements, management maintains a system of internal controls designed to provide reasonable assurance that transactions are authorized, assets are safeguarded and proper records are maintained. Management believes that 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,
President and Chief Executive Officer



Paul Van Damme,
Chief Financial Officer

August 11, 2005

auditors' report to the shareholders >

We have audited the consolidated balance sheets of Lorus Therapeutics Inc. as at May 31, 2005 and 2004 and the consolidated statements of loss and deficit and cash flows for each of the years in the three-year period ended May 31, 2005 and the related consolidated statements of loss and deficit and cash flows for the period from inception on September 5, 1986 to May 31, 2005. 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, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the three-year period ended May 31, 2005 and for the period from inception on September 5, 1986 to May 31, 2005 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 16 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

August 11, 2005

consolidated balance sheets >

(amounts in 000's) (Canadian Dollars)

As at May 31	2005	2004
ASSETS		
Current		
Cash and cash equivalents	$ 2,776	$ 1,071
Short-term investments	18,683	25,657
Prepaid expenses and other assets	1,126	1,697
	22,585	28,425
Long-term		
Fixed assets (note 4)	1,581	1,471
Deferred financing charges (note 11)	568	–
Goodwill	606	606
Acquired patents and licenses (note 5)	2,226	3,922
	4,981	5,999
	$ 27,566	$ 34,424
LIABILITIES		
Current		
Accounts payable	$ 1,069	$ 2,429
Accrued liabilities	3,019	3,396
	4,088	5,825
Long-term		
Secured convertible debentures (note 11)	10,212	–
SHAREHOLDERS' EQUITY		
Share capital (note 6)		
Common shares	144,119	143,670
Equity portion of secured convertible debentures (note 11)	3,814	–
Stock options (notes 3 and 7)	4,252	–
Contributed surplus (note 6 (a))	6,733	1,003
Warrants (notes 6(c) and 11)	991	4,325
Compensation options (note 6(c))	–	1,405
Deficit accumulated during development stage	(146,643)	(121,804)
	13,266	28,599
	$ 27,566	$ 34,424

See accompanying notes to consolidated financial statements
Basis of Presentation (note 1)
Commitments and Guarantees (note 12)
Canada and United States Accounting Policy Differences (note 16)

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			
	2005	2004	2003	Period from inception Sept. 5, 1986 to May 31, 2005
REVENUE (note 15)	**$ 6**	$ 608	$ 66	$ 680
EXPENSES				
Cost of sales	**1**	28	55	84
Research and development (note 9)	**14,394**	26,785	12,550	100,238
General and administrative	**5,348**	4,915	4,290	43,141
Stock-based compensation (note 7)	**1,475**	(43)	674	5,545
Depreciation and amortization of fixed assets	**564**	463	286	8,052
Operating expenses	**21,782**	32,148	17,855	157,060
Interest expense (note 11)	**300**	–	–	300
Accretion in carrying value of secured convertible debentures (note 11)	**426**	–	–	426
Amortization of deferred financing charges (note 11)	**84**	–	–	84
Interest income	**(524)**	(1,239)	(1,155)	(10,547)
Loss for the period	**22,062**	30,301	16,634	146,643
Deficit, beginning of period (as previously reported)	**121,804**	91,503	74,869	–
Impact of change in accounting for stock based compensation (note 3)	**2,777**	–	–	–
Deficit, beginning of period (as restated)	**124,581**	91,503	74,869	–
Deficit, end of period	**$ 146,643**	$ 121,804	$ 91,503	$ 146,643
Basic and diluted loss per common share	**$ 0.13**	$ 0.18	$ 0.12	
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share	**172,112**	171,628	144,590	

See accompanying notes to consolidated financial statements

consolidated statements of cash flows >

(amounts in 000's) (Canadian Dollars)

	Years ended May 31			
	2005	2004	2003	Period from inception Sept. 5, 1986 to May 31, 2005
OPERATING ACTIVITIES				
Loss for the period	**$ (22,062)**	$ (30,301)	$ (16,634)	$ (146,643)
Add items not requiring a current outlay of cash:				
Stock-based compensation (note 7)	**1,475**	(43)	674	5,545
Interest expense (note 11)	**300**	–	–	300
Accretion in carrying value of secured convertible debentures (note 11)	**426**	–	–	426
Amortization of deferred financing charges (note 11)	**84**	–	–	84
Depreciation, amortization and write-down of fixed assets	**2,260**	2,166	2,033	18,387
Other	**(38)**	245	–	706
Net change in non-cash working capital balances related to operations (note 10)	**(1,166)**	(129)	2,019	2,055
Cash used in operating activities	**(18,721)**	(28,062)	(11,908)	(119,141)
INVESTING ACTIVITIES				
Maturity (purchase) of short-term investments, net	**6,974**	(1,438)	12,438	(18,683)
Business acquisition, net of cash received	**–**	–	–	(539)
Acquired patents and licenses	**–**	–	–	(715)
Additions to fixed assets	**(599)**	(383)	(1,260)	(5,974)
Cash proceeds on sale of fixed assets	**–**	–	–	348
Cash provided by (used in) investing activities	**6,375**	(1,821)	11,178	(25,563)
FINANCING ACTIVITIES				
Issuance of debentures, net (note 11)	**12,948**	–	–	12,948
Issuance of warrants, net	**991**	4,537	–	37,405
Issuance of common shares	**112**	25,512	715	97,371
Additions to deferred financing charges (note 11)	**–**	–	(245)	(245)
Cash provided by financing activities	**14,051**	30,049	470	147,479
Increase (decrease) in cash and cash equivalents during the period	**1,705**	166	(260)	2,776
Cash and cash equivalents, beginning of period	**1,071**	905	1,165	–
Cash and cash equivalents, end of period	**$ 2,776**	$ 1,071	$ 905	$ 2,776

See accompanying notes to consolidated financial statements

notes to consolidated financial statements >

For the years ended May 31, 2005, 2004 and 2003

1. BASIS OF PRESENTATION

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 various stages of evaluation, from preclinical through to Phase III trials, Lorus develops therapeutics that seek to manage cancer with efficacious low-toxicity compounds that improve patients' quality of life.

Future Operations

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 are dependent upon the Company's ability to successfully finance and complete its research and development programs.

The Company's future operations is highly dependent upon the outcome of the Phase III trial of its lead product, Virulizin®. Should the trial prove successful, the Company will pursue regulatory approval and subsequent commercialization of Virulizin®. The Company's commercialization efforts are dependent upon its ability to raise additional financing through a combination of equity or debt financing, or payments from strategic partners. Should the Company's ability to raise additional financial support be delayed, management believes the Company's current level of cash and cash equivalents and short-term investments are sufficient to fund planned expenditures for the next twelve months.

In the event the result of the Phase III trial does not warrant efforts to commercialize Virulizin® at the present time, the Company will be required to re-evaluate its business operations and to reduce expenditures. Should commercialization not be pursued, management believes that the Company's current level of cash and cash equivalents and short-term investments is sufficient to fund the planned expenditures for the next twelve months.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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") which are both located in Canada. 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 16, "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 persuasive evidence of an arrangement exists, delivery has occurred, the Company's price to the customer is fixed or determinable, and collectibility is reasonably assured. The Company allows customers to return product within a specified period of time before and after its expiration date. Provisions for these returns are estimated based on historical return and exchange levels.

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 reasonably assured. Future non-refundable milestone payments receivable upon the achievement of third-party performance are recognized upon the achievement of specified milestones when collection of the milestone payment is reasonably assured 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

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 more than three months, are recorded at their accreted value as they are held to maturity instruments. The Company invests in high quality fixed income government (2005 – $3,229,000, 2004 – $3,811,000) and corporate (2005 – $15,452,000, 2004 – $21,846,000) instruments with low credit risk. All investments held at year-end approximate fair value, mature within one-year and are denominated in Canadian dollars.

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 Canadian generally accepted accounting principles for deferral and amortization. No development costs have been deferred to date.

Goodwill and Acquired Patents and Licenses

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 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.

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.

The Company capitalized the cost of acquired patent and license assets 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.

The Company has identified no impairment relating to goodwill and intangible assets for 2005 and 2004.

Impairment of Long-Lived Assets

The Company periodically reviews the useful lives and the carrying values of its long-lived assets. The Company reviews for impairment in long-lived assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted 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 proportionate with the risks associated with the recovery of the asset.

Stock-Based Compensation

The Company has a stock-based compensation plan described in note 7. Prior to June 1, 2004, stock-based awards granted to employees were accounted for using the intrinsic method with the exception of options with contingent vesting criteria for which the variable accounting method was used. On June 1, 2004, the Company adopted the fair value method of accounting for stock-based awards to employees, officers and directors granted or modified after June 1, 2004. The change was adopted retroactively without restatement (note 3).

Stock options and warrants awarded to non-employees are accounted for using the fair value method and expensed as the service or product is received. Consideration paid on the exercise of stock options and warrants is credited to capital stock.

The Company has a deferred share unit plan that provides directors the alternative of receiving payment for their services in the form of share units rather than common shares or cash. Share units entitle the directors 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 Company records an expense and a liability equal to the market value of the shares to be issued. The accumulated liability is adjusted for market fluctuations on a quarterly basis.

Common shares issued under the Alternate Compensation Plan are accounted for using the fair value of the common shares on the day they are granted.

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. The amounts recognized as a reduction to research and development expense total $400 thousand (2004 – $180 thousand, 2003 – $355 thousand).

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 carryforwards. 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 enactment or substantive enactment occurs. A valuation allowance is recorded for the portion of the future tax assets where the realization of any value is uncertain, for which management has deemed to be 100% of the assets available.

Loss Per Share

Basic loss per common share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the 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 antidilutive.

Deferred Financing Charges

Deferred financing charges, comprised primarily of legal costs, represent costs related to the issuance of the Company's convertible debentures. Deferred financing charges are amortized over the five-year term of the convertible debentures.

Segmented Information

The Company is organized and operates as one operating segment, the research, development and commercialization of pharmaceuticals. Substantially all of the Company's identifiable assets as at May 31, 2005 and 2004 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 financial statements in accordance with Canadian Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Significant estimates include the valuation of the convertible debentures, the fair value of stock options granted and warrants issued and the useful lives of capital and intangible assets.

Recent Canadian Accounting Pronouncements

Variable Interest Entities

In July 2004, the Canadian Institute of Chartered Accountants ("CICA") amended Accounting Guideline AcG-15, "Consolidation of Variable Interest Entities", to provide guidance for applying the principles in Handbook Section 1590, "Subsidiaries", to certain entities. The Guideline is effective for the fiscal years beginning on or after November 1, 2004.

The Company has determined that adoption of this standard will not have a material effect on its consolidated financial position, results of operations or cash flows.

Financial Instruments – Disclosure and Presentation

In November 2003, CICA Handbook Section 3860, "Financial Instruments – Disclosure and Presentation", was amended to require that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The amendments to Section 3860 are effective for fiscal years beginning on or after November 1, 2004.

The Company has determined that adoption of this standard will not have a material effect on its consolidated financial position, results of operations or cash flows.

Financial Instruments – Recognition and Measurement

In January 2005, the CICA released new Handbook Section 3855, "Financial Instruments – Recognition and Measurement", effective for annual and interim periods beginning on or after October 1, 2006. This new section prescribes when a financial instrument is to be recognized on the balance sheet and at what amount, sometimes using fair value and other times using cost-based measures. It also specifies how financial instrument gains and losses are to be presented and defines financial instruments to include accounts receivable and payable, loans, investments in debt and equity securities, and derivative contracts.

The Company has not yet determined the impact of the adoption of this standard on its consolidated results of operations or financial position.

Comprehensive Income and Equity

In January 2005, the CICA released new Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity", effective for annual and interim periods beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. The section does not address issues of recognition or measurement for comprehensive income and its components. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in this section are in addition to Section 1530.

The Company has not yet determined the impact of the adoption of these standards on the presentation of its results of operations or financial position.

Non-Monetary Transactions

In June 2005, the CICA released a new Handbook Section 3831, *Non-monetary Transactions*, effective for fiscal periods beginning on or after January 1, 2006. This standard requires all non-monetary transactions to be measured at fair value unless they meet one of four very specific criteria.

Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. Commercial substance is a function of the cash flows expected by the reporting entity.

The Company has determined that this standard will not have any impact to the Company's consolidated financial statements.

3. CHANGE IN ACCOUNTING POLICIES

Effective June 1, 2004, the Company adopted the fair value method of accounting for stock options granted to employees on or after June 1, 2002 as required by the amended CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments" ("Section 3870"). The change was adopted retroactively without restatement as permitted under the revised section.

Under the fair value method, the estimated fair value of stock options granted is recognized over the service period, that is, the applicable vesting period, as stock-based compensation expense and a credit to stock options. When options granted on or after June 1, 2002 are exercised, the proceeds received and the related amounts in stock options are credited to share capital. For options granted prior to June 1, 2002, the Company continues to provide pro forma disclosure of the effect of the fair value method on the net loss and net loss per share. When options granted prior to June 1, 2002 are exercised, the proceeds are credited to share capital. The impact to the financial statements arising from adoption of the fair value method was an increase to the deficit and stock option balances presented in shareholders' equity of $2.8 million at June 1, 2004.

Asset Retirement Obligations

Effective June 1, 2004, the Company adopted CICA Handbook Section 3110, "Asset Retirement Obligations", which harmonize Canadian GAAP with SFAS No. 143, Accounting for Asset Retirement Obligations. This Section establishes standards for the recognition, measurement, and disclosure of liabilities for asset retirement obligations and the associated retirement costs. This Section applies to legal obligations associated with the retirement of a tangible long-lived asset that result from its acquisition, construction, development, or normal operation. The adoption of Section 3110 had no material effect on the Company's consolidated financial position or results of operations.

4. FIXED ASSETS

As at May 31 *(amounts in 000's)*	2005		
	Cost	**Accumulated Amortization**	**Carrying Value**
Furniture and equipment	**$ 2,575**	**$ 1,517**	**$ 1,058**
Leasehold improvements	**908**	**385**	**523**
End of year	**$ 3,483**	**$ 1,902**	**$ 1,581**

	2004		
	Cost	Accumulated Amortization	Carrying Value
Furniture and equipment	$ 1,977	$ 1,180	$ 797
Leasehold improvements	907	233	674
End of year	$ 2,884	$ 1,413	$ 1,471

During the year, a write-down of $75 thousand was taken on certain furniture and equipment whose carrying value was in excess of the estimated future undiscounted cash flows and therefore deemed to be unrecoverable. The impairment charge was reported in the consolidated statements of loss and deficit in depreciation and amortization of fixed assets.

5. ACQUIRED PATENTS AND LICENSES

As at May 31 *(amounts in 000's)*	**2005**	2004
Cost	**$ 12,228**	$ 12,228
Accumulated amortization	**(10,002)**	(8,306)
	$ 2,226	$ 3,922

Amortization of $1.7 million (2004 – $1.7 million, 2003 – $1.7 million) has been included in research and development expense reported in the consolidated statements of loss and deficit.

6. 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, 2002	144,412	$ 118,165	–	$ –
Exercise of stock options	873	715	–	–
Stock-based compensation	–	558	–	–
Balance at May 31, 2003	145,285	119,438	–	–
Share issuance	26,220	24,121	13,110	4,325
Exercise of stock options	289	171	–	–
Stock-based compensation	–	(88)	–	–
Other	–	28	–	–
Balance at May 31, 2004	171,794	143,670	13,110	4,325
Interest payments (note 11)	**421**	**300**	–	–
Issuance under ACP (note 6 (b))	**50**	**37**		
Exercise of stock options	**276**	**112**	–	–
Convertible debentures (note 11)	–	–	**3,000**	**991**
Warrants expiry (note 6 (c))	–	–	**(13,110)**	**(4,325)**
Balance at May 31, 2005	**172,541**	**$ 144,119**	**3,000**	**$ 991**

Contributed Surplus

As at May 31 *(amounts in 000's)*	**2005**	2004	2003
Beginning of year	**$ 1,003**	$ 1,003	$ 1,003
Expiry of warrants (note 6 (c))	**4,325**	–	–
Expiry of compensation options (note 6 (c))	**1,405**	–	–
End of year	**$ 6,733**	$ 1,003	$ 1,003

(b) Alternate Compensation Plans ("ACP")

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, 121,000 shares have been issued under this plan. For the year ended May 31, 2005, 50,000 shares were issued under this plan (2004 – nil, 2003 – nil).

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 directors 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 at May 31, 2005, 99,708 deferred share units have been issued (2004 – 68,183, 2003 – 45,964), with a cash value of $71 thousand (2004 – $57 thousand, 2003 – $58 thousand) being recorded in accrued liabilities.

(c) Share Issuance

On June 11, 2003, the Company raised gross proceeds of $3.3 million 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 entitled 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 $1.5 million for services in connection with the completion of the offering. Each compensation option entitled the holder to acquire one unit for $1.27 at any time on or before December 10, 2004. The Company incurred expenses of $4.4 million for the issuance, which include the non-cash charge of $1.5 million being the fair value of the compensation option. The Company allocated $4.4 million of the net proceeds to the warrants, $1.4 million to the compensation option and $24,121,000 to share capital.

On December 10, 2004 the warrants and options described above expired without being exercised. The expiry of these warrants and options had no impact on earnings or the net balance of shareholders' equity.

(d) Employee Share Purchase Plan ("ESPP")

The Company's ESPP was established January 1, 2005. The purpose of the ESPP is to assist the Company in retaining the services of its employees, to secure and retain the services of new employees and to provide incentives for such persons to exert maximum efforts for the success of the Company. The ESPP provides a means by which employees of the Company and its affiliates may purchase common stock of the company at a discount through accumulated payroll deductions. Generally, each offering is of three months' duration with purchases occurring every month. Participants may authorize payroll deductions of up to 15% of their base compensation for the purchase of common stock under the ESPP. At May 31, 2005, a total of 106,339 common shares have been purchased under the ESPP, and Lorus has recognized an expense of $16 thousand related to this plan in the financial statements.

7. STOCK-BASED COMPENSATION

(a) Effective June 1, 2004, the Company adopted the fair value-based method of accounting for employee stock options granted on or after June 1, 2002. The Company adopted this new accounting policy retroactively without restatement as allowed for under the transitional provisions of Section 3870.

For the year ended May 31, 2005, $1.5 million of stock compensation expense was recognized, representing the amortization of stock compensation expense applicable to the current period of the estimated fair value of options granted since June 1, 2002 which included an additional compensation expense of $208 thousand due to the shareholder approved amendment of the 1993 Stock Option Plan to extend the life of options from five years to 10 years. This additional expense represents the incremental value conveyed to holders of the options as a result of extending the life of the options. For the year ended May 31, 2005, stock option expense of $1.5 million was allocated $445 thousand to research and development and $1.0 million to general and administrative expense.

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of stock options granted during the period:

	2005	2004	2003
Risk-free interest rate	**2.25-3.00%**	2.25-3.05%	3.20-3.50%
Expected dividend yield	**0%**	0%	0%
Expected volatility	**70-90%**	89%	110%
Expected life of options	**1-5 years**	5 years	5 years
Weighted average grant date fair value	**$ 0.54**	$ 0.74	$ 0.75

The Company has assumed no forfeiture rate as adjustments for actual forfeitures are made in the year they occur.

(b) 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 10 years. Stock option transactions for the three years ended May 31, 2005 are summarized as follows:

Stock Option Transactions

	2005		2004		2003	
	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	**6,372**	**$ 1.05**	5,378	$ 1.05	5,425	$ 1.17
Granted	**3,173**	**$ 0.77**	2,629	$ 1.16	2,613	$ 0.72
Exercised	**(276)**	**$ 0.40**	(289)	$ 0.59	(873)	$ 0.83
Forfeited	**(1,234)**	**$ 1.05**	(1,346)	$ 1.29	(1,787)	$ 1.01
Outstanding at end of year	**8,035**	**$ 0.96**	6,372	$ 1.05	5,378	$ 1.05
Exercisable at end of year	**4,728**	**$ 1.04**	3,542	$ 1.01	2,921	$ 1.26

The following table summarizes information about stock options outstanding at May 31, 2005:

	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	275	5.62	$ 0.37	275	$ 0.37
$0.50 to $0.99	5,218	8.04	$ 0.78	2,541	$ 0.79
$1.00 to $1.99	2,167	7.96	$ 1.22	1,537	$ 1.24
$2.00 to $2.50	375	5.39	$ 2.44	375	$ 2.44
	8,035	7.81	$ 0.96	4,728	$ 1.04

(c) Pro Forma Information – Stock-Based Compensation

In periods prior to June 1, 2002, the Company recognized no compensation expense when stock options were granted to employees.

For the year ended May 31, 2005, the pro forma compensation charge for stock options granted prior to June 1, 2002 was $27 thousand (2004 – $551 thousand, 2003 – $509 thousand). These amounts have no material impact on loss per share figures.

8. 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)*	**2005**	2004
Non-capital loss carryforwards	**$ 23,081**	$ 19,746
Research and development expenditures	**20,436**	17,613
Book over tax depreciation	**1,529**	1,307
Other	**1,089**	1,345
Future tax assets	**46,135**	40,011
Valuation allowance	**(46,135)**	(40,011)
	$ –	$ –

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.

The Company has undeducted research and development expenditures, totaling $58.9 million for federal purposes and, $52.8 million for provincial purposes and these can be carried forward indefinitely. In addition, the Company has non-capital loss carryforwards of $62.7 million for federal purposes and $65.7 million for provincial purposes. 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
2006	$ 3,468
2007	4,626
2008	4,985
2009	6,658
2010	8,279
2011	1,131
2012	–
2013	–
2014	20,126
2015	13,476
	$ 62,749

Income Tax Rate Reconciliation *(amounts in 000's)*	**2005**	2004
Recovery of income taxes based on statutory rates	**$ (7,971)**	$(11,008)
Expiry of losses	**780**	730
Change in valuation allowance	**6,124**	15,214
Non deductible accretion and stock-based compensation expense	**687**	–
Change in enacted tax rates	**–**	(4,941)
Other	**380**	5
	$ –	$ –

9. 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 nearing the end of a global Phase III clinical trial for the treatment of pancreatic cancer.

(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 preclinical anticancer activity across a broad range of cancers and are currently in various Phase II trials.

(c) Small Molecules
Anticancer activity was discovered with an antifungal agent Clotrimazole ("CLT"). Based on the structural feature found to be responsible for the anticancer effect of CLT, chemical analogs of CLT have been designed and tested. In addition, our library of Clotrimazole analogs has been licensed to Cyclacel Limited, as described in note 15.

Lorus scientists discovered novel low molecular weight compounds with anticancer and antibacterial activity in preclinical investigations. Of particular interest were compounds that inhibit the growth of 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 preclinical development, including a tumor suppressor or gene therapy approach to inhibiting the growth of tumors.

Research and Development (amounts in 000's)	Years ended May 31 2005	2004	2003	Period from inception Sept 5, 1986 to May 31, 2005
Immunotherapy				
Expensed	**$ 11,891**	$ 19,944	$ 7,433	$ 68,756
Acquired	**–**	–	–	–
Antisense				
Expensed	**2,384**	6,666	4,911	27,259
Acquired	**–**	–	–	11,000
Small Molecules				
Expensed	**119**	175	206	4,223
Acquired	**–**	–	–	1,228
Total expensed	**$ 14,394**	$ 26,785	$ 12,550	$ 100,236
Total acquired	**$ –**	$ –	$ –	$ 12,228

10. 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 2005	2004	2003	Period from inception Sept 5, 1986 to May 31, 2005
(Increase) decrease				
Prepaid expenses and other assets	**$ 571**	$ (593)	$ 91	$ (549)
Increase (decrease)				
Accounts payable	**(1,360)**	1,111	876	(175)
Accrued liabilities	**(377)**	(647)	1,052	2,779
	$ (1,166)	$ (129)	$ 2,019	$ 2,055

During the year ended May 31, 2005, the Company received interest of $679 thousand (2004 – $1.2 million, 2003 – $1.7 million).

11. CONVERTIBLE DEBENTURES

On October 6, 2004, the Company entered into a Subscription Agreement (the "Agreement") to issue an aggregate of $15.0 million of secured convertible debentures (the "debentures") and 3,000,000 purchase warrants. The debentures are secured by a first charge over all of the assets of the Company.

The Company received $4.4 million on October 6, 2004 (representing a $5.0 million debenture less an investor fee representing 4% of the $15.0 million to be received under the Agreement), and 1,000,000 purchase warrants and $5.0 million on each of January 14 and April 15, 2005. All debentures issued under this Agreement are due on October 6, 2009 and are subject to interest payable monthly at a rate of prime +1% until such time as the Company's share price reaches $1.75 for 60 consecutive trading days, at which time, interest will no longer be charged. Interest is payable in common shares of Lorus until Lorus' 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. To May 31, 2005, the Company has issued 421,000 shares in settlement of $300 thousand in interest.

The $15.0 million principal amount of debentures issued on October 6, 2004, January 14 and April 15, 2005 is convertible at the holder's option at any time into common shares of the Company with a conversion price per share of $1.00.

With the issuance of each $5.0 million debenture, the Company issued to the debt holder 1,000,000 purchase warrants expiring October 6, 2009 to buy common shares of the Company at a price per share equal to $1.00.

The convertible debentures contain both a liability and an equity element, represented by the conversion option, and therefore, under Canadian GAAP these two elements must be split and classified separately as debt and equity. In addition, as noted above, the debenture holder received 1,000,000 purchase warrants on the issuance of each tranche of convertible debt. The Company has allocated the total proceeds received from the issuance of the convertible debentures to these three elements based on their relative fair values. The fair value of the purchase warrants has been determined based on an option-pricing model. The fair value of the debt has been based on the discounted cash flows using an estimated cost of borrowing of 15% to represent an estimate of what the Company may borrow secured debt without a conversion option or purchase warrant. The convertible debenture conversion option was valued using a trinomial model. The resulting allocation based on relative fair values resulted in the allocation of $9.8 million to the debt instrument, $4.1 million to the conversion option and $1.1 million to the purchase warrants. The financing fees totalling $1.1 million related to the issuance of the convertible debentures have been allocated pro rata between deferred financing charges of $652 thousand, against the equity portion of the convertible debenture of $322 thousand and against the purchase warrants of $87 thousand. This allocation resulted in net amounts allocated to the equity portion of the convertible debentures and warrants of $3.8 million and $991 thousand respectively. The financing charges are being amortized over the five-year life of the convertible debenture agreement and as at May 31, 2005, the balance is $568 thousand.

Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be their face value of $15.0 million. To date, the Company has recognized $426 thousand in accretion expense. This accretion expense has increased the value of the convertible debenture from $9.8 million to $10.2 million at May 31, 2005.

12. COMMITMENTS AND GUARANTEES

(a) Operating Lease Commitments

The Company has entered into operating leases for premises under which it is obligated to make minimum annual payments of approximately $136 thousand in 2006, $128 thousand in 2007 and $107 thousand in 2008.

During the year ended May 31, 2005, operating lease expenses were $136 thousand (2004 – $141 thousand, 2003 – $122 thousand).

(b) Other Contractual Commitments

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

(i) A 20% share interest in NuChem;

(ii) A payment of U.S. $350 thousand in shares of Lorus, and

(iii) Up to U.S. $3.5 million in cash.

To date, the Company has made cash payments of U.S. $500 thousand. The remaining balance of up to U.S. $3.0 million 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 patents and licenses and will be amortized over the estimated useful life of the licensed asset.

The Company holds an exclusive worldwide license from the University of Manitoba (the "University") and Cancer Care Manitoba ("CCM") to certain patent rights to develop and sublicense 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 sublicenses 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.

(d) Contracts

The Company contracts with Clinical Research Organizations to facilitate some of our clinical trials. These contracts may be terminated upon sixty days written notice. Lorus is committed to $2.2 million in expenditures in the next twelve months related to these contracts.

13. RELATED PARTY TRANSACTIONS

During the year ended May 31, 2003, consulting fees of $49 thousand were paid to a company which is controlled by a director of the Company. These transactions were in the normal course of operations and were measured at the exchange amount of consideration established and agreed to by the related parties. There were no consulting fees incurred during the years ended May 31, 2005 or 2004.

The amount payable to related parties as at May 31, 2005 was nil (2004 – nil, 2003 – nil).

14. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, short-term investments, amounts receivable and other assets, 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.

The carrying value of the convertible debentures approximates their fair values, as the interest rate is variable and the carrying values are being accreted to face value over the term of the convertible debentures such that they will be recorded at their face value if and when they become due and payable.

15. REVENUE

During the year ended May 31, 2004, the Company recorded license revenue of $546 thousand (2003 – nil) in connection with a worldwide exclusive license agreement entered into with Cyclacel Limited in the United Kingdom for the out-licensing of the Company's small molecule program. Additional license fees of up to $11.6 million may be earned if Cyclacel achieves certain defined research and development milestones. No such milestones were achieved during the year ended May 31, 2005.

16. CANADA AND UNITED STATES ACCOUNTING POLICY DIFFERENCES

These consolidated financial statements have been prepared in accordance with Canadian GAAP which differ in some respects from accounting principles generally accepted in the United States (U.S. GAAP). The following reconciliation identifies material differences in the Company's consolidated statements of loss and deficit and consolidated balance sheets.

(a) Consolidated Statements of Loss and Deficit

	Years ended May 31		
(amounts in 000's)	**2005**	2004	2003
Loss per Canadian GAAP	**$ (22,062)**	$ (30,301)	$ (16,634)
Accretion of convertible debenture (i)	**329**	–	–
Amortization of debt issue costs (i)	**(40)**	–	–
Stock compensation expense (ii)	**1,475**	–	–
Loss and comprehensive loss per U.S. GAAP	**$ (20,298)**	$ (30,301)	$ (16,634)
Basic and diluted loss per share per U.S. GAAP	**$ (0.12)**	$ (0.18)	$ (0.12)

Under U.S. GAAP, the number of weighted average common shares outstanding for basic and diluted loss per share are the same as under Canadian GAAP.

(b) Consolidated Balance Sheets:

	May 31, 2005				
		Adjustments			
(amounts in 000's)	Canadian GAAP	Convertible Debentures (i)	Stock Options (ii)	Other	U.S. GAAP
Deferred financing charges	$ 568	$ 272	$ –	$ –	$ 840
Secured convertible debenture	(10,212)	(3,740)	–	–	(13,952)
Equity portion of secured convertible debentures	(3,814)	3,814	–	–	–
Stock options	(4,252)	–	4,252	–	–
Contributed surplus/Additional paid in capital (APIC)	(6,733)	(1,048)	–	–	(7,781)
Warrants	(991)	991	–	–	–
Deficit accumulated during development stage	146,643	(289)	(4,252)	–	142,102

	May 31, 2004				
		Adjustments			
(amounts in 000's)	Canadian GAAP	Convertible Debentures (i)	Stock Options (ii)	Other (iii)	U.S. GAAP
Contributed surplus/APIC	$ (1,003)	$ –	$ –	$ (4,325)	$ (5,328)
Warrants	(4,325)	–	–	4,325	–
Deficit accumulated during development stage	121,804	–	–	–	121,804

(i) Convertible Debenture

Under Canadian GAAP, the conversion option embedded in the convertible debentures is presented separately as a component of shareholders' equity. Under U.S. GAAP, the embedded conversion option is not subject to bifurcation and is thus presented in the balance of the convertible debentures. Under U.S. GAAP, Emerging Issues Task Force 00-19 and APB Opinion No. 14, the fair value of warrants issued in connection with the convertible debenture financing would be recorded as a reduction to the proceeds from the issuance of convertible debentures, and are classified as additional paid-in capital. The warrants have been presented as a separate component of shareholders' equity for Canadian GAAP purposes. The Company has allocated the total proceeds received from the issuance of the convertible debentures to the debt and warrant portions based on their relative fair values. The resulting allocation based on relative fair values resulted in the allocation of $13.9 million to the debt instrument and $1.1 million to the purchase warrants. The financing fees totaling $1.1 million related to the issuance of the convertible debentures have been allocated pro rata between deferred financing charges of $1.0 million and against the purchase warrants of $97 thousand. This allocation resulted in the net amount allocated to the warrants of $1.0 million. The financing charges are being amortized over the five-year life of the convertible debentures.

Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be their face value of $15.0 million. To date, the Company has recognized $97 thousand in accretion expense. This accretion expense has increased the value of the convertible debenture from $13.9 million to $14.0 million at May 31, 2005.

(ii) Stock-Based Compensation

Effective June 1, 2004, the Company adopted the fair value based method of accounting for employee stock options granted on or after June 1, 2002, retroactively without restatement as allowed under the transitional provisions of CICA Handbook Section 3870. As a result, the opening balances of deficit accumulated during development stage and stock options were increased by $2.8 million at June 1, 2004. During 2005, the Company recorded stock compensation expense of $1.5 million in the consolidated statements of loss, representing the amortization applicable to the current year at the estimated fair value of options granted since June 1, 2002; and an offsetting adjustment to stock options of $1.5 million in the consolidated balance sheets. No similar adjustments are required under U.S. GAAP

as the Company has elected to continue measuring compensation expense, as permitted under SFAS No. 123, using the intrinsic value based method of accounting for stock options. Under this method, compensation expense is the excess, if any, of the quoted market value of the stock at the date of the grant over the amount an employee must pay to acquire the stock. Election of this method requires pro forma disclosure of compensation expense as if the fair value method has been applied for awards granted in fiscal periods after December 15, 1994.

The Company grants performance based stock options as a compensation tool. Under Canadian GAAP, the fair value treatment of these options is consistent with all other employee stock options. Under U.S. GAAP, 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. Due to the decline in our common share price during the year, there was no expense recorded for U.S. GAAP purposes. Prior to the adoption of CICA Handbook Section 3870, Lorus accounted for performance based stock options using the intrinsic value method, and a recovery of $43 thousand was included in the statements of loss in 2004 and an expense of $674 thousand was included in net income in 2003 related to these options.

The table below presents the pro forma disclosures required under U.S. GAAP:

	2005	2004	2003
Net loss to common shareholders – U.S. GAAP	**(20,298)**	(30,301)	(16,634)
Compensation expense under SFAS 123	**(1,475)**	(1,623)	(1,418)
Pro forma net loss to common shareholders – U.S. GAAP	**(21,773)**	(31,924)	(18,052)
Pro forma basic and diluted loss per share – U.S. GAAP	**(0.13)**	(0.19)	(0.12)

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of stock options granted during the period:

	2005	2004	2003
Risk-free interest rate	**2.25-3.00%**	2.25-3.05%	3.20-3.50%
Expected dividend yield	**0%**	0%	0%
Expected volatility	**70-90%**	89%	110%
Expected life of options	**1-5 years**	5 years	5 years
Weighted average grant date fair value	**$0.54**	$0.74	$0.75

(iii) Warrants

These warrants were issued in connection with the June 11, 2003 financing. Under Canadian GAAP, the fair value of the warrants have been presented as a separate component of shareholders' equity. Under U.S. GAAP, the fair value of the warrants issued would be recorded as additional paid in capital.

(c) Consolidated Statements of Cash Flows

There are no differences between Canadian and U.S. GAAP that impact the amounts of cash used or provided by operating activities, investing activities and financing activities in the consolidated statements of cash flows for the years ended May 31, 2005, 2004 and 2003.

(d) Income Taxes

Under Canadian GAAP, investment tax credits and other research and development credits are deducted from research and development expense for items of a current nature, and deducted from property and equipment for items of a capital nature. Under U.S. GAAP, these tax credits would be reclassified as a reduction of income tax expense. The impact would be higher research and development expense and an income tax recovery of $400 thousand for the year ended May 31, 2005 (2004 – $180 thousand, 2003 – $355 thousand) with no net impact to shareholders' equity, net income or earnings per share.

(e) New Accounting Pronouncements Not Yet Adopted

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* (which supercedes Statements No. 123 and 95) that addresses the accounting for share-based payments transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise, or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The new standard eliminates the ability to account for share-based compensation transactions using

APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and instead requires that such transactions be accounted for using a fair value based method. The new standard is effective for interim or annual periods beginning after January 1, 2006, meaning that an entity must apply the guidance to all employee awards of share-based payment granted, modified, or settled in any interim or annual period beginning after January 1, 2006. The cumulative effect of initially applying this standard, if any, must be recognized as of the required effective date. The Company is reviewing the standard to determine the potential impact, if any, on the consolidated financial statements.

In March 2005, FASB issued FIN 47 *Accounting for Conditional Asset Retirement Obligations* as an interpretation of FASB Statement No. 143 *Accounting For Asset Retirement Obligations* (FAS 143). This Interpretation clarifies that the term *conditional asset retirement obligation* as used in FAS 143, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The Company does not expect this standard to have any impact on its consolidated financial statements.

In May 2005, FASB issued Statement of Financial Accounting Standards No. 154 *Accounting Changes and Error Corrections*. This Statement replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this Statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this Statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This Statement should be effective for accounting changes made in fiscal years beginning after December 15, 2005.

In December 2004, FASB issued Financial Accounting Standard 153: *Exchanges of Nonmonetary Assets as an amendment of APB Opinion No. 29*. The guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for years beginning after June 15, 2005. This standard will not have any impact to the Company's consolidated financial statements.

(f) Consolidated Statement of Shareholders Equity for the Period From June 1, 1998 to May 31, 2005:

This Statement is prepared in compliance with US GAAP.

	Number of Shares (000's)	Amount	Contributed Surplus/APIC	Deficit	Total
Balance May 31, 1998	**36,785**	**$ 37,180**	**$ 667**	**$ (32,946)**	**$ 4,901**
Exercise of special warrants	5,333	1,004	(1,217)	–	(213)
Exercise of stock options	46	48	–	–	48
Issue of warrants	–	–	1,217	–	1,217
Issue of special warrants	–	–	213	–	213
Other issuances	583	379	–	–	379
Loss for the year	–	–	–	(4,623)	(4,623)

	Number of Shares (000's)	Amount	Contributed Surplus/APIC	Deficit	Total
Balance May 31, 1999	**42,747**	**$ 38,611**	**$ 880**	**$ (37,569)**	**$ 1,922**
Exercise of warrants	12,591	7,546	(534)	–	7,012
Issuance of special and purchase warrants	–	–	8,853	–	8,853
Issuance of public offering	15,333	41,952	659	–	42,611
Issued on acquisition	36,050	14,000	–	–	14,000
Exercise of units	893	1,821	(321)	–	1,500
Issuance under alternate compensation plan	18	15	–	–	15
Exercise of special warrants	30,303	8,438	(8,438)	–	–
Exercise of stock options	1,730	1,113	–	–	1,113
Stock-based compensation	–	869	–	–	869
Loss for the year	–	–	–	(8,599)	(8,599)
Balance May 31, 2000	**139,665**	**$144,365**	**$ 1,099**	**$ (46,168)**	**$ 69,296**
Exercise of warrants	168	93	(25)	–	68
Issuance under alternate compensation plan	28	49	–	–	49
Exercise of stock options	2,550	1,866	–	–	1,866
Stock-based compensation	–	351	–	–	351
Loss for the year	–	82	–	(15,213)	(15,131)
Balance May 31, 2001	**142,411**	**$ 116,806**	**$ 1,074**	**$ (61,381)**	**$ 56,499**
Exercise of compensation warrants	476	265	(71)	–	194
Exercise of stock options	1,525	1,194	–	–	1,194
Stock-based compensation	–	(100)	–	–	(100)
Loss for the year	–	–	–	(13,488)	(13,488)
Balance May 31, 2002	**144,412**	**$ 118,165**	**$ 1,003**	**$ (74,869)**	**$ 44,299**
Exercise of stock options	873	715	–	–	715
Stock-based compensation	–	558	–	–	558
Loss for the year	–	–	–	(16,634)	(16,634)
Balance May 31, 2003	**145,285**	**$ 119,438**	**$ 1,003**	**$ (91,503)**	**$ 28,938**
Share issuance	26,220	24,121	4,325	–	28,446
Exercise of stock options	289	171	–	–	171
Stock-based compensation	–	27	–	–	27
Other issuances	–	28	–	–	28
Loss for the year	–	–	–	(30,301)	(30,301)
Balance May 31, 2004	**171,794**	**$ 143,670**	**$ 5,328**	**$ (121,804)**	**$ 27,194**
Interest payment	421	300	–	–	300
Exercise of stock options	276	112	–	–	112
Expiry of compensation options	–	–	1,405	–	1,405
Issuance under alternate compensation plan	50	37	–	–	37
Issuance of warrants	–	–	1,048	–	1,048
Loss for the year	–	–	–	(20,298)	(20,298)
Balance May 31, 2005	**172,541**	**$ 144,119**	**$ 7,781**	**$ (142,102)**	**$ 9,798**

17. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the current year's method of presentation.

directors and officers >

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Paul Van Damme, M.B.A., C.A.
Chief Financial Officer

Bruce Rowlands
Senior Vice President, Planning
and Public Affairs

Shane Ellis, B.A., LL.B., LL.M.
Vice President, Legal Affairs
and Corporate Secretary

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future

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INQUIRIES, ANNUAL AND QUARTERLY REPORTS

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Fax: 416 798 2200
email: ir@lorusthera.com
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ANNUAL MEETING

The 2005 Annual Meeting of Shareholders will be held on Tuesday September 13, 2005 at 10 a.m. at:

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

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