

## REPORT OF MANAGEMENT'S ACCOUNTABILITY

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

Management is responsible for ensuring that these statements, which include amounts based upon estimates and judgement, are consistent with other information and operating data contained in the annual report and reflect the Company's business transactions and financial position.

The integrity and reliability of Patheon's reporting systems are achieved through the use of formal policies and procedures, the careful selection of employees, and appropriate delegation of authority and division of responsibilities. Patheon's Code of Business Conduct requires employees to maintain high standards in their conduct of the Company's affairs.

Our shareholders' independent auditors, Ernst & Young LLP, whose report on their examination follows, have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards.

The Board of Directors annually appoints an Audit Committee comprised of directors who are not employees of the Company. This Committee meets regularly with management and the shareholders' auditors to review significant accounting, reporting and internal control matters. The shareholders' auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings. Following its review of the financial statements and the report of the shareholders' auditors, the Audit Committee submits its report to the Board of Directors for formal approval of the financial statements.



**ROBERT C. TEDFORD**  
CHIEF EXECUTIVE OFFICER



**RONALD B. MITCHELL**  
CHIEF FINANCIAL OFFICER

Toronto, Canada  
December 7, 2004

## AUDITORS' REPORT

To the Shareholders of Patheon Inc.

We have audited the consolidated balance sheets of Patheon Inc. as at October 31, 2004 and 2003 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. 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 October 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



**ERNST & YOUNG LLP**  
CHARTERED ACCOUNTANTS

Toronto, Canada  
December 7, 2004  
(except as to Note 19 for which the date is December 23, 2004)

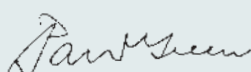
## CONSOLIDATED BALANCE SHEETS

As at October 31  
(in thousands of U.S. dollars)

	<b>2004</b>	2003
	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (note 4)	<b>7,626</b>	9,170
Accounts receivable	<b>95,305</b>	90,896
Inventories (note 5)	<b>58,763</b>	46,446
Income taxes receivable	<b>1,029</b>	–
Prepaid expenses and other	<b>2,768</b>	2,746
<b>Total current assets</b>	<b>165,491</b>	149,258
Capital assets, net (note 6)	<b>331,725</b>	267,587
Future tax assets (note 12)	<b>15,800</b>	10,730
Goodwill	<b>2,837</b>	2,619
Deferred pre-operating and financing costs (note 9)	<b>5,498</b>	5,244
Investment	<b>1,232</b>	1,422
	<b>522,583</b>	436,860
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness (note 7)	<b>21,454</b>	12,113
Accounts payable and accrued liabilities	<b>105,567</b>	89,292
Income taxes payable	–	1,810
Current portion of long-term debt (note 7)	<b>11,146</b>	7,698
<b>Total current liabilities</b>	<b>138,167</b>	110,913
Long-term debt (note 7)	<b>113,116</b>	94,655
Other long-term liabilities (note 8)	<b>21,660</b>	17,627
Future tax liabilities (note 12)	<b>28,242</b>	19,742
<b>Total liabilities</b>	<b>301,185</b>	242,937
<b>Shareholders' equity</b>		
Share capital (note 10)	<b>118,954</b>	118,932
Contributed surplus (note 9)	<b>1,373</b>	–
Retained earnings	<b>76,629</b>	65,951
Cumulative translation adjustment (note 9)	<b>24,442</b>	9,040
<b>Total shareholders' equity</b>	<b>221,398</b>	193,923
	<b>522,583</b>	436,860

See accompanying notes

On behalf of the Board:



PETER A. W. GREEN  
DIRECTOR



ROBERT C. TEDFORD  
DIRECTOR

## CONSOLIDATED STATEMENTS OF EARNINGS

Years ended October 31 (in thousands of U.S. dollars except earnings per share)	<b>2004</b> \$	2003 \$
<b>Revenues</b>	<b>470,259</b>	407,144
Operating expenses	<b>416,374</b>	357,599
Repositioning expenses (note 17)	<b>4,407</b>	–
Stock-based compensation (note 2)	<b>1,373</b>	–
Earnings before depreciation and amortization, interest and income taxes	<b>48,105</b>	49,545
Depreciation and amortization	<b>22,765</b>	16,330
Interest	<b>5,609</b>	4,508
Earnings before income taxes	<b>19,731</b>	28,707
Provision for income taxes (note 12)		
Current	<b>6,669</b>	6,433
Future	<b>2,384</b>	3,696
	<b>9,053</b>	10,129
<b>Net earnings for the year</b>	<b>10,678</b>	18,578
<b>Earnings per share</b> (note 9)		
Basic	<b>\$0.21</b>	\$0.36
Diluted	<b>\$0.21</b>	\$0.36

See accompanying notes

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended October 31 (in thousands of U.S. dollars)	<b>2004</b> \$	2003 \$
<b>Retained earnings, beginning of year</b>	<b>65,951</b>	47,373
Net earnings for the year	<b>10,678</b>	18,578
<b>Retained earnings, end of year</b>	<b>76,629</b>	65,951

See accompanying notes

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended October 31 (in thousands of U.S. dollars)	<b>2004</b> \$	2003 \$
<b>OPERATING ACTIVITIES</b>		
Net earnings for the year	<b>10,678</b>	18,578
Add charges to operations not requiring a current cash payment		
Depreciation and amortization	<b>22,765</b>	16,330
Employee future benefits	<b>2,688</b>	1,059
Future income taxes	<b>2,384</b>	3,696
Loss on sale of investment	<b>33</b>	–
Equipment write-down <i>(note 17)</i>	<b>671</b>	–
Stock-based compensation <i>(note 2)</i>	<b>1,373</b>	–
Cash provided from operations	<b>40,592</b>	39,663
Net change in non-cash working capital balances related to operations	<b>(173)</b>	(4,356)
<b>Cash provided by operating activities</b>	<b>40,419</b>	35,307
<b>INVESTING ACTIVITIES</b>		
Acquisition of new manufacturing site <i>(note 3)</i>		
Capital assets acquired	–	(19,288)
Inventory acquired	–	(9,528)
Liabilities assumed	–	596
Cash consideration	–	(28,220)
Additions to capital assets		
Sustaining	<b>(11,232)</b>	(14,436)
Project-related	<b>(51,372)</b>	(39,233)
Total additions to capital assets	<b>(62,604)</b>	(53,669)
Proceeds on sale of investment	<b>265</b>	–
Decrease (increase) in deferred pre-operating and financing costs	<b>(1,422)</b>	367
<b>Cash used in investing activities</b>	<b>(63,761)</b>	(81,522)
<b>FINANCING ACTIVITIES</b>		
Increase (decrease) in bank indebtedness	<b>8,246</b>	(7,082)
Increase in term loans	<b>74,588</b>	63,124
Repayment of long-term debt and other long-term liabilities	<b>(61,137)</b>	(8,081)
Issue of common shares	<b>22</b>	640
<b>Cash provided by financing activities</b>	<b>21,719</b>	48,601
Effect of exchange rate changes on cash and cash equivalents	<b>79</b>	908
<b>Net increase (decrease) in cash and cash equivalents during the year</b>	<b>(1,544)</b>	3,294
Cash and cash equivalents, beginning of year	<b>9,170</b>	5,876
<b>Cash and cash equivalents, end of year</b>	<b>7,626</b>	9,170
<b>Supplemental cash flow information</b>		
Interest paid	<b>5,778</b>	4,720
Income taxes paid	<b>12,497</b>	7,697
See accompanying notes		

## Notes to Audited Consolidated Financial Statements

October 31, 2004 and 2003

(Dollar information in tabular form is expressed in thousands of U.S. dollars.)

### 1 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Patheon Inc. ("Patheon" or the "Company") is a Canadian public company, which trades under the symbol PTI on the Toronto Stock Exchange. The Company is an independent provider of commercial manufacturing and pharmaceutical development services of prescription ("Rx") and over-the-counter ("OTC") drugs to the international pharmaceutical industry.

Patheon's commercial manufacturing activities relate primarily to Rx and OTC products in solid, semi-solid, liquid and sterile dosage forms. The Company manufactures a wide variety of products to client specifications in many packaging formats. The Company can be responsible for each aspect of the manufacturing and packaging process, from sourcing raw materials and packaging components to delivering the finished product in consumer-ready form to the client's distribution facilities.

Patheon's pharmaceutical development services include dosage form development, analytical methods development, pilot batch manufacture of new products for the regulatory drug approval process, and the provision of scale-up services designed to show that a drug can be manufactured in commercial volumes.

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies followed by the Company are summarized as follows:

#### Change in reporting currency

Effective August 1, 2003, the Company adopted the U.S. dollar as its reporting currency. The Company's revenues from U.S.-based clients have increased significantly as a result of increased activity at the Company's Canadian sites and the acquisition of the Cincinnati site on December 31, 2002. At the time of making the change in reporting currency, approximately 60% of revenues of the Canadian sites and 70% of revenues of the North American sites were transacted in U.S. dollars. The Company concluded that it was appropriate to report in U.S. dollars in order to better communicate the Company's performance to stakeholders.

For periods prior to August 1, 2003, the Company is required to restate all amounts presented into U.S. dollars using the current rate method, whereby all revenues, expenses and cash flows are translated at the average rates that were in effect at the end of these periods.

For periods after August 1, 2003, the assets and liabilities of the Company's operations having a functional currency other than U.S. dollars are translated into U.S. dollars using the exchange rate in effect at the month end, and revenues and expenses are translated at the average rate during the period.

#### Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions have been eliminated.

#### Revenue recognition

The Company recognizes revenue for its commercial manufacturing and pharmaceutical development services when services are completed in accordance with specific agreements with its clients, and all costs connected with providing these services have been incurred, price is fixed or determinable, and collectibility is reasonably assured.

#### Foreign exchange translation

The assets and liabilities of the Company's operations having a functional currency other than the U.S. dollar are translated into the Company's U.S. dollar reporting currency using the exchange rate in effect at the year end, and revenues and expenses are translated at the average rate during the year. Exchange gains or losses on translation of the Company's net equity investment in these operations are deferred as a separate component of shareholders' equity.

The appropriate amounts of exchange gains or losses accumulated in the separate component of shareholders' equity are reflected in income when there is a realized reduction, as a result of capital transactions, in the Company's net investment in the operations that gave rise to such exchange gains and losses.

Foreign exchange gains and losses on transactions occurring in a currency other than an operation's functional currency are reflected in income.

**1 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****Derivative financial instruments**

Derivative financial instruments are utilized by the Company in the management of its foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes. Foreign exchange contracts have been designated as hedges against future net foreign currency cash flows arising from operating activities. Gains and losses on these instruments are unrecognized until realized.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy when undertaking various hedge transactions. This process includes linking all derivatives to specific firm commitments or forecast transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The mark-to-market value of derivative financial instruments reflects the estimated amount that the Company would have been required to pay if required to settle all unfavourable outstanding contracts or the amount that would have been received if required to settle all favourable contracts at the year-end. The mark-to-market value represents a point-in-time estimate that may not be relevant in predicting the Company's future income or cash flows.

**Cash and cash equivalents**

Cash and cash equivalents include cash in interest-bearing accounts and term deposits with remaining maturities of less than three months at the date the term deposit was acquired.

**Inventories**

Inventories, consisting of raw materials, packaging components and work-in-process, are valued at the lower of weighted average cost and net realizable value.

**Capital assets**

Capital assets are carried at cost less accumulated depreciation. The cost of assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in earnings.

Depreciation is provided on the straight-line basis based on estimated useful lives as follows:

Buildings	40 – 50 years
Machinery and equipment	5 – 15 years
Office equipment	4 – 10 years
Furniture and fixtures	10 years

Repairs and maintenance costs are charged to operations as incurred.

In the consolidated statements of cash flows, additions to capital assets are classified as either project-related (additions related to revenue growth) or sustaining (additions related to the preservation of existing assets and capacity).

**Deferred pre-operating and financing costs**

During the development and pre-operating phases of new businesses or facilities, incremental costs are deferred. Once commercial operations have commenced, the costs are amortized on a straight-line basis over five years. Grants under available government assistance programs, relating to these costs, are reflected as a reduction of amounts deferred.

The costs of obtaining bank and other debt financing are deferred and amortized on a straight-line basis over the term of the debt to which they relate.

**Goodwill**

Goodwill represents the excess of the purchase price of the Company's interest in subsidiary companies over the fair value of the underlying net identifiable assets arising on acquisitions. Goodwill is not subject to amortization but is subject to an annual review for impairment, or more frequently if events or changes in circumstances indicate that goodwill is impaired, which consists of a comparison of the fair value of the assets to their carrying value. Any impairment in the carrying value is expensed.

## Notes to Audited Consolidated Financial Statements

October 31, 2004 and 2003

(Dollar information in tabular form is expressed in thousands of U.S. dollars.)

### 1 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Investment

The investment in the shares of a drug technology company is accounted for on the cost basis, whereby the Company records, as earnings, its share of dividends as declared net of any impairment allowance. On an ongoing basis, management reviews the valuation of the investment, taking into consideration any events or circumstances which might have impaired its carrying value.

#### Employee benefit plans

The cost of pension and post-employment benefits related to employees' current service is charged to earnings annually. The cost is computed on an actuarial basis using the projected benefit method prorated on service and management's best estimates of various actuarial factors, including salary escalation, other cost escalation and retirement ages of employees.

Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets.

Past service costs resulting from plan amendments are deferred and amortized on a straight-line basis over the remaining service life of employees active at the time of amendment.

Actuarial gains (losses) arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plans and the other retirement benefit plans at the measurement date of October 31, 2004 is 13 years (2003 – 15 years).

Unfunded termination benefits for the Company's Italian employees are accrued based on Italian severance pay statutes. The liability recorded on the consolidated balance sheets is the amount to which the employees would be entitled if the employees separated immediately.

#### Income taxes

The Company follows the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

#### Stock-based compensation plan

Prior to 2004, no compensation expense was recognized for stock options granted under the Company's incentive stock option plan.

Commencing in 2004, the fair value of stock options granted, modified or settled on or after November 1, 2003 is recognized on a straight-line basis over the applicable stock option vesting period as stock-based compensation expense in the consolidated statements of earnings, and contributed surplus in the consolidated balance sheets. On the exercise of stock options, consideration received and the accumulated contributed surplus amount is credited to share capital.

For stock options granted prior to November 1, 2003, that are not accounted for at fair value, pro-forma earnings disclosure showing the impact of fair value accounting is included in note 16.

The fair value of stock options is estimated at the grant date using the Black-Scholes option pricing model. This model requires the input of a number of assumptions, including dividend yields, expected stock price volatility, expected time until exercise, and risk-free interest rates. Although the assumptions used reflect management's best estimates, they involve inherent assumptions based on market conditions generally outside of the control of the Company.

**1 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****Earnings per share**

The calculation of earnings per share is based on the reported net earnings divided by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflect the assumed conversion of all diluted securities using the treasury stock method.

Under the treasury stock method:

- the exercise of options is assumed to be at the beginning of the period (or at the time of issuance, if later);
- the proceeds from the exercise of options, plus future period compensation expense on options granted on or after November 1, 2003, are assumed to be used to purchase common shares at the average price during the period; and
- the incremental number of common shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) is included in the denominator of the diluted earnings per share computation.

**Government financing**

The Company makes periodic applications for financial assistance under available government assistance programs in the various jurisdictions in which the Company operates. Grants relating to capital expenditures are reflected as a reduction in the cost of the related assets. Grants and tax credits relating to current operating expenditures are generally recorded as a reduction in expense at the time the eligible expenses are incurred. In the case of certain foreign subsidiaries, the Company receives investment incentive allowances, which are accounted for as a reduction in income tax expense.

**Use of estimates**

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles 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 consolidated financial statements; and the reported amounts of revenue and expenses in the reporting period. Management believes that the estimates and assumptions used in preparing its consolidated financial statements are reasonable and prudent; however, actual results could differ from those estimates.

**2 ACCOUNTING CHANGE****Stock-based compensation**

Effective November 1, 2003, the Company adopted the revised recommendations of the Canadian Institute of Chartered Accountants ("CICA") with respect to the recognition and measurement of stock-based compensation and other stock-based payments at fair value. Stock options granted after November 1, 2003 are accounted for under the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and recognized, over the vesting period, with a corresponding credit to contributed surplus. On the exercise of stock options, consideration received and the accumulated contributed surplus account are credited to share capital.

On January 9, 2004 and April 21, 2004, the Company issued 582,000 and 40,000 options, respectively. On August 25, 2004, 5,000 of these options were forfeited. Stock-based compensation expense related to these options was \$1,373,000 for the year ended October 31, 2004. The effect of this change was to decrease net earnings by \$1,373,000 (\$0.03 per share) for the year ended October 31, 2004.

Stock options granted prior to November 1, 2003 continue to be accounted for using the intrinsic value method, which does not give rise to compensation expense. Pro-forma earnings disclosure for stock options granted prior to November 1, 2003 is included in note 16.

## Notes to Audited Consolidated Financial Statements

October 31, 2004 and 2003

(Dollar information in tabular form is expressed in thousands of U.S. dollars.)

### 3 ACQUISITION OF MANUFACTURING SITE IN 2003

On December 31, 2002, the Company acquired a pharmaceutical manufacturing and development facility located in Cincinnati, Ohio, U.S.A., for total cash consideration of \$28,220,000, including related acquisition costs and inventory and net of liabilities assumed.

The acquisition has been accounted for using the purchase method, and the accompanying consolidated financial statements include the results of operations from the date of purchase. The purchase price was allocated in the accounts based on the estimated fair value of the assets acquired less liabilities assumed as follows:

	2003 \$
Capital assets acquired	19,288
Inventory acquired	9,528
Liabilities assumed	(596)
<b>Cash consideration for net assets acquired</b>	<b>28,220</b>

### 4 CASH AND CASH EQUIVALENTS

	2004 \$	2003 \$
Interest-bearing balances with banks	<b>4,315</b>	4,948
Term deposits	<b>3,311</b>	4,222
	<b>7,626</b>	9,170

### 5 INVENTORIES

	2004 \$	2003 \$
Raw materials and packaging components	<b>39,934</b>	29,664
Work-in-process	<b>18,829</b>	16,782
	<b>58,763</b>	46,446

### 6 CAPITAL ASSETS

	COST \$	ACCUMULATED DEPRECIATION \$	2004 NET BOOK VALUE \$	2003 NET BOOK VALUE \$
Land	<b>17,484</b>	-	<b>17,484</b>	15,620
Buildings	<b>140,255</b>	<b>15,765</b>	<b>124,490</b>	100,629
Machinery and equipment	<b>188,004</b>	<b>58,361</b>	<b>129,643</b>	111,783
Office equipment	<b>17,304</b>	<b>10,695</b>	<b>6,609</b>	7,879
Furniture and fixtures	<b>9,642</b>	<b>5,309</b>	<b>4,333</b>	2,932
Construction in progress	<b>49,166</b>	-	<b>49,166</b>	28,744
	<b>421,855</b>	<b>90,130</b>	<b>331,725</b>	267,587

Capital commitments to complete authorized capital projects were \$13,197,000 at October 31, 2004. The majority of these expenditures are expected to be incurred during the year ending October 31, 2005.

**7 LONG-TERM DEBT AND BANK INDEBTEDNESS**

	<b>2004</b>	2003
	\$	\$
Canadian and U.S. revolving facilities, bearing interest at floating rates based on bankers' acceptances, prime, U.S. base rate or U.S. LIBOR, maturing in 2005	–	19,712
Canadian and U.S. term facilities bearing interest at floating rates based on bankers' acceptances, prime, U.S. base rate or U.S. LIBOR, maturing in 2006 (Canadian portion – C\$65,000,000)	<b>53,366</b>	31,639
U.S. mortgage, bearing interest at 3.5%, maturing in 2010	<b>9,000</b>	9,000
U.S. mortgage, bearing interest at 3.0%, maturing in 2008	<b>2,680</b>	2,955
Italian mortgages, bearing interest at floating rates based on 3-month Euribor (€31,007,000), maturing in 2006, 2011, and 2012	<b>39,681</b>	24,783
Italian mortgage, bearing interest at 4.68% per annum (€8,785,000), maturing in 2008	<b>11,242</b>	12,192
Italian government loan, bearing interest at 0.9% per annum (€1,274,000), maturing in 2014	<b>1,630</b>	–
U.K. asset financing facilities, bearing interest at floating rates based on U.K. base rate (£3,625,000)	<b>6,663</b>	2,072
	<b>124,262</b>	102,353
Less current portion	<b>11,146</b>	7,698
	<b>113,116</b>	94,655

**Canada**

On July 9, 2004, the Company completed a financing agreement with a consortium of Canadian banks. This revolving, floating rate committed facility comprises two parts: i) C\$45,000,000 (US\$36,946,000) relates to operating requirements and is for 364 days, extendible at the option of the lenders, and ii) C\$65,000,000 (US\$53,366,000) is a two-year, revolving term loan. The facility is collateralized by general security agreements and fixed and floating charge debentures covering the assets of the borrower's Canadian operations. This facility can be drawn in bankers' acceptance, prime, U.S. LIBOR, U.S. base rate, at spreads between 0.0% and 5.0%.

At October 31, 2004, the Company was not in compliance with certain financial covenants contained in its debt agreement. However, the Company has obtained a waiver of the non-compliance from its lenders and has also obtained amendments to the covenants for specific periods of 2005. As the Company expects to be in compliance with its financial covenants during the next twelve months, no change has been made to assumptions on long-term debt as presented in the accompanying balance sheet.

**United States**

In June 2003, financing arrangements were completed with the State of Ohio. The financing comprises a \$3,000,000, seven-year loan with an interest rate of 3.0% granted under the State of Ohio's 166 Direct Loan program, and a \$9,000,000, five-year bond at 3.5% granted under the Ohio Enterprise Bond Fund. The financing arrangements are being administered by the Ohio Department of Development, which provides funds to borrowers who will create jobs and promote economic development in the State of Ohio.

**Europe**

The Company's U.K. subsidiary has an asset finance line of credit with a U.K. bank of £3,000,000 (\$5,514,000) with interest at base rate plus 0.9% and collateralized by a chattels mortgage on specific assets acquired and fixed and floating charge debentures covering the assets of the borrower. Amounts drawn are repayable in equal monthly installments over a period of 36 to 60 months. As at October 31, 2004, the amount outstanding was £2,471,000 (\$4,541,000). The aggregate amount outstanding under the operating line of credit and the asset finance line of credit is limited to £6,000,000 (\$11,027,000).

## Notes to Audited Consolidated Financial Statements

October 31, 2004 and 2003

(Dollar information in tabular form is expressed in thousands of U.S. dollars.)

### 7 LONG-TERM DEBT AND BANK INDEBTEDNESS (CONTINUED)

During 2004, the Company's U.K. subsidiary completed asset finance line of credit agreements with a U.K. bank in the amount of £5,000,000 (\$9,189,000) which are collateralized by chattels mortgages on specific assets acquired and fixed charge debentures covering the assets of the borrower and a limited guarantee by the Company. Amounts drawn are repayable in equal monthly instalments over a period of 36 or 48 months. As at October 31, 2004, the amount outstanding was £1,154,000 (\$2,122,000) and bears interest of 6.2%.

During 2004, the Company's Italian subsidiary completed a financing agreement with its Italian bankers in the amount of €22,000,000 (\$28,154,000), which has to be fully drawn by May 15, 2006. No principal payments are required until June 15, 2006, at which time principal payments commence and continue through June 15, 2014. The loan was drawn at €6,000,000 (\$7,678,000) as of October 31, 2004 and bears interest at Euribor (three months) plus 1.25%.

During 2004, the Company's Italian subsidiary received approval for a government-assisted, 10-year loan in the amount of €3,442,000 (\$4,405,000) for qualifying scientific expenditures. As of October 31, 2004, the loan was drawn at €1,274,000 (\$1,630,000) and bears interest at 0.886%. No principal payments are required until 18 months after the project has been officially completed and the first principal payment is not expected until June 2007, at which time principal payments will commence and continue through June 2014.

During 2002, the Company's Italian subsidiary completed a financing agreement with its Italian bankers in the amount of €10,000,000 (\$12,797,000). No principal payments were required until September 30, 2004, at which time principal payments commenced and will continue through September 30, 2012. The loan was drawn at €9,501,000 (\$12,159,000) as of October 31, 2004 and bears interest at Euribor (three months) plus 1.08%.

Patheon Italia S.p.A. also has long-term credit facilities in the amount of €14,097,000 (\$18,041,000), all of which was drawn at October 31, 2004. Equal semi-annual principal repayments commenced on June 30, 2004 and continue through December 31, 2011. The mortgage bears interest at Euribor plus 1.10%. The facilities are secured by mortgages on the Monza, Italy, and Ferentino, Italy, properties. As at October 31, 2004, the amount outstanding was €8,785,000 (\$11,242,000).

The mortgage bearing interest at 4.68% was assumed on the acquisition of Patheon Italia S.p.A. and is collateralized by a first mortgage on the Italian subsidiary's building and a letter of comfort to the lender. The mortgage is repayable in equal semi-annual amounts until December 31, 2008.

The mortgage bearing interest at Euribor plus 0.7%, assumed on the acquisition of Patheon Italia S.p.A., is collateralized by a second mortgage on the Italian subsidiary's building. Principal repayments commenced on March 31, 2001 and are payable in equal semi-annual amounts until March 31, 2006. As at October 31, 2004, the amount outstanding was €1,409,000 (\$1,803,000).

The estimated minimum annual repayment schedule for long-term debt based on current exchange rates for the next five fiscal years is: 2005 – \$11,146,000; 2006 – \$67,032,000; 2007 – \$14,674,000; 2008 – \$12,574,000; 2009 – \$6,486,000.

Interest on long-term debt amounted to \$4,912,000 (2003 – \$2,729,000) for the year.

**7 LONG-TERM DEBT AND BANK INDEBTEDNESS (CONTINUED)****Bank indebtedness****Canada**

As at October 31, 2004, the amount outstanding under the operating facility component of the financing agreement was \$7,331,000.

**United States**

The Company's U.S. subsidiary has an operating line of credit with its U.S. bankers of \$14,000,000. The line of credit, with interest at U.S. base rate or U.S. LIBOR plus 1.5%, may not exceed an allowable portion of accounts receivable and inventory. The line of credit is collateralized by general security agreements and fixed and floating charge debentures covering the assets of the borrower, a pledge of shares of the borrower and a \$10,000,000 limited guarantee by the Company and certain of its subsidiaries. As at October 31, 2004, the line of credit was not utilized.

**Europe**

The Company's U.K. subsidiary has an operating line of credit with its U.K. bankers of £4,000,000 (\$7,351,000). The line of credit, with interest at U.K. base rate plus 1.0%, may not exceed the lesser of £4,000,000 (\$7,351,000) and an allowable portion of accounts receivable. The line of credit is collateralized by general security agreements and fixed and floating charge debentures covering the assets of the borrower, a pledge of shares of the borrower and guarantees by the Company and certain of its subsidiaries. As at October 31, 2004, the line of credit utilized by the Company amounted to £2,307,000 (\$4,375,000).

The Company's Italian subsidiary has several short-term operating credit facilities with its Italian bankers totaling €13,100,000 (\$16,800,000). These credit facilities bear interest at between Euribor (3 months) plus 0.50% and Euribor (3 months) plus 1.25%. Certain of the short-term credit facilities are provided on an unsecured basis and others are secured against invoices issued by the Company's Italian subsidiary. As at October 31, 2004, the amount outstanding under these facilities was €7,618,000 (\$9,748,000).

**8 OTHER LONG-TERM LIABILITIES**

	<b>2004</b>	2003
	\$	\$
Unfunded termination indemnities (€5,200,000)	<b>6,647</b>	5,813
Employee future benefits (note 13)	<b>15,013</b>	11,744
Preferred shares (note 10)	<b>76</b>	161
	<b>21,736</b>	17,718
Less current portion included in accounts payable and accrued liabilities	<b>76</b>	91
	<b>21,660</b>	17,627

The unfunded termination indemnities relate to the employees of the Company's Italian subsidiary. In accordance with Italian severance pay statutes, an employee benefit is accrued for service to date and is payable immediately upon separation from employment. The termination indemnity liability is calculated in accordance with local civil and labour laws based on each employee's length of service, employment category and remuneration. The termination liability is adjusted annually by a cost-of-living index provided by the Italian Government. There is no vesting period or funding requirement associated with the liability. The liability recorded in the consolidated balance sheets is the amount to which the employees would be entitled if the employees separated immediately. The expense for the year amounted to \$1,324,000 (2003 – \$1,050,000).

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### 9 OTHER INFORMATION

#### Cumulative translation adjustment

The cumulative translation adjustment amount will be impacted by fluctuations in the value of the U.S. dollar relative to the Canadian dollar, the euro and U.K. sterling.

Unrealized translation adjustments, which arise on the translation into U.S. dollars of assets and liabilities of the Company's self-sustaining foreign operations, resulted in an unrealized currency translation gain of \$15,402,000 for the year ended October 31, 2004 (2003 – unrealized currency translation gain of \$6,468,000). For the year ended October 31, 2004, the net unrealized gain of \$15,402,000 is attributable to the weakening of the U.S. dollar against the euro, U.K. sterling and the Canadian dollar, as measured at October 31, 2004 and October 31, 2003.

#### Earnings per share

The following is a reconciliation of the numerator and denominator of earnings per share computations:

	<b>2004</b>	2003
	\$	\$
<b>Net earnings for the year</b>	<b>10,678</b>	18,578
Weighted average number of shares outstanding (in thousands)	<b>51,521</b>	51,384
Effect of dilutive stock options	<b>446</b>	795
<b>Diluted weighted average number of shares outstanding</b>	<b>51,967</b>	52,179
<b>Earnings per share</b>		
Basic	<b>\$0.21</b>	\$0.36
Diluted	<b>\$0.21</b>	\$0.36

Options to purchase 1,771,000 and 442,000 common shares for the years ended October 31, 2004 and 2003, respectively, were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

#### Deferred pre-operating and financing costs

Deferred pre-operating and financing costs consist of the following:

	COST	ACCUMULATED DEPRECIATION	2004 NET BOOK VALUE	2003 NET BOOK VALUE
	\$	\$	\$	\$
Start-up costs	<b>8,586</b>	<b>3,721</b>	<b>4,865</b>	5,244
Financing costs	<b>830</b>	<b>197</b>	<b>633</b>	–
	<b>9,416</b>	<b>3,918</b>	<b>5,498</b>	5,244

#### Foreign exchange

Foreign exchange gain for the year amounted to \$24,000 (2003 loss – \$962,000).

#### Contributed surplus

Contributed surplus arises solely from the recording of stock-based compensation expense commencing November 1, 2003, as described in note 2.

**10 SHAREHOLDERS' EQUITY****Share capital**

Share capital consists of the following:

	<b>2004</b>	2003
	\$	\$
<b>Authorized</b>		
Unlimited Class I preferred shares issuable in series, eligible for a cumulative cash dividend of C\$6.00 (US\$4.93) per share payable annually in arrears. Redeemable at the option of the Company for C\$100 (US\$82) per share with 1,331 preferred shares being required to be redeemed annually		
Unlimited common shares		
<b>Issued and outstanding</b>		
1,029 Class I preferred shares, Series A (2003 – 2,360)	<b>76</b>	161
51,555,822 common shares (2003 – 51,505,822)	<b>118,954</b>	118,932

**Preferred shares**

Due to their mandatory redemption provisions, the Company's preferred shares are classified as other long-term liabilities, and associated dividends paid are reflected as interest expense. During each of 2004 and 2003, the Company redeemed 1,331 of its preferred shares at C\$100 (US\$82) (2003 – US\$76) per share. The Company's preferred shares will be fully redeemed in 2005.

**Common shares issued**

During the year, the Company issued 50,000 (2003 – 592,800) common shares under the stock option plan for proceeds of \$22,000 (2003 – \$640,000).

**Incentive stock option plan**

The Company has an incentive stock option plan, which provides for the granting of options for the benefit of employees, officers and directors. The total number of Company shares that may be issued under this plan is 6,422,923. However, between inception of the plan and October 31, 2004, 2,107,628 common shares had been issued on the exercise of the options granted under the plan.

At October 31, 2004, the total number of common shares still available to be issued under the plan was 4,315,295, of which 3,551,713 were reserved for options granted and outstanding under the incentive stock option plan. The exercise price per share will be the market price at the time of granting and the maximum term is 10 years. Options generally vest equally after the end of the first, second and third year of grant; however, under certain circumstances, options vest immediately.

A summary (all dollar amounts in Canadian) of the plan and changes during each of 2004 and 2003 are as follows:

	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE
	#	\$	#	\$
(Dollar amounts in Canadian)				
<b>Outstanding, beginning of year</b>	<b>3,015,278</b>	<b>10.81</b>	3,017,111	8.53
Granted	<b>622,000</b>	<b>11.20</b>	629,500	13.26
Exercised	<b>(50,000)</b>	<b>0.60</b>	(592,800)	1.66
Forfeited	<b>(35,565)</b>	<b>13.81</b>	(38,533)	12.91
<b>Outstanding, end of year</b>	<b>3,551,713</b>	<b>10.99</b>	3,015,278	10.81
<b>Options exercisable at year end</b>	<b>2,705,893</b>	<b>10.77</b>	2,300,130	10.03

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### 10 SHAREHOLDERS' EQUITY (CONTINUED)

#### Incentive stock option plan (continued)

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

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	OPTIONS OUTSTANDING		OPTIONS EXERCISABLE	
		WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
<b>\$1.32 – 3.53</b>	<b>385,000</b>	<b>3.5 years</b>	<b>\$2.91</b>	<b>385,000</b>	<b>\$2.91</b>
<b>\$8.15 – 9.91</b>	<b>689,000</b>	<b>5.1 years</b>	<b>\$8.39</b>	<b>689,000</b>	<b>\$8.39</b>
<b>\$10.91 – 13.95</b>	<b>1,844,147</b>	<b>8.0 years</b>	<b>\$12.17</b>	<b>1,006,329</b>	<b>\$12.60</b>
<b>\$14.01 – 15.96</b>	<b>633,566</b>	<b>5.9 years</b>	<b>\$15.30</b>	<b>625,564</b>	<b>\$15.30</b>

### 11 SHAREHOLDER RIGHTS PLAN

On March 20, 2002, the shareholders approved renewal of an amended and restated shareholder rights plan (the "Renewal Plan") and continuation of the rights granted under a shareholder rights plan approved by shareholders on March 23, 1999. The Renewal Plan applies to all common shares and all future issues of common shares. The Renewal Plan is designed to encourage fair treatment of all the Company's shareholders in the event of a take-over bid, to provide shareholders and the Board of Directors with more time to fully consider any unsolicited take-over bid for the Company, to allow the Board of Directors to pursue, if appropriate, other alternatives to enhance shareholder value, and to allow additional time for competing bids to emerge. The Renewal Plan will be in effect until the close of the 2005 annual shareholders' meeting of the Company.

Under the terms of the Renewal Plan, one right has been granted for each common share. Each right entitles the registered holder to purchase an additional common share for C\$50 (US\$38) but is not exercisable until certain events occur. The rights issued under the Renewal Plan become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the Company's outstanding common shares without complying with the "Permitted Bid" provisions or without approval of the Board of Directors. Should such an acquisition occur, each right would entitle a holder, other than the acquiring person and persons related to it, to purchase common shares of the Company at a 50% discount to the market price.

A Permitted Bid is a bid made to all shareholders that is open for at least 60 days. If at the end of 60 days at least 50% of the outstanding shares, other than those owned by the offeror and certain related parties, have been tendered, then the offeror may take up and pay for the shares but must extend the bid for a further 10 business days to allow other shareholders to tender.

**12 INCOME TAXES**

The following is a reconciliation of the expected income tax expense obtained by applying the combined corporate tax rates to income before income taxes:

	<b>2004</b>	2003
	\$	\$
Expected income tax expense using statutory tax rates	<b>6,732</b>	9,508
Permanent differences and other		
Foreign	<b>1,159</b>	584
Domestic	<b>474</b>	90
Foreign rate differentials	<b>688</b>	490
Benefit resulting from Italian investment tax deductions	-	(543)
<b>Provision for income taxes</b>	<b>9,053</b>	10,129
<b>Effective tax rate</b>	<b>45.9%</b>	35.3%

Components of future income taxes by jurisdiction are summarized as follows:

	<b>2004</b>	2003
	\$	\$
<b>Canada</b>		
Future income tax assets – long term		
Share issue costs	<b>143</b>	374
Accounting provisions not currently deductible for tax purposes	<b>1,914</b>	1,459
	<b>2,057</b>	1,833
Future income tax liabilities – long term		
Tax depreciation in excess of book depreciation	<b>9,356</b>	7,848
Investment tax credits	<b>2,324</b>	1,033
Other	<b>286</b>	208
	<b>11,966</b>	9,089
<b>Foreign</b>		
Future income tax assets – long term		
Accounting provisions not currently deductible for tax purposes	<b>6,839</b>	4,717
Net operating loss carryforward	<b>6,336</b>	3,242
Other	<b>568</b>	938
	<b>13,743</b>	8,897
Future income tax liabilities – long term		
Tax depreciation in excess of book depreciation	<b>15,870</b>	10,328
Other	<b>406</b>	325
	<b>16,276</b>	10,653

The 2001 Italian investment tax incentive law was enacted in order to encourage capital investments and other expenditures in Italy. Companies were able to reduce their taxable income by up to 50% of the excess of new qualifying capital and other expenditures made during a specified period of time in capital assets (tangibles and specified intangibles) over the average of the investments made in such assets during the five prior years. The incentive law also applied to certain expenses incurred in connection with the training of the companies' personnel. The incentive resulted in a current deduction and neither increased nor decreased the tax bases of the assets to compute future tax deductions for depreciation and amortization relating to investment deductions granted. This tax incentive program was discontinued. No amount was recorded in 2004 (2003 – \$543,000).

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### 13 EMPLOYEE FUTURE BENEFITS

The Company has a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to substantially all of its employees. The Company measured the accrued benefit obligation and the fair value of plan assets for accounting purposes as at October 31, 2004 for the pension and other benefit plans.

Total cash payments for employee future benefits for 2004, consisting of cash contributed by the Company to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to its defined contribution plans, were \$6,520,000 (2003 – \$5,208,000).

Information about the Company's defined benefit pension and other benefit plans, in aggregate, is as follows:

	PENSION PLANS <b>2004</b> \$	OTHER BENEFIT PLANS <b>2004</b> \$	PENSION PLANS 2003 \$	OTHER BENEFIT PLANS 2003 \$
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of year	<b>67,691</b>	<b>4,314</b>	48,699	3,264
Current service cost	<b>3,889</b>	<b>456</b>	3,102	(5)
Interest cost	<b>1,501</b>	<b>304</b>	3,118	227
Plan amendments	<b>613</b>	–	–	–
Past service costs	<b>399</b>	–	–	–
Member contributions during the year	<b>722</b>	–	785	–
Benefits paid	<b>(1,054)</b>	<b>(39)</b>	(757)	(22)
Actuarial loss (gain)	<b>(26,103)</b>	<b>1,317</b>	6,826	218
Currency translation	<b>5,562</b>	<b>529</b>	5,918	632
<b>Benefit obligation, end of year</b>	<b>53,220</b>	<b>6,881</b>	67,691	4,314
<b>Change in plan assets</b>				
Market value of plan assets, beginning of year	<b>46,134</b>	–	36,793	–
Actual return of plan assets	<b>(18,882)</b>	–	2,396	–
Member contributions during the year	<b>722</b>	–	785	–
Employer contributions	<b>3,243</b>	<b>39</b>	2,937	22
Benefits paid	<b>(1,054)</b>	<b>(39)</b>	(757)	(22)
Currency translation	<b>3,655</b>	–	3,980	–
<b>Market value of plan assets, end of year</b>	<b>33,818</b>	–	46,134	–
<b>Reconciliation of funded status</b>				
Funded status, deficit	<b>(19,402)</b>	<b>(6,881)</b>	(21,557)	(4,314)
Contributions after measurement date	<b>679</b>	–	679	–
Unamortized past service and net actuarial loss	<b>8,384</b>	<b>2,207</b>	12,884	564
<b>Accrued benefit liability</b>	<b>(10,339)</b>	<b>(4,674)</b>	(7,994)	(3,750)

The accrued benefit liability—which includes both the pension plans and other benefit plans—of \$15,013,000 (2003 – \$11,744,000) is included in other long-term liabilities (note 8).

**13 EMPLOYEE FUTURE BENEFITS (CONTINUED)**

Pension plan assets consist of:

	PENSION PLANS <b>2004</b> %	PENSION PLANS 2003 %
Equity securities	<b>73</b>	84
Debt securities	<b>23</b>	14
Other	<b>4</b>	2
Total	<b>100</b>	100

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows (weighted average assumptions as at October 31):

	PENSION PLANS <b>2004</b> %	OTHER BENEFIT PLANS <b>2004</b> %	PENSION PLANS 2003 %	OTHER BENEFIT PLANS 2003 %
<b>Accrued benefit obligation</b>				
Discount rate	<b>6</b>	<b>6</b>	6.5	6.5
Rate of compensation increase	<b>3.5</b>	–	4	–
<b>Defined benefit pension costs</b>				
Discount rate	<b>6.5</b>	<b>6</b>	6.5	6.5
Expected long-term rate of return on plan assets	<b>7</b>	–	7	–
Rate of compensation increase	<b>3.5</b>	–	4	–

For measurement purposes, a 4% to 12% annual rate of increase in the per capita cost of covered health care and dental benefits was assumed for 2004. The rate was assumed to decrease gradually over the next seven years to 6% and to remain at that level thereafter. The following table outlines the effects of a one-percentage-point increase and decrease in the assumed health care and dental benefit trend rates:

		BENEFIT OBLIGATION \$	BENEFIT EXPENSE \$
Impact of:	1% increase	<b>1,382</b>	<b>241</b>
	1% decrease	<b>(1,150)</b>	<b>(198)</b>

The Company's net benefit plan expense is as follows:

	PENSION PLANS <b>2004</b> \$	OTHER BENEFIT PLANS <b>2004</b> \$	PENSION PLANS 2003 \$	OTHER BENEFIT PLANS 2003 \$
<b>Components of defined benefit plan expense</b>				
Current service cost	<b>3,889</b>	<b>456</b>	3,102	(5)
Interest cost	<b>1,501</b>	<b>304</b>	3,118	227
Amortization of net actuarial loss (gain)	<b>40</b>	<b>30</b>	(3)	–
Amortization of past service costs	<b>444</b>	–	3	–
Expected return on plan assets (income)	<b>(1,076)</b>	–	(3,015)	–
<b>Net expense</b>	<b>4,798</b>	<b>790</b>	3,205	222

The Company also provides retirement benefits for the majority of its employees at its Canadian and U.S. sites under a defined contribution plan. The total expense for the plan amounted to \$3,238,000 (2003 – \$2,249,000).

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### 14 SEGMENTED INFORMATION

The Company is organized and managed as a single business segment, being the provider of commercial manufacturing and pharmaceutical development services (note 1).

Canadian and foreign operations consist of the following:

	Year ended October 31, 2004			TOTAL \$
	CANADA \$	U.S.A. \$	EUROPE \$	
<b>Revenues</b>				
Canada	<b>25,169</b>	<b>2,081</b>	<b>622</b>	<b>27,872</b>
U.S.A.	<b>113,807</b>	<b>113,905</b>	<b>5,715</b>	<b>233,427</b>
Europe	<b>34,761</b>	<b>2,507</b>	<b>165,131</b>	<b>202,399</b>
Other geographic areas	<b>2,936</b>	<b>516</b>	<b>3,109</b>	<b>6,561</b>
Total revenues	<b>176,673</b>	<b>119,009</b>	<b>174,577</b>	<b>470,259</b>
Capital assets	<b>113,484</b>	<b>33,808</b>	<b>184,433</b>	<b>331,725</b>
Goodwill	<b>2,837</b>	-	-	<b>2,837</b>

	Year ended October 31, 2003			TOTAL \$
	CANADA \$	U.S.A. \$	EUROPE \$	
<b>Revenues</b>				
Canada	22,890	965	165	24,020
U.S.A.	112,946	79,223	2,064	194,233
Europe	32,665	1,817	151,856	186,338
Other geographic areas	1,544	627	382	2,553
Total revenues	170,045	82,632	154,467	407,144
Capital assets	98,179	27,711	141,697	267,587
Goodwill	2,619	-	-	2,619

Revenues are attributed to countries based on the location of the client's billing address, and capital assets and goodwill are based in the country in which they are located. During the year ended October 31, 2004, two (2003 – three) clients accounted for more than 10% of the Company's total revenues. As a percentage of total revenues, revenues from these clients amounted to 20% and 13% (2003 – 25%, 11% and 10%).

Revenue information by service activity is as follows:

	2004 \$	Year ended October 31	
		2003 \$	
Commercial manufacturing – prescription	<b>302,315</b>	<b>64%</b>	258,372 63%
Commercial manufacturing – over-the-counter	<b>102,165</b>	<b>22%</b>	106,351 26%
Pharmaceutical development services	<b>65,779</b>	<b>14%</b>	42,421 11%
	<b>470,259</b>	<b>100%</b>	407,144 100%

**15 COMMITMENTS AND CONTINGENCIES****Long-term leases**

The Company has entered into long-term rental agreements expiring at various dates until 2014. The future rental payments for the next five years are estimated as follows: 2005 – \$1,077,000, 2006 – \$1,086,000, 2007 – \$1,042,000, 2008 – \$594,000, 2009 – \$532,000.

**16 STOCK-BASED COMPENSATION**

The Company recorded stock-based compensation expense in the year of \$1,373,000 for options granted on or after November 1, 2003.

As described in note 1 “Stock-based compensation plan”, no compensation expense has been recorded for options granted before November 1, 2003. Stock options granted prior to November 1, 2003 are accounted for using the intrinsic value method which does not give rise to compensation expense. Had compensation expense been determined based on the fair value at grant dates for stock options granted prior to November 1, 2003, the Company’s pro-forma results would have been:

	<b>2004</b>	2003
	\$	\$
Net earnings as reported	<b>10,678</b>	18,578
Pro-forma compensation expense	<b>(869)</b>	(1,421)
Pro-forma net earnings	<b>9,809</b>	17,157
Pro-forma earnings per share:		
Basic	<b>\$0.19</b>	\$0.33
Diluted	<b>\$0.19</b>	\$0.33

The fair value of stock options is estimated at the date of the grant. The weighted average fair value of stock options granted for the year ended October 31, 2004 was \$3.94 (2003 – \$3.91).

The fair value of stock options for purposes of determining stock-based compensation and pro-forma disclosures is estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

	<b>2004</b>	2003
Risk free interest rate	<b>3.7%</b>	4.0%
Expected volatility	<b>48%</b>	48%
Expected weighted average life of the options	<b>5 years</b>	4.3 years
Expected dividend yield	<b>0%</b>	0%

**17 REPOSITIONING EXPENSES**

During the 2004 fiscal year, the Company adopted a repositioning plan for its U.K. operations designed to reduce operating losses. The repositioning plan was completed by October 31, 2004. The plan included both a reduction in the work force and a reorganization of production processes. The total cost of the plan for the year ended October 31, 2004 was \$4,407,000 which was comprised of:

	<b>2004</b>
	\$
Employee-related expenses	<b>2,255</b>
Equipment write-down	<b>671</b>
Other	<b>1,481</b>
	<b>4,407</b>

As at October 31, 2004, the majority of Other costs were not yet paid and were reflected as current liabilities.

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### 18 FINANCIAL INSTRUMENTS

#### (a) Foreign exchange forward contracts

The Company utilizes financial instruments to manage the risk associated with fluctuations in foreign exchange rates.

The Company has entered into foreign exchange expandable forward contracts with an aggregate amount of between US\$17,000,000 and US\$25,500,000 as at October 31, 2004 (2003 – US\$22,000,000 and US\$33,000,000). These contracts mature at the latest on March 30, 2005, at exchange rates varying between 1.3300 and 1.4065 Canadian.

The mark-to-market value of these financial instruments as at October 31, 2004 was an unrealized gain of US\$2,352,000 (2003 – unrealized gain US\$80,000).

#### (b) Fair value

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. Accordingly, these estimated fair values are not necessarily indicative of the amounts the Company could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of financial instruments are described below:

#### Cash and cash equivalents, accounts receivable, bank indebtedness and accounts payable and accrued liabilities

Due to the short period to maturity of these instruments, the carrying values as presented in the consolidated balance sheets are reasonable estimates of fair value.

#### Long-term debt

The fair value of the Company's long-term debt, based on current rates for debt with similar terms and maturities, is not materially different from its carrying value.

#### (c) Credit risk

The Company's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents, accounts receivable and foreign exchange forward contracts with positive fair values.

The Company, in the normal course of business, is exposed to credit risk from its clients, substantially all of which are in the pharmaceutical industry. These accounts receivable are subject to normal industry credit risks.

Cash and cash equivalents, which include short-term investments, are only invested in entities with an investment grade credit rating. Credit risk is further reduced by limiting the amount which is invested in any one government or corporation.

The Company is also exposed to credit risk from potential default by any of its counterparties on its forward exchange forward contracts. The Company manages this credit risk by dealing with counterparties which are major financial institutions and which the Company anticipates will satisfy their obligations under the contracts.

#### (d) Interest rate risk

The Company is not exposed to significant interest rate risk due to the short-term maturity of its monetary current assets and current liabilities and its present levels of fixed rate long-term debt.

## 19 SUBSEQUENT EVENTS

On December 23, 2004, the Company completed the acquisition of MOVA Pharmaceutical Corporation and MOVA Investments, Inc. (collectively "MOVA"), a leading U.S. prescription pharmaceutical contract manufacturer located in Puerto Rico, U.S.A.

The purchase price for the acquisition was based on an enterprise value for MOVA at closing of \$350,000,000. The Company issued 12,684,866 common shares to the shareholders of MOVA in satisfaction of \$81,500,000 of the purchase price. The Company also assumed approximately \$131,300,000 in debt and related costs and paid \$137,200,000 in cash at closing.

The purchase price may be increased to a maximum of \$441,000,000, based on earn-out arrangements relating to MOVA's results of operations for its year ended December 31, 2004 and for the first six months of its year ended December 31, 2005. At closing, the Company placed into escrow \$74,700,000 to support the potential payments under the escrow arrangements.

The cash portion of the purchase price was funded through a combination of debt and equity financing, as described below.

On December 23, 2004, the Company completed an offering of 26 million common shares for gross proceeds of \$181,000,000 (net proceeds of \$172,600,000 after offering costs). Of the net proceeds, \$97,900,000 was used to finance the cash payment of the acquisition on closing, and \$74,700,000 was placed into escrow.

Also, on December 23, 2004, the Company completed a financing agreement for a new \$169,000,000 committed facility, comprising a three-year revolving credit facility of up to \$55,000,000 and a 12-month bridge facility of \$114,000,000. This bridge facility is intended to be refinanced by a term loan. At the signing of the financing agreement, \$116,000,000 was drawn under these facilities in partial payment of the cash portion of the purchase price of MOVA and related transaction costs and to refinance substantially all of the Company's existing North American debt of approximately \$63,000,000.

## 20 COMPARATIVE AMOUNTS

Certain of the comparative amounts have been reclassified to conform to the current year presentation.