

OUR PERFORMANCE

17 MANAGEMENT'S DISCUSSION AND ANALYSIS

- 17** Cautionary Statement Regarding
Forward-Looking Statements
Vision and Strategy
- 18** Overview of Pharmaceutical Industry
Outsourcing
- 19** Overview of Patheon
- 21** Use of Non-GAAP Financial Measures
Results of Operations
- 27** Seasonal Variability of Results
- 28** Liquidity and Capital Resources
- 32** Critical Accounting Policies and Estimates
- 33** Change in Accounting Policy
Change in Reporting Currency
Risk Management
- 37** Selected Annual Financial Information
Selected Quarterly Financial Information
- 38** Additional Information
Subsequent Event – Acquisition of MOVA
Pharmaceutical Corporation
- 39** Outlook for 2005

40 FIVE-YEAR FINANCIAL SUMMARY

41 FIVE-YEAR SUMMARY OF QUARTERLY RESULTS

42 REPORT OF MANAGEMENT'S ACCOUNTABILITY AUDITORS' REPORT

43 AUDITED CONSOLIDATED FINANCIAL STATEMENTS

46 NOTES TO AUDITED CONSOLIDATED FINANCIAL STATEMENTS

This management's discussion and analysis (MD&A) should be read in conjunction with the Company's consolidated financial statements and related notes and the Auditors' Report contained in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). This information is current to February 18, 2005.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements with respect to the Company, including its business operations and strategy and financial performance and condition. Although management believes that the expectations reflected in such forward-looking statements are reasonable, such statements involve risks and uncertainties. Actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially from expectations include, but are not limited to, currency fluctuations, the level of outsourcing services required by pharmaceutical companies (and in particular our clients), the impact of changes in pharmaceutical development and manufacturing regulations and general economic and market factors (including inflation and changes in laws), and other factors discussed in materials filed with applicable securities regulatory authorities from time to time.

VISION AND STRATEGY

Patheon's vision is to be the pre-eminent provider of pharmaceutical manufacturing and development services across several dosage forms (solid, semi-solid, liquid, powder and sterile/injectable). To achieve its goal, Patheon has focused on being the preferred manufacturing and pharmaceutical development services partner to the pharmaceutical industry.

Patheon's strategy is focused on supporting clients around the world with the efficient delivery of high-quality, comprehensive services. Patheon believes that stronger manufacturing and development relationships will continue to emerge between pharmaceutical companies and service companies as the pharmaceutical industry continues to re-evaluate its internal manufacturing capabilities and streamlines its external service-provider network. The Company intends to use its position as a comprehensive provider of commercial manufacturing services to establish and maintain long-term relationships with clients on a global basis.

Patheon has successfully pursued a strategy of expanding capabilities to provide higher-margin products and services. Commercial manufacturing of prescription ("Rx") products and providing pharmaceutical development services ("PDS") typically generate higher margins than commercial manufacturing of over-the-counter ("OTC") products.

In implementing its strategy, the Company will continue to seek to increase the percentage of higher-margin products manufactured at its facilities, maximize capacity utilization, improve efficiency and broaden services to existing clients to include other manufacturing capabilities. In addition, the Company will seek to expand its PDS capabilities in North America and Europe to better serve the needs of the global pharmaceutical industry. Pharmaceutical development services are an important source of new business for commercial manufacturing of prescription pharmaceuticals.



OVERVIEW OF PHARMACEUTICAL INDUSTRY OUTSOURCING

The global pharmaceutical industry comprises global, regional and national pharmaceutical manufacturers and distributors, biotechnology companies and specialty pharmaceutical companies.

The focus and operational structures of many pharmaceutical companies, including research-oriented global pharmaceutical companies, have undergone significant changes in the past few years. Many global pharmaceutical companies are relying on the services of contract product development and commercial manufacturing companies to help them meet growing demand and bring new drugs to market more quickly. As a result, certain competencies such as dosage form manufacturing and dosage form development increasingly are being restructured or outsourced to third-party service providers such as Patheon.

In addition, more biotech products are being developed by biotechnology companies, focused on new drug discoveries. Many of these companies have focused their financial resources on the development and marketing of their products, rather than investing in their own manufacturing capacity. As a result, the demand for third-party dosage form manufacturing services continues to increase as these smaller companies face the increasing costs of launching a new pharmaceutical product.

Finally, specialty pharmaceutical companies (pharmaceutical companies focused on in-licensing or acquiring products, rather than new drug discovery) typically operate in a particular niche segment, such as drug delivery systems or product portfolios focused on specific therapeutic categories. These companies are increasingly in-licensing or developing their own branded products, for which they may not have the necessary manufacturing capacity or capabilities, and are therefore turning to third-party service providers to provide manufacturing services.

According to leading market research firm IMS Health, in recent years, the global pharmaceutical industry has grown rapidly with revenues increasing from \$354 billion in 2000 to approximately \$492 billion in 2003 (representing an average annual growth rate of approximately 12%). Management of Patheon believes that annual global expenditures for finished dosage form commercial pharmaceutical manufacturing are currently approximately \$65 billion, of which approximately \$7.5 billion to \$10 billion is currently outsourced. Management further believes that the global demand for dosage form pharmaceutical development services is currently valued at more than \$3 billion, of which approximately \$1 billion is outsourced.

Demand for outsourced pharmaceutical development and commercial manufacturing services is expected to continue to grow. In addition to pressure on pharmaceutical and biotechnology companies to reduce costs, management of Patheon believes that growth of pharmaceutical industry outsourcing will be driven by the following factors:

- ♦ the global pharmaceutical industry is expected to continue to grow;
- ♦ the biotechnology and specialty pharmaceutical industries continue to grow, providing a source of opportunities for pharmaceutical service providers;
- ♦ the consolidation of the pharmaceutical industry, and supply chain restructuring, are providing new opportunities for pharmaceutical service providers as companies seek to reduce overall spending by reducing excess capacity in their manufacturing networks;
- ♦ increased demand for specialized manufacturing capabilities in key technical niches (for example, lyophilization);
- ♦ increased focus on R&D and marketing by global pharmaceutical companies;
- ♦ increased demand for back-up sources of supply;
- ♦ the number of product candidates in development continues to expand, providing a growing source of opportunities for pharmaceutical service providers; and
- ♦ increased spending on research and development will increase the opportunities for pharmaceutical development services.

OVERVIEW OF PATHEON

Patheon is focused exclusively on providing commercial manufacturing and pharmaceutical development services to pharmaceutical companies, biotechnology companies and specialty pharmaceutical companies located primarily in North America, Europe and Japan. Patheon serves its international clientele from its operating facilities in North America and Europe.

Patheon's commercial manufacturing activities relate primarily to R_x and OTC products in solid, semi-solid and liquid dosage forms and the manufacture of R_x products in sterile dosage forms. Conventional dosage forms include compressed tablets, hard shell gelatin capsules, powders, ointments, creams, gels, syrups, suspensions, solutions and suppositories. Sterile dosage forms include aseptically filled liquids or terminally sterilized liquids filled in ampoules, vials, bottles or pre-filled syringes. Sterile lyophilized products are also manufactured in both vials and ampoules. Patheon also operates a fully segregated sterile cephalosporin filling facility at its Swindon Operations site in the United Kingdom. The manufacturing capabilities of the three sites of MOVA Pharmaceutical, acquired by Patheon in December 2004, include oral solids, liquids, powders and sterile injectables and, at MOVA's Carolina site, oral cephalosporin products. Patheon and MOVA manufacturing operations personnel are experienced in working on a wide variety of dosage forms.

The pharmaceutical development services provided by Patheon include most of the pharmaceutical development services typically required by companies conducting clinical trials and preparing for full-scale commercial production of a new drug. By offering pharmaceutical development services in addition to commercial manufacturing services, Patheon is able to provide clients with drug development and scale-up services, often at the same site as commercial manufacturing, thus reducing the need for costly and time-consuming product transfers. Since the beginning of the 2001 fiscal year, Patheon's pharmaceutical development services units have launched 10 products into commercial production. The most recent launch occurred in August 2004. Three of these 10 are among the world's 200 top-selling R_x drugs, currently defined as drugs with total global retail sales of US\$340 million or more.

Commercial manufacturing of R_x products typically generates higher margins than commercial manufacturing of OTC products, and providing pharmaceutical development services typically generates higher margins than commercial manufacturing. Patheon has successfully pursued a strategy of increasing its higher-margin R_x commercial manufacturing and PDS revenues, increasing R_x commercial manufacturing and PDS revenues from \$49.0 million and \$8.1 million, respectively, in fiscal 1999, to \$302.3 million and \$65.8 million, respectively, in fiscal 2004.

Commercial Manufacturing

Patheon provides manufacturing services for a broad range of products in many dosage forms and packaging formats in accordance with client specifications. Depending on the particular client, Patheon may be responsible for most or all aspects of the manufacturing and packaging process, from sourcing excipient raw materials and packaging components to delivering the finished product in consumer-ready form to the client. Typically, Patheon's clients supply the active pharmaceutical ingredients ("API") used in the production process.

In 2004, Patheon's facilities were audited by 168 separate client audit teams, representing both prospective and existing clients. Audits by prospective clients permit these prospective clients to gain confidence that Patheon's operations are conducted in accordance with applicable regulatory requirements. Audits by existing clients permit these clients to reaffirm that Patheon's operations, as they relate to their products, are conducted in accordance with these regulatory requirements. These audits contribute to Patheon's ongoing improvement of manufacturing and development practices. In addition, there were 15 regulatory audits conducted at the Company's sites in North America and Europe.

Pharmaceutical Development

The pharmaceutical development services provided by Patheon include most of the dosage form development services typically required by companies conducting clinical trials and preparing for full-scale commercial production of a new drug. In providing its pharmaceutical development services, Patheon is able to: (i) develop an appropriate dosage form; (ii) develop analytical methods; (iii) manufacture the proposed new drug product to client specifications during the regulatory drug approval process; (iv) manufacture pilot batches of proposed new drug products for the regulatory drug approval process; and (v) provide scale-up and technology transfer services designed to validate that a drug can be manufactured commercially.

Patheon offers pharmaceutical development services at four facilities in North America and Europe. In addition to possessing pharmaceutical development capabilities for a broad range of dosage forms, each of Patheon's PDS units provides a different specialized pharmaceutical development capability (high potency, sterile, lyophilization and controlled release). At October 31, 2004, the Company was working on a total of 112 projects in the pipeline, including five drug candidates at the New Drug Application ("NDA") stage. Since the beginning of fiscal 2001, 10 new pharmaceutical products developed by Patheon's PDS unit have progressed to commercial manufacturing. These include four products launched in fiscal 2004, all of which have contributed to Patheon's commercial manufacturing revenues. At the end of fiscal 2004, the growing PDS team included more than 380 scientists and technical staff, more than 65 of them holding doctoral degrees. Patheon's development scientists have extensive development experience with a wide variety of pharmaceutical dosage forms.

Key Performance Drivers

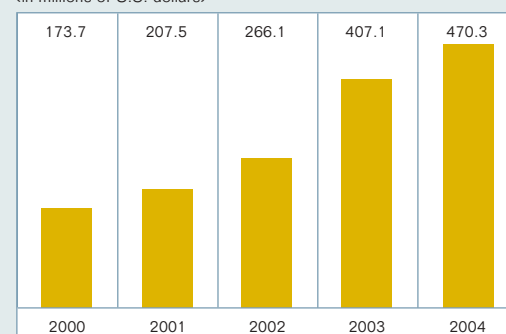
The Company is organized and managed as a single business segment, being the provider of commercial manufacturing and pharmaceutical development services.

Since 1992, the Company has grown from a contract OTC pharmaceutical manufacturer with two facilities to become a leading provider of Rx and OTC manufacturing and PDS services to the international pharmaceutical industry, operating 11 sites in five countries in North America and Europe at the end of the 2004 fiscal year. In 2004, prescription manufacturing services and pharmaceutical development services comprised 78% of total revenues, compared with 74% in the 2003 fiscal year. In implementing its strategy, the Company will continue to increase the percentage of higher-margin prescription products at its facilities, and continue to expand its PDS capabilities in North America and Europe as PDS services generate an attractive margin and are an important source of new business for commercial manufacturing of higher-margin prescription pharmaceuticals.

The Company's operating sites have a largely fixed-cost base in the short term. Therefore, changes in manufacturing capacity utilization at the sites can impact EBITDA margins. The Company currently has capacity for sale at all of its sites.

Because the Company's contracts in North America are primarily in U.S. dollars, the profitability of the Company's Canadian operations can be impacted by significant changes in the foreign exchange trading relationship between the Canadian and U.S. dollar. Approximately 65% to 75% of revenues of the Canadian operations and approximately 15% to 25% of operating expenses are transacted in U.S. dollars. The Company has to convert a portion of its net U.S. dollar inflow to Canadian dollars to finance its Canadian dollar expenses of its Canadian sites. A one-cent change in the U.S./Canadian dollar exchange rate is estimated to impact income by approximately \$0.5 million on an annual basis, before the impact of the hedging program. As discussed in this MD&A, the Company employs a hedging program to mitigate the impact of this risk.

REVENUES
(in millions of U.S. dollars)



USE OF NON-GAAP FINANCIAL MEASURES

In this MD&A, EBITDA, EBITDA margin, EBITDA before repositioning expenses, and net income before repositioning expenses are provided in respect of Patheon. Except as otherwise indicated, references in this MD&A to "EBITDA" are to earnings before depreciation and amortization, interest and income taxes. "EBITDA margin" is EBITDA divided by revenues. "EBITDA before repositioning expenses" is EBITDA adjusted to eliminate the impact of certain repositioning expenses. "Net income before repositioning expenses" is net income adjusted to eliminate the after-tax impact of certain repositioning expenses. Please refer to the reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measure within this MD&A.

None of EBITDA, EBITDA margin, EBITDA before repositioning expenses and net income before repositioning expenses is a measure of earnings or earnings margin recognized by generally accepted accounting principles in Canada ("Canadian GAAP"). Since each of these measures is a non-GAAP measure, it may not be comparable to similar measures presented by other issuers. Prospective investors are cautioned that these non-GAAP measures should not be construed as an alternative to net income determined in accordance with Canadian GAAP as an indicator of performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows.

RESULTS OF OPERATIONS

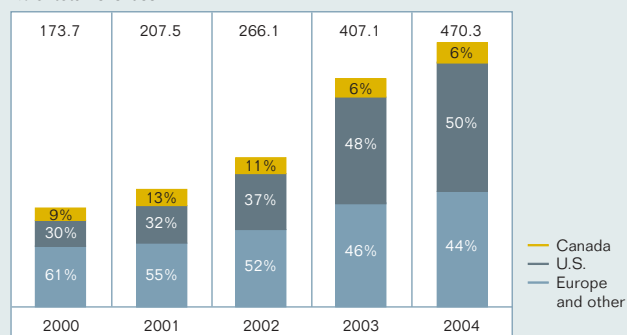
Revenues

Consolidated revenues for the fiscal year ended October 31, 2004 increased 16%, or \$63.1 million, to \$470.3 million. On a consolidated basis, commercial manufacturing revenues grew 11%, with R_x manufacturing up 17%, offset somewhat by declines in OTC volumes for the full year of 4%. PDS revenues grew 55%, a reflection of strong performance in both North America and Europe, compared with the same period in 2003.

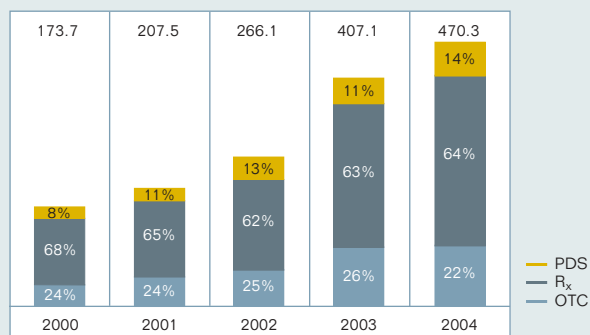
The revenue increase from internal growth, or new business from existing sites, was \$49.8 million, or 12%, in fiscal 2004 – 12% in North America and 13% in Europe.

Management's Discussion and Analysis

REVENUES BY GEOGRAPHIC REGION
(in millions of U.S. dollars)
(% of total revenues)



REVENUES BY SERVICE ACTIVITY
(in millions of U.S. dollars)
(% of total revenues)



REVENUES BY GEOGRAPHIC REGION AND SERVICE ACTIVITY

Years ended October 31

(in thousands of U.S. dollars, except percentages)

	2004 \$	2003 \$	% CHANGE
North America			
Commercial Manufacturing			
Prescription	141,539	110,586	28%
Over-the-counter	100,613	104,094	-3%
	242,152	214,680	13%
Development Services	53,530	37,997	41%
	295,682	252,677	17%
Europe			
Commercial Manufacturing			
Prescription	160,776	147,786	9%
Over-the-counter	1,552	2,257	-31%
	162,328	150,043	8%
Development Services	12,249	4,424	177%
	174,577	154,467	13%
Total			
Commercial Manufacturing			
Prescription	302,315	258,372	17%
Over-the-counter	102,165	106,351	-4%
	404,480	364,723	11%
Development Services	65,779	42,421	55%
CONSOLIDATED REVENUES	470,259	407,144	16%

Prescription manufacturing and development services represented 78% of revenues, compared with 74% for the comparable period in 2003, driven by increased R_x volumes from the North American operations, principally Cincinnati, combined with increased R_x volumes in Italy and France. Revenue increases from PDS were strong throughout North America and Europe, as compared with the prior year. Growth in PDS revenues reflects the continuing favourable financing environment for drug development as well as Patheon's enhanced reputation in the marketplace for formulation development services and commercialization of newly approved products for its clients.

Geographically, North American revenue growth was \$43.0 million or 17% over the same period in the prior year. Of the revenue increase, \$13.3 million was strategic growth related to the additional two months of revenues from Cincinnati Operations. Net internal growth was \$29.7 million, reflecting strong growth in PDS at both the U.S. and Canadian sites and strong growth in R_x manufacturing services, principally from the Cincinnati Operations as a result of new R_x commercial volumes at the site.

Revenues from sites in North America represented 63% of total revenues in fiscal 2004 compared with 62% in fiscal 2003.

In Europe, revenues were 13% higher than the same period of 2003. Internal growth in prescription manufacturing revenues at the Italian and French sites was offset by declines in commercial volumes at Swindon, U.K. The euro and the U.K. sterling remained strong against the U.S. dollar throughout fiscal 2004 compared with the prior year. The euro strengthened approximately 12% and the U.K. sterling strengthened approximately 12% against the U.S. dollar, increasing reported revenues by approximately \$17.8 million. Had European currencies remained constant with the rates of the prior year, European revenues would have been 1% higher than the same period in 2003. Net earnings would have been up approximately 1.1¢ per share, on a constant exchange rate basis.

On January 1, 2004, the Company commenced a new manufacturing and supply agreement with Roche for an initial term of three years, with annual renewal provisions thereafter. The new agreement replaced the supply agreement which was signed as part of the Company's acquisition of its facility in Monza, Italy, from the Roche Group in December 1998.

Operating Expenses

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support and administrative expenses. In fiscal 2004, operating expenses as a percentage of revenues were 88.5%, compared with 87.8% in the prior year. The year-over-year increase in operating expenses can be attributed to the increased costs of site infrastructure, principally employee-related costs, in anticipation of new product launches at the Canadian sites. Although the costs were required to be in place in anticipation of the launches, the new product launches did not contribute significantly to revenues in 2004. The Company expects increased revenues in 2005 from the 2004 new product launches.

Swindon, U.K. Repositioning Expenses

On July 14, 2004, the Company announced its plan to reposition its site in Swindon, U.K., to take advantage of the considerable skills of its employees in sterile manufacturing and capitalize on the opportunity for FDA-approved sterile manufacturing capabilities. The facility's performance has been negatively impacted by declines in base volumes of mature products. Repositioning of the Swindon site resulted in expenses of approximately \$4.4 million in fiscal 2004, or approximately 6 cents per share. The Company recorded \$2.1 million of these expenses in the third quarter and \$2.3 million in the fourth quarter, and does not expect to incur further repositioning expenses in connection with its repositioning plan. Although the site incurred higher-than-anticipated operating losses during 2004, the Company expects to reduce operating losses in 2005 and to return to profitability in the 2006 fiscal year. The Company believes that the Swindon operations will continue to be a strategic asset in its global network.

A reconciliation of the impact of repositioning expenses incurred during 2004 is as follows:

(in thousands of U.S. dollars, except per-share amounts)	2004 \$	2003 \$
Revenues	470,259	407,144
EBITDA	48,105	49,545
Net earnings	10,678	18,578
Earnings per share	20.7¢	36.2¢
EBITDA before repositioning expenses	52,512	49,545
(as a % of revenues)	11.2%	12.2%
Net earnings before repositioning expenses ⁽¹⁾	13,763	18,578
(as a % of revenues)	2.9%	4.6%
Earnings per share before repositioning expenses ⁽¹⁾	26.7¢	36.2¢

⁽¹⁾ Net earnings before repositioning expenses have been determined by adding net earnings and repositioning expenses for the period, and then deducting the provision for income taxes applicable to the repositioning expenses. Earnings per share before repositioning expenses have been determined by dividing net earnings before repositioning expenses by the average number of shares outstanding during the period.

A reconciliation of net earnings and earnings per share before repositioning expenses with net earnings and earnings per share is as follows:

(in thousands of U.S. dollars, except per-share amounts)	2004		2003	
	EARNINGS \$	EPS ¢	EARNINGS \$	EPS ¢
Net earnings	10,678	20.7	18,578	36.2
Repositioning expenses	4,407	8.6	–	–
Income taxes related to repositioning expenses	(1,322)	(2.6)	–	–
Net earnings before repositioning expenses	13,763	26.7	18,578	36.2

Please refer to **Use of Non-GAAP Financial Measures**. The Company has included these measures because it believes that this information is used by certain investors to assess financial performance. However, non-GAAP measures (such as net earnings before repositioning expenses and earnings per share before repositioning expenses) do not have standardized meaning and are therefore unlikely to be comparable to similar measures presented by other issuers.

Stock-Based Compensation

The Company adopted the new accounting rules relating to the accounting for stock options. (See **Change in Accounting Policy** in this MD&A.) An amount of \$1.4 million was recorded in 2004 and no amount was recorded in 2003.

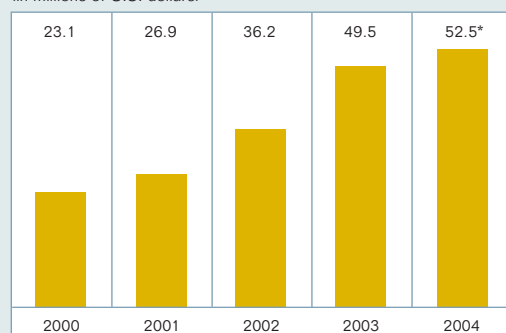
EBITDA and EBITDA Margin

On a consolidated basis in 2004, EBITDA before repositioning expenses, representing earnings before repositioning expenses, interest, income taxes, and depreciation and amortization, increased by \$3.0 million, or 6%, to \$52.5 million from \$49.5 million for the comparable period in 2003. As a percentage of consolidated revenues, EBITDA before repositioning expenses was 11.2% in the twelve-month period, compared with 12.2% in the same period a year ago. After reflecting repositioning expenses, the EBITDA margin was 10.2%.

Despite the strong growth in revenues, this performance was not reflected in profitability. The strength of the Canadian dollar against the U.S. dollar had a significant impact on results in fiscal 2004, almost entirely in the first half. On a year-over-year basis, the Canadian dollar strengthened 9% in the twelve-month period. This had a significant impact on the operating profits of the Canadian facilities, as they transact 65% to 75% of their revenues in U.S. dollars but require Canadian dollars to finance some capital requirements and the majority of operating costs. Commencing in 2004, the Company changed its accounting policy for accounting for stock options. EBITDA was negatively impacted by \$1.4 million by the recording of stock-based compensation.

EBITDA

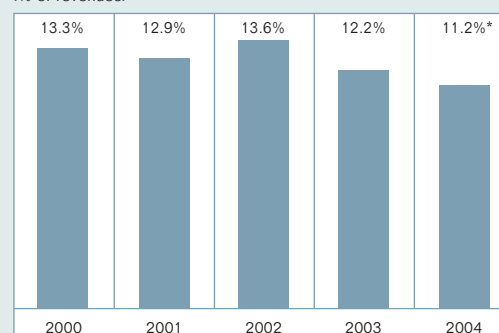
(in millions of U.S. dollars)



*Before Swindon, U.K. repositioning expenses of \$4.4 million

EBITDA MARGIN

(% of revenues)



*Before Swindon, U.K. repositioning expenses of \$4.4 million

Depreciation and Amortization Expense

Depreciation and amortization expense was \$22.8 million in fiscal 2004, compared with \$16.3 million in fiscal 2003, an increase of \$6.5 million, or 39%. Of the increase, \$1.8 million was attributable to the effect of translation into U.S. dollars of depreciation related to Canadian and European sites, \$0.5 million was attributable to two additional months of depreciation of the Cincinnati assets, and the remainder was principally related to the coming on-stream of expanded lyophilization capacity at the Italian sites and capital programs at the Cincinnati site.

Interest Expense

Interest expense for 2004 was \$5.6 million compared with \$4.5 million in 2003. The increase, compared with the prior year, is principally related to new debt to finance the increased capital spending program in Italy, the impact of financing the Cincinnati acquisition for twelve months in 2004 compared with ten months in 2003, and the cost to finance additional working capital requirements during periods in 2004 to support new product launches. In addition, higher interest rates of the new financing arrangements in Canada, completed in July 2004, resulted in increased interest costs for the period through the year end.

Earnings Before Income Taxes

Earnings before income taxes and repositioning expenses decreased 16% to \$24.1 million in 2004, down from \$28.7 million in 2003. Although EBITDA before repositioning expenses increased \$3.0 million year-over-year, this was offset by increased costs to support new product launches in 2004, the impact of the strengthening of the Canadian dollar on the operating profits of the Canadian facilities, the recording for the first time in 2004 of stock-based compensation expense, and higher depreciation and interest costs principally related to the Company's capital investment programs.

Income Taxes

The effective income tax rate before repositioning expenses in 2004 was 43.0% versus 35.3% in 2003. After adjusting for the non-recurring Italian tax credit in 2003, the comparable rate is 37.2%. The higher effective tax rate reflects greater earnings in the higher tax jurisdictions of Ohio, U.S.A., and Italy, tax relief on losses incurred in the U.K. that are recorded at a lower rate of 30%, as well as the impact of accounting for stock-based compensation. Under current income tax legislation in Canada, the expense of recording stock options is not deductible for tax purposes, which increased the effective tax rate, before repositioning expenses, by 2.3 points in 2004.

The effective tax rate is sensitive to the portion of income earned in higher, relative to lower, tax jurisdictions. The general corporate income tax rates applicable to the Company's operations are as follows :

	2005	2004	2003
Canada	35%	35%	34%
United States	37%	37%	37%
United Kingdom	30%	30%	30%
France	34%	35%	35%
Italy	34%	36%	36%

The 2005 rates are indicative only and may be subject to change.

Net Earnings and Earnings Per Share

Net earnings before repositioning expenses in fiscal 2004 were \$13.8 million, compared with \$18.6 million in the same period last year, a reduction of \$4.8 million. Prior year results include the recording of the non-recurring Italian tax credit of \$0.5 million. Although EBITDA before repositioning expenses increased \$3.0 million year over year, this did not contribute to increased net earnings and earnings per share, principally due to increased depreciation and interest costs.

Basic earnings per share before repositioning expenses in 2004 were 26.7¢ compared with 36.2¢ in 2003, a decrease of 26%. Excluding the impact of the recording of the Italian tax credit, earnings per share in 2003 would have been 35.1¢.

Diluted earnings per share before repositioning expenses were 26.5¢ compared with 35.6¢ in 2003, a decrease of 26%. Excluding the impact of the recording of the Italian tax credit, earnings per share on the diluted basis in 2003 would have been 34.6¢. Dilution arises solely from options issued under the Company's stock option plan.

Net earnings after repositioning expenses in fiscal 2004 were \$10.7 million, compared with \$18.6 million in the same period last year, a decrease of 43%. The impact of repositioning expenses on net earnings in 2004 was \$3.1 million. Net earnings in 2004 were also impacted by the recording of stock-based compensation expense, which is not deductible for tax purposes in Canada, of \$1.4 million. No amounts were recorded in 2003 for either repositioning expenses or the recording of stock-based compensation expense. Excluding the impact of these items, net earnings in 2004 would have been 19% lower than the same period last year, principally due to increased depreciation and interest costs.

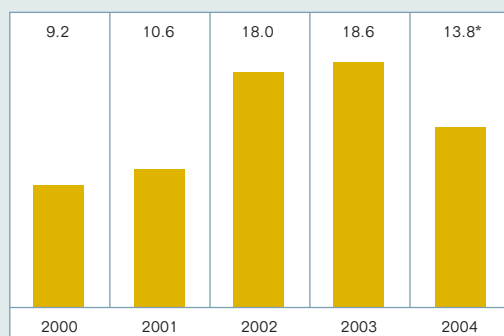
Basic earnings per share after repositioning expenses in 2004 were 20.7¢ compared with 36.2¢ in 2003, a decrease of 43%. Excluding the impact of the recording of the Italian tax credit, earnings per share in 2003 would have been 35.1¢.

Diluted earnings per share after repositioning expenses were 20.6¢ compared with 35.6¢ in 2003, a decrease of 42%. Excluding the impact of the recording of the Italian tax credit, earnings per share on the diluted basis in 2003 would have been 34.6¢. Dilution arises solely from options issued under the Company's stock option plan.

The average number of shares outstanding during the twelve-month period, determined on the basic and diluted bases, increased 0.3% and decreased 0.4%, respectively. Please refer to **Subsequent Event** for information regarding the issuance of 41,284,866 common shares in December 2004 and January 2005 related to the acquisition of MOVA Pharmaceutical Corporation.

NET EARNINGS

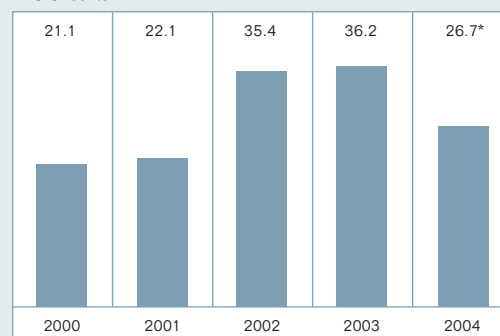
(in millions of U.S. dollars)



*Before Swindon, U.K. repositioning expenses of \$4.4 million

EPS (basic)

(in U.S. cents)



*Before Swindon, U.K. repositioning expenses of 6.0 cents per share

RESULTS OF CONSOLIDATED OPERATIONS

Years ended October 31

(in thousands of U.S. dollars, except percentages and per-share amounts)

	2004	2003	%
	\$	\$	CHANGE
Revenues	470,259	407,144	16%
Operating expenses	416,374	357,599	16%
Repositioning expenses	4,407	-	
Stock-based compensation	1,373	-	
Earnings before depreciation and amortization, interest and income taxes	48,105	49,545	-3%
(% of revenues)	10.2%	12.2%	
Depreciation and amortization	22,765	16,330	39%
Interest	5,609	4,508	24%
Earnings before income taxes	19,731	28,707	-31%
Provision for income taxes	9,053	10,129	-11%
Net earnings for the year	10,678	18,578	-43%
Earnings per share			
Basic	\$0.21	\$0.36	-42%
Diluted	\$0.21	\$0.36	-42%

SEASONAL VARIABILITY OF RESULTS

Revenues from some of Patheon's OTC and R_x commercial manufacturing services and its pharmaceutical development services have been traditionally lower in Patheon's first fiscal quarter, being the three months ending January 31. Patheon attributes this to several factors, including: (i) many clients reassess their need for additional product in the last quarter of the calendar year in order to use existing inventories of products; (ii) the lower production of seasonal cough and cold remedies; (iii) many small pharmaceutical and small biotechnology clients involved in PDS projects limit their project activity toward the end of the calendar year in order to reassess progress on their projects and manage cash resources; and (iv) Patheon-wide plant shut-downs during a portion of the traditional holiday period in December. In addition, the introduction and marketing by our clients of new products traditionally occurs during Patheon's second fiscal quarter, which begins on February 1.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

The following table summarizes the Company's cash flows for the fiscal years indicated:

(in thousands of U.S. dollars)	2004	2003
	\$	\$
Net earnings	10,678	18,578
Depreciation and amortization	22,765	16,330
Future income taxes	2,384	3,696
Employee future benefits	2,688	1,059
Stock-based compensation and other	2,077	–
Non-cash working capital	(173)	(4,356)
Cash provided by operating activities	40,419	35,307
Cash provided by financing activities	21,719	48,601
Cash used in investing activities	(63,761)	(81,522)
Other	79	908
Net increase (decrease) in cash and cash equivalents	(1,544)	3,294

Cash Flow

The Company's principal sources of liquidity are cash provided from operations and borrowing under bank revolving and non-revolving credit facilities. However, the Company has issued common share equity from time to time to finance its cash requirements, principally related to acquisitions. See **Subsequent Event** for information relating to the financing of the acquisition of MOVA Pharmaceutical Corporation in December 2004. The Company's principal uses of cash have been to finance working capital, repay debt, finance its annual capital expenditures programs, and finance acquisitions. In 2004, the Company increased its bank borrowings by \$21.7 million, principally to finance its capital spending program.

Cash Provided by Operating Activities

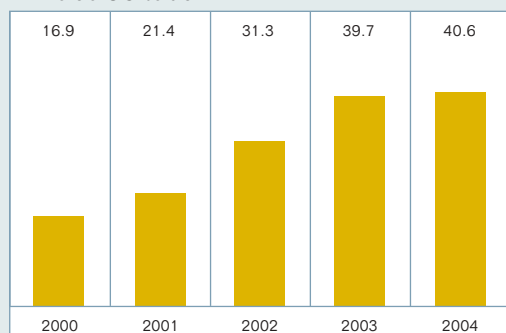
Although net earnings were down \$7.9 million year over year, cash provided by operating activities in 2004 was \$40.4 million compared with \$35.3 million in 2003, an increase of 14%. This was due principally to a reduction of \$4.1 million in requirements to finance working capital.

Cash Used in Investing Activities

Cash used in investing activities was \$63.8 million, compared with \$81.5 million in 2003. A summary is as follows:

(in thousands of U.S. dollars)	2004	2003
	\$	\$
Additions to capital assets		
Sustaining	11,232	14,436
Project-related	51,372	39,233
Total additions to capital assets	62,604	53,669
Acquisition of Cincinnati manufacturing site	–	28,220
Increase (decrease) in deferred pre-operating and financing costs	1,422	(367)
Proceeds on sale of investment	(265)	–
Cash used in investing activities	63,761	81,522

CASH PROVIDED FROM OPERATIONS
(in millions of U.S. dollars)



The Company's principal ongoing investment activities are sustaining and project-related capital programs at its network of sites. The majority of the Company's capital allocation is invested in project-related programs, which are defined as outlays that will generate growth in capacity and revenues, while sustaining expenditures relate to the preservation of existing assets and capacity. The Company invested \$62.6 million in capital expenditures in 2004 compared with \$53.7 million in 2003, of which project-related expenditures were \$51.4 million in 2004 and \$39.2 million in 2003.

Currently, the Company's major project-related programs are at its Monza and Ferentino facilities in Italy, in connection with the expansion of sterile lyophilization services, and at its Toronto Region facility in Canada, in connection with improvements related to high-potency pharmaceutical manufacturing services, and at its Cincinnati facility in the U.S.A., in connection with raw materials receipt, staging and dispensing.

Capital commitments to complete authorized capital projects were \$13.2 million at October 31, 2004. The majority of these expenditures are expected to be incurred during the fiscal year ending October 31, 2005.

The major capital programs anticipated in 2005 consist of approximately (in millions):

Capital programs in Swindon, U.K. facility	\$13.0
Capital programs in Cincinnati, U.S.A. facility	\$10.0
Completion of the lyophilization expansion in Italy	\$ 9.0
Capabilities upgrades at the Whitby, Canada facility	\$ 4.0

Certain of the Company's anticipated capital spending programs in 2005 are dependent on new business commitments.

The increase in deferred pre-operating and financing costs of \$1.4 million in 2004 was comprised of deferred costs related to the start-up of certain new sterile operations at Ferentino, Italy, and financing costs related to the completion of new Canadian financing lines in July 2004. Deferred pre-operating costs are amortized on a straight-line basis over a period of five years from date of start-up and deferred financing costs are amortized over the term of the debt to which they relate. As a result of the refinancing of the Canadian financing facilities concurrent with the acquisition of MOVA Pharmaceutical Corporation in December 2004 (see **Subsequent Event**), the net amount of \$0.6 million will be expensed in the first quarter of 2005.

Cash Provided from Financing Activities

Cash provided from financing activities was \$21.7 million for the year ended October 31, 2004, compared with \$48.6 million in 2003, a decrease of \$26.9 million. The higher financing requirements in 2003 related to the acquisition of the Cincinnati manufacturing site, amounting to \$28.2 million.

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 and the Canadian operations. Please see **Subsequent Event** for information relating to the refinancing of these facilities concurrent with the acquisition of MOVA Pharmaceutical Corporation.

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 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 closed, and the first payment is not expected until June 2007, at which time payments will commence and continue through June 2014.

Financing Arrangements and Ratios

At October 31, 2004, the Company's consolidated ratio of interest-bearing long-term debt (including current portion) to shareholders' equity was 56.1% compared with 52.8% at the end of 2003. The increase was principally due to expenditures related to the Company's capital programs in excess of cash provided by operating activities. At October 31, 2004, the Company's consolidated ratio of interest-bearing debt (including current portion and bank indebtedness) to shareholders' equity was 65.9%, compared with 59.1% at the end of the 2003 fiscal year. Approximately 42% of the debt outstanding at the end of fiscal 2004 was with respect to the Canadian financing agreement, approximately 43% related to the financing of the Italian operations, approximately 8% to the Cincinnati operations, and approximately 7% to the U.K. operations.

The Company obtained a waiver from its lenders and obtained amendments to certain covenants in connection with not being in compliance with certain financial covenants from its lenders at October 31, 2004. 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.

The weighted average rate of interest paid on both short-term and long-term debt during 2004 was 4.8%, compared with 3.9% a year earlier. The increase in the weighted average interest rate is principally due to the higher interest rate structure of new financing arrangements entered into in 2004. At the end of the 2004 and 2003 fiscal years, the interest rate structure of the Company's interest-bearing debt was as follows:

	% OF DEBT OUTSTANDING		INTEREST RATES AT QUARTER ENDS IN 2004			
	2004	2003	Q4	Q3	Q2	Q1
Fixed rate	19%	22%				
Variable rate based on						
Prime - Canada	14%	3%	4.25%	3.75%	3.75%	4.25%
Bankers' acceptances (1 month)	23%	25%	2.53%	2.03%	2.12%	2.59%
U.S. base rate	4%	–	5.25%	4.75%	4.50%	4.50%
U.S. LIBOR (1 month)	–	21%	1.96%	1.50%	1.10%	1.10%
Euribor (3 months)	34%	22%	2.15%	2.12%	2.07%	2.09%
U.K. base rate	6%	7%	4.75%	4.50%	4.00%	3.75%

Subsequent to the year end, the Company refinanced its debt facilities with its Canadian lenders and entered into new arrangements with the Royal Bank of Canada, (see **Subsequent Event** section). 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 to provide term financing requirements of the Company's Canadian and Cincinnati, U.S.A., locations. The bridge facility is repayable no later than December 23, 2005, one year following the closing of the MOVA acquisition. Prior to repayment of the bridge facility, amounts drawn will be shown as a current liability. 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.

Also, subsequent to the year end, the Company entered into final negotiations for new financing arrangements in the amount of £10,000,000 for its Swindon, U.K. operations. This financing, along with financing in place with existing lenders in the U.K., will be sufficient to finance the capital programs for the Swindon site through its expected return to profitability in 2006.

Contractual repayments of long-term debt, commitments under operating leases, and purchase obligations, are as follows:

CONTRACTUAL OBLIGATIONS	TOTAL	PAYMENTS DUE BY PERIOD			
		LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER 5 YEARS
Long-term debt	124,262,000	11,146,000	81,706,000	19,060,000	12,350,000
Operating leases	4,331,000	1,077,000	2,128,000	1,126,000	–
Purchase obligations	18,485,591	18,485,591	–	–	–
Total contractual obligations	147,078,591	30,708,591	83,834,000	20,186,000	12,350,000

Long-term debt includes capital lease obligations. Purchase obligations relate principally to arrangements in North America for the supply of hydro and gas for operating requirements.

In addition, at October 31, 2004, capital commitments to complete authorized capital projects were \$13.2 million. The majority of these expenditures are expected to be incurred during the fiscal year ending October 31, 2005.

Adequacy of Financial Resources

With the completion of the additional financing arrangements for the Swindon, U.K. operations, cash from operations and available credit facilities, the Company believes that its financial resources are sufficient to fund projected capital expenditures and debt service requirements in the normal course of business. Please see **Subsequent Event** section for a description of additional financial resources that were required in the form of new common share equity and bank financing commitments to finance the acquisition of MOVA Pharmaceutical Corporation on December 23, 2004.

Off-Balance Sheet Arrangements

The Company does not engage in off-balance sheet accounting to structure any of its financial arrangements. The Company does not have any interests in unconsolidated special-purpose or structured finance entities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

General

Patheon's significant accounting policies are described in Note 1 to the consolidated financial statements. The most critical of these policies are those related to revenue recognition, goodwill, income taxes and employee future benefits (Notes 1, 12 and 13 of the audited financial statements).

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based upon management's historical experience and are believed by management to be reasonable under the circumstances. Such estimates and assumptions are evaluated on an ongoing basis and form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ significantly from these estimates.

The Company's Critical Accounting Policies have been reviewed and discussed with the Company's Audit Committee.

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.

The Company does not receive any fees on signing of contracts. In the case of pharmaceutical development services, revenue is recognized on the achievement of specific milestones. In the case of commercial manufacturing services, revenue is recognized when services are complete and the product has met rigorous quality assurance testing.

Valuation of Goodwill

The Company evaluates goodwill for impairment at least annually. If the carrying value of the reporting unit exceeds the reporting unit's fair value, any excess represents an impairment loss.

The goodwill shown on these financial statements relates solely to the acquisition in 2000 of the remaining shares of Global Pharm Inc., which now operates as Toronto York Mills Operations.

Goodwill arising from the acquisition of MOVA Pharmaceutical Corporation on December 23, 2004 (see **Subsequent Event**) will be evaluated during the 2005 fiscal year, and each year thereafter.

Income Taxes

In accordance with Canadian GAAP, the Company uses the liability method of accounting for future income taxes and provides for future income taxes for significant temporary timing differences.

Preparation of the consolidated financial statements requires an estimate of income taxes in each of the jurisdictions in which the Company operates. The process involves an estimate of the Company's current tax exposure and an assessment of temporary differences resulting from differing treatment of items such as depreciation and amortization for tax and accounting purposes. These differences result in future tax assets and liabilities and are reflected in the consolidated balance sheets.

Future tax assets of \$15.8 million have been recorded at October 31, 2004. These are comprised primarily of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, and the tax benefit of net operating loss carryforwards related to the U.K. operations. The Company evaluates, quarterly, the ability to realize its future tax assets. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets. The Company has available to it tax planning strategies to realize future tax assets in order to avoid the potential loss of benefits.

Future tax liabilities of \$28.2 million have been recorded at October 31, 2004. This liability is comprised primarily of tax depreciation in excess of book depreciation.

The Company's tax filings are subject to audit by taxation authorities. Although management believes that it has adequately provided for income taxes based on the information available, the outcome of audits cannot be known with certainty and the potential impact on the financial statements is not determinable.

Employee Future Benefits

The Company provides pensions and post-retirement benefits, including medical benefits and dental care. The determination of the obligation and expense for defined benefit pensions and post-retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are disclosed in Note 13 to the Company's consolidated financial statements, the most significant of which are the discount rate, the expected long-term rate of return on plan assets, the rates of increase in compensation costs, and the rates of increase in the cost of health care and dental benefits. The significant actuarial assumptions adopted are internally consistent and reflect the long-term nature of employee future benefits. Significant changes in assumptions could materially affect the Company's employee benefit obligations and future expense.

CHANGE IN ACCOUNTING POLICY

Stock-Based Compensation

As explained in Note 2 on page 49, on November 1, 2003, the Company changed its accounting policy for stock options accounted for on or after that date. Under the new policy, the fair value of stock options is expensed over their vesting period. The effect of this change was to decrease net earnings by \$1.4 million (\$0.03 per share) for the year ended October 31, 2004.

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 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 therefore appropriate to report in U.S. dollars in order to better communicate the Company's performance to stakeholders.

In accordance with Canadian generally accepted accounting principles, 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 with 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. Exchange gains and losses on translation of the Company's net equity investment in these operations are deferred as a separate component of shareholders' equity.

RISK MANAGEMENT

Overview and Risk Management Practices

The Company's business is conducted under various types of contractual agreements with its clients and suppliers. Patheon applies rigorous assessment, mitigation and management practices to reduce the nature and extent of the financial, regulatory and legal risks under each of the types of contractual agreements.

Contractual Arrangements

Patheon has commercial manufacturing services contracts with its clients, typically with multi-year terms. These contracts formalize the standard business arrangements outlined above, including production based on the delivery of firm purchase orders. In addition, the contracts generally provide for six to 18 months' advance notice for the transfer or discontinuance of any product. The client assumes liability for all material commitments made in accordance with purchase orders. Patheon maintains the right to negotiate increases in prices based on extraordinary market changes in material costs. The anticipated revenues to be generated by Patheon's major client agreements are not determinable with any precision, as volumes are based on the client's market demands from time to time.

Patheon's pharmaceutical development services are provided on a fee-for-service basis. Patheon typically responds to a request for proposal and, if the proposal is accepted, it normally forms the basis of the contract with the client. Frequently, the scope of work in the initial contract changes over the life of the project in response to research results and client needs.

Foreign Currency

The Company's European operations negotiate sales contracts for payment principally in euros and U.K. sterling. The European operations' material, equipment and labour and other operating expenses are paid for principally in euros and U.K. sterling. Consequently, there is minimal exposure to foreign exchange gains or losses in the European operations. The Company's U.S. operations negotiate sales contracts for payment principally in U.S. dollars; and materials, equipment, labour, and other operating expenses are paid for principally in U.S. dollars. There is minimal exposure to foreign exchange gains or losses in the U.S. operations.

The Company's Canadian operations negotiate sales contracts for payment in both U.S. and Canadian dollars, and materials and equipment are purchased in both U.S. and Canadian dollars. The majority of its non-material costs (including payroll, facilities' costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars. Approximately 65% to 75% of revenues of the Canadian operations and approximately 15% to 25% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience trading and translation gains or losses because of volatility in the exchange rate between the Canadian and U.S. dollar.

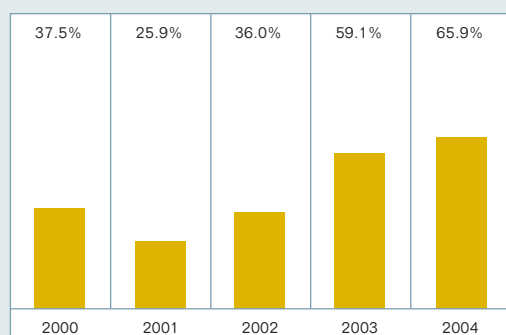
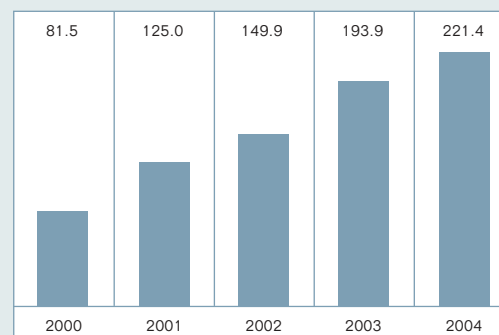
To mitigate this risk, the Company maintains net monetary asset and/or liability balances in foreign currencies and engages in foreign currency hedging activities using derivative financial instruments. The Company does not purchase any derivative instruments for speculative purposes.

The table below reflects the foreign exchange rates between the most common currencies in which Patheon conducts business and its U.S. dollar reporting currency.

	2004	2003	%
	\$	\$	CHANGE
AVERAGE EXCHANGE RATES			
1 Canadian dollar equals U.S. dollars	0.7583	0.6951	9%
1 Euro equals U.S. dollars	1.2238	1.0997	11%
1 U.K. sterling equals U.S. dollars	1.8038	1.6108	12%
YEAR-END EXCHANGE RATES			
	2004	2003	%
	\$	\$	CHANGE
1 Canadian dollar equals U.S. dollars	0.8210	0.7584	8%
1 Euro equals U.S. dollars	1.2797	1.1618	10%
1 U.K. sterling equals U.S. dollars	1.8378	1.6973	8%

The Company has entered into forward exchange contracts to sell U.S. dollars and purchase Canadian dollars. At October 31, 2004, the unrealized gain on these forward contracts was \$2.4 million (2003 – \$0.1 million).

INTEREST-BEARING DEBT TO SHAREHOLDERS' EQUITY

SHAREHOLDERS' EQUITY
(in millions of U.S. dollars)

Translation gains and losses related to the carrying value of the Company's foreign operations are deferred and included in the cumulative translation account in shareholders' equity. At October 31, 2004, the balance in the account was a \$24.4 million gain, compared with a \$9.0 million gain at the end of 2003.

Management of Expanded Operations

Patheon has experienced significant growth in a relatively short period of time. Managing such growth could place a significant burden on managerial, financial and other resources of the combined business. The ability of the Company to manage future growth will depend on its ability to attract, train, motivate and manage key employees and to continue to implement and improve operations, financial and management information systems, procedures and controls. In particular, the Company's success will depend to a significant degree on senior management's contributions and its ability to retain and attract key management and other highly skilled technical personnel. Any failure by the Company to manage its growth could have a material adverse effect on its business, financial condition and results of operations.

International Operations

Patheon's operations are subject to the risks of doing business in several countries in North America and Europe including, but not limited to, varying economic and political conditions, cultures and business practices, tax rates, possible restrictions on the transfer of funds, employee turnover, labour unrest, longer payment cycles, and the burdens and costs of compliance with a variety of foreign laws. There can be no assurance that these factors will not have an adverse effect on business, financial conditions and results of operations of the Company.

Demand for Clients' Products

Revenues are dependent on demand for the products the Company manufactures on behalf of its clients and on the ability of its clients to successfully market and obtain coverage and reimbursement for their products. Demand for clients' products can be influenced by, among other things, the emergence of competing products and the degree to which health authorities subsidize payment for a particular product. As well, the financial performance of the Company may be materially adversely affected by changes in the marketing strategies of its clients and product portfolios. As such, there can be no assurance that production volumes of key products and related revenues will be maintained.

Product Liability Claims

The Company may be subject to liability claims by those who purchase its services and the ultimate consumers of clients' products it manufactures. To date, Patheon has been able to obtain liability insurance for the operation of its business. However, there can be no assurance that existing liability insurance will be adequate, or that it will be able to be maintained, or that all possible claims that may be asserted against the Company will be covered by insurance. A partially or completely uninsured claim, if successful and if of sufficient magnitude, could have a material adverse effect on the business, financial condition and results of operations of the Company.

Interest Rate Exposure

The Company has exposure to movements in interest rates. At October 31, 2004, approximately 81% (2003 – 78%) of the Company's total debt portfolio was subject to movements in floating interest rates. Assuming no change to the structure of the debt portfolio at October 31, 2004, the sensitivity to interest rate changes is as follows:

APPROXIMATE IMPACT ON CASH FLOW AND NET EARNINGS

Change of 1% in floating interest rates	\$0.8 million
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Following the acquisition of MOVA Pharmaceutical Corporation and the entering into of additional debt agreements with various lenders to finance the transaction, it is the Company's intention to increase the portion of fixed rate debt to at least 50% of total debt outstanding.

Credit and Client Concentration

Patheon has historically been dependent on a small but increasing number of significant clients with respect to its manufacturing and development services. The Company, in the normal course of business, monitors the financial condition of its clients and reviews the credit history of each new client. The Company establishes an allowance for doubtful accounts that corresponds to the specific credit risk of its clients, historical trends and economic circumstances.

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%).

Patheon believes that the risks related to its reliance on its major clients are reduced by a number of factors, including:

- (a) the negotiation of long-term manufacturing agreements with these clients;
- (b) the fact that manufacturing services for these clients are not concentrated at a single facility or on a single product;
- (c) the diversity of products and projects undertaken by Patheon; and
- (d) the expansion of PDS units in both Europe and North America; by increasing the variety of service activities offered to its clients, Patheon is also lowering the risk of depending on a small number of clients for a significant portion of its revenues.

Environmental, Health and Safety Risks

Patheon's approach is to continually improve the management of operational risks in the areas of the environment, health and safety while developing mechanisms to manage future risks. The Company has a commitment to safeguard the health of employees and the quality of the environment. Highly qualified environmental, health and safety professionals at all Company locations are dedicated to the maintenance and improvement of programs and procedures to ensure continued employee and environmental protection. To the best of the Company's knowledge, all of its facilities are in compliance with environmental and occupational health and safety regulations.

SELECTED ANNUAL FINANCIAL INFORMATION

The Company discloses the following selected financial information for the three most recent fiscal years:

(in thousands of U.S. dollars, except per-share amounts)	Years ended October 31,		
	2004	2003	2002
Revenues	470,259	407,144	266,078
Net earnings before repositioning expenses	13,763	18,578	17,977
Earnings per share before repositioning expenses			
Basic	26.7¢	36.2¢	35.4¢
Diluted	26.5¢	35.6¢	34.7¢
Net earnings	10,678	18,578	17,977
Earnings per share			
Basic	20.7¢	36.2¢	35.4¢
Diluted	20.6¢	35.6¢	34.7¢
Total assets	522,583	436,860	285,568
Total long-term liabilities	163,018	132,024	55,010
Cash dividends	—	—	—

Changes in revenues, net earnings before repositioning expenses, net earnings and related basic and diluted earnings per share between 2004 and 2003 are explained in this MD&A. The increase in assets and long-term liabilities in 2004 compared with 2003 is principally due to the capital spending of \$62.6 million in 2004, approximately \$20 million of which was financed by long-term debt.

On December 2002, the Company acquired a pharmaceutical manufacturing site in Cincinnati, Ohio, U.S.A. and entered into long-term supply agreements in connection with the acquisition. Cash consideration was \$28.2 million, all of which was financed by bank credit facilities. The results for the 2003 fiscal year include the operations of this site for ten months. Revenues related to the site in 2003 were \$82.6 million. The revenue increase from internal growth, or new business from existing sites in Canada and Europe, was \$60.1 million in the 2003 fiscal year. Net earnings were impacted by net foreign exchange losses as a result of the significant weakening of the U.S. dollar against the Canadian dollar in 2003 and by operating losses at the Swindon, U.K. operations as a result of lower commercial volumes. Capital spending in 2003 was \$53.7 million, approximately 40% of which was financed by bank credit facilities.

SELECTED QUARTERLY FINANCIAL INFORMATION

The Company discloses the following selected financial information for the eight most recent quarters:

(in thousands of U.S. dollars, except per-share amounts)	REVENUES \$	EBITDA \$	NET EARNINGS \$	EARNINGS PER SHARE	
				BASIC ¢	DILUTED ¢
2004					
January 31	107,780	10,972	2,589	5.0	5.0
April 30	122,818	12,613	3,102	6.0	5.9
July 31	116,840	11,035	1,990	3.9	3.9
October 31	122,821	13,485	2,997	5.8	5.8
	470,259	48,105	10,678	20.7	20.6
2003					
January 31	79,052	7,967	3,080	6.0	5.9
April 30	105,016	12,073	4,791	9.3	9.2
July 31	113,379	15,442	6,097	11.9	11.7
October 31	109,697	14,063	4,610	9.0	8.8
	407,144	49,545	18,578	36.2	35.6

Revenues from some of Patheon's services are traditionally lower in the Company's first fiscal quarter, being the three months ending January 31. Please see **Seasonable Variability of Results** for additional information. In fiscal 2004, results were further impacted by new product launches approved for commercialization by the regulatory authorities. These impacts were principally from the second quarter of 2004, to the end of the Company's fiscal year. Client volume forecasts are typically subject to volatility during the early stages of commercialization. Results were further impacted by repositioning expenses incurred at Swindon Operations. The Company recorded \$2.1 million of these expenses in the third quarter and \$2.3 million in the fourth quarter of 2004.

ADDITIONAL INFORMATION

Share Capital

As of December 7, 2004, the date of the Auditors' Report, the Company had outstanding 51,555,822 common shares and 1,029 Class I preferred shares.

Subsequent to this date and as discussed in **Subsequent Event** in this MD&A, the Company completed the following transactions:

- ♦ On December 23, 2004, completion of an offering of 26,000,000 common shares in connection with the acquisition of MOVA Pharmaceutical Corporation;
- ♦ On January 11, 2005, exercise of the over-allotment option granted in connection with the offering of 26,000,000 common shares to purchase an additional 2,600,000 common shares.

As of February 18, 2005, the Company had outstanding 92,845,688 common shares and 1,029 Class I preferred shares.

Obligations with Respect to Employee Future Benefit Plans

In addition to the disclosure relating to contractual obligations contained in this MD&A, the Company's obligations as at October 31, 2004 with respect to employee future benefit plans, which have been actuarially determined, were:

(in millions of U.S. dollars)	DEFINED BENEFIT PENSION PLANS	POST-RETIREMENT PLANS	ITALY: TERMINATION INDEMNITIES	TOTAL
Projected benefit obligations	53.2	6.9	6.7	66.8
Less plan assets	(33.8)	–	–	(33.8)
Unfunded amount	19.4	6.9	6.7	33.0
Unrecognized past service costs and actuarial losses	9.1	2.2	–	11.3
Amount included in other long-term liabilities	10.3	4.7	6.7	21.7

Employer contributions to the defined benefit pension plans amounted to \$3.2 million in 2004 (2003 – \$2.9 million).

Public Securities Filings

Other information about the Company, including the annual information form and other disclosure documents, reports, statements or other information that is filed with Canadian securities regulatory authorities can be accessed through SEDAR at www.sedar.com.

SUBSEQUENT EVENT – ACQUISITION OF MOVA PHARMACEUTICAL CORPORATION

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 earn-out 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. Until the bridge facility is refinanced, the amount outstanding will be shown as a current liability.

On January 11, 2005, the underwriters for the offering of 26 million shares exercised the over-allotment option granted to purchase an additional 2.6 million shares, resulting in gross proceeds of \$18.3 million (net proceeds of \$17.5 million after offering costs). Of the net proceeds, \$8.1 million was placed into escrow, \$9.0 million was used to reduce the committed and outstanding amount of the bridge facility, and the remainder was used to pay expenses related to the transaction.

OUTLOOK FOR 2005

In June 2004, the Company announced that the Board of Directors had amended Patheon's Corporate Disclosure Policy so that, effective at the end of the 2004 fiscal year, Patheon would no longer provide guidance on its expected revenues or net earnings. The Company will continue to provide investors with information on those factors, both internal and in the external operating environment, that aid in understanding the Company's progress in implementing its long-term strategy.

The Company is uniquely positioned at the end of fiscal 2004 to serve the evolving market for full-service pharmaceutical manufacturing services. The Company completed the acquisition of MOVA Pharmaceutical on December 23, 2004 (see **Subsequent Event**). The rationale for and the benefits of this transaction are compelling. Not only will it be accretive to both EBITDA margin and earnings per share in the 2005 fiscal year, it also creates an organization with the resources, the global presence and the capacity to fully capitalize on the evolving market for integrated dosage form development and R_x manufacturing.

The Company also reached a milestone in its PDS business this year. In addition to a solid performance by PDS units in Europe and North America, a total of four new products for which the Company provided development services on behalf of clients received regulatory approval in fiscal 2004. In all cases, the Company was selected to produce commercial quantities to support the launch of these products, clearly validating the strategy to serve the innovators from development through to commercialization of their new products. At year end, there were a total of 112 projects in the PDS pipeline, including five drug candidates at the NDA stage, of which three are in line for approval as early as fiscal 2005.

After a challenging year for the Company's OTC sites in Canada, the Company is pleased by steadily improving volumes and looks forward to a solid contribution from these sites in fiscal 2005. At the Swindon site, significant progress was made during the year on initiatives to improve the 2005 operating performance at this site. The Company expects a return to profitability for this site in 2006.

Patheon is entering a new era in fiscal 2005. The combination with MOVA has created one of the world's leading dosage form manufacturers. In addition, the market segment is growing for those companies that can deliver the necessary manufacturing scale and expertise. More than ever before, the Company is ready to be the supplier of choice for the pharmaceutical industry's innovators.

Five-Year Financial Summary

Years ended October 31 (in thousands of U.S. dollars, except share information, per-share amounts and percentages)	2004 \$	2003 \$	2002 \$	2001 \$	2000 \$
REVENUES AND NET EARNINGS					
Revenues	470,259	407,144	266,078	207,495	173,669
EBITDA ⁽¹⁾	48,105	49,545	36,162	26,857	23,114
(% of revenues)	10.2%	12.2%	13.6%	12.9%	13.3%
Depreciation and amortization	22,765	16,330	10,354	8,227	5,977
Interest	5,609	4,508	1,999	1,955	2,840
Provision for income taxes	9,053	10,129	5,832	6,100	5,134
Net earnings	10,678	18,578	17,977	10,575	9,163
(% of revenues)	2.3%	4.6%	6.8%	5.1%	5.3%
Earnings per share					
Basic	0.21	0.36	0.35	0.22 ⁽⁷⁾	0.21 ⁽⁶⁾
Diluted	0.21	0.36	0.35	0.21 ⁽⁷⁾	0.20 ⁽⁶⁾
Number of shares					
Outstanding at October 31	51,556	51,506	50,913	50,296	46,121
Weighted average for the year	51,521	51,384	50,727	47,924	43,438
FINANCIAL POSITION					
Current assets	165,491	149,258	88,487	71,872	53,526
Current liabilities	138,167	110,913	80,650	64,434	49,709
Working capital	27,324	38,345	7,837	7,438	3,817
Total assets	522,583	436,860	285,568	222,584	159,283
Book value per share at year end ⁽²⁾	4.29	3.77	2.94	2.48	1.77
Interest-bearing debt	145,792	114,626	54,003	32,408	30,555
Interest-bearing long-term debt	124,262	102,353	38,576	17,255	21,565
Shareholders' equity	221,398	193,923	149,908	124,974	81,482
Return on shareholders' equity ⁽³⁾	5.2%	11.4%	13.2%	9.7%	15.2%
Interest-bearing debt to shareholders' equity	65.9%	59.1%	36.0%	25.9%	37.5%
Interest-bearing long-term debt to shareholders' equity	56.1%	52.8%	25.7%	13.8%	26.5%
Total capitalization ⁽⁴⁾	367,190	308,549	203,911	157,382	112,037
Interest-bearing debt to total capitalization	39.7%	37.2%	26.5%	20.6%	27.3%
Interest-bearing long-term debt to total capitalization	33.8%	33.2%	18.9%	11.0%	19.2%
CASH FLOW					
Cash provided from operations ⁽⁵⁾	40,592	39,663	31,296	21,420	16,919
Cash provided by operating activities	40,419	35,307	24,153	15,860	7,714
Additions to capital assets					
– sustaining	11,232	14,436	5,938	10,458	8,027
– project-related	51,372	39,233	35,058	17,110	11,411
Total additions to capital assets	62,604	53,669	40,996	27,568	19,438
Acquisitions	–	28,220	–	22,712	33,433
Net proceeds from equity issues	–	–	–	35,213	24,854

(1) Earnings before interest, income taxes, depreciation and amortization.

(2) Book value per share is defined as shareholders' equity divided by the number of shares outstanding at year end.

(3) Ratio of net earnings to the average shareholders' equity during the fiscal year, adjusted for the effect of share proceeds received during the year.

(4) Total capitalization is the sum of interest-bearing debt and shareholders' equity.

(5) Cash provided from operations before net change in non-cash working capital balances related to operations.

(6) FY00 shares outstanding increased 7% as a result of an equity offering in October 2000.

(7) FY01 shares outstanding increased 9% as a result of an equity offering in June 2001.

		Q1 RATE	Q2 RATE	Q3 RATE	Q4 RATE	
Average Canadian/U.S. dollar exchange rates						
	FY00	1.4623	1.4600	1.4834	1.4937	
	FY01	1.5226	1.5459	1.5321	1.5597	
	FY02	1.5849	1.5881	1.5424	1.5738	
	FY03	1.5572	1.4822	1.3728	1.3602	
	FY04	1.3071	1.3332	1.3527	1.2822	
(in thousands of U.S. dollars except per-share amounts)						
		Q1 \$	Q2 \$	Q3 \$	Q4 \$	YEAR \$
Revenues	FY00	34,443	46,497	43,935	48,794	173,669
	FY01	42,175	45,506	56,511	63,303	207,495
	FY02	59,072	65,001	70,502	71,503	266,078
	FY03	79,052	105,016	113,379	109,697	407,144
	FY04	107,780	122,818	116,840	122,821	470,259
Earnings before interest, income taxes, depreciation and amortization (EBITDA)	FY00	3,974	5,632	5,875	7,633	23,114
	FY01	5,163	6,357	6,419	8,918	26,857
	FY03	7,967	12,073	15,442	14,063	49,545
	FY04	10,972	12,613	11,035	13,485	48,105
Depreciation and amortization	FY00	1,323	1,343	1,586	1,725	5,977
	FY01	1,801	1,896	1,939	2,591	8,227
	FY02	2,205	2,203	2,631	3,315	10,354
	FY03	3,202	3,363	4,435	5,330	16,330
	FY04	5,292	5,779	5,743	5,951	22,765
Interest	FY00	456	892	769	723	2,840
	FY01	380	439	701	435	1,955
	FY02	381	402	546	670	1,999
	FY03	812	1,173	1,273	1,250	4,508
	FY04	1,143	1,264	1,404	1,798	5,609
Net earnings	FY00	1,219	2,210	2,177	3,557	9,163
	FY01	1,958	2,497	2,373	3,747	10,575
	FY02	2,794	3,830	5,474	5,879	17,977
	FY03	3,080	4,791	6,097	4,610	18,578
	FY04	2,589	3,102	1,990	2,997	10,678
Basic EPS (US¢)	FY00 ⁽¹⁾	2.8	5.1	5.1	8.1	21.1
	FY01 ⁽²⁾	4.2	5.4	5.0	7.5	22.1
	FY02	5.5	7.5	10.8	11.6	35.4
	FY03	6.0	9.3	11.9	9.0	36.2
	FY04 ⁽³⁾	5.0	6.0	3.9 ⁽⁴⁾	5.8 ⁽⁴⁾	20.7 ⁽⁴⁾
Diluted EPS (US¢)	FY00 ⁽¹⁾	2.7	4.9	4.8	7.8	20.2
	FY01 ⁽²⁾	4.0	5.1	4.9	7.3	21.3
	FY02	5.4	7.4	10.5	11.4	34.7
	FY03	5.9	9.2	11.7	8.8	35.6
	FY04 ⁽³⁾	5.0	5.9	3.9 ⁽⁴⁾	5.8 ⁽⁴⁾	20.6 ⁽⁴⁾

⁽¹⁾ FY00 shares outstanding increased 7% as a result of an equity offering in October 2000.

⁽²⁾ FY01 shares outstanding increased 9% as a result of an equity offering in June 2001.

⁽³⁾ FY04 includes stock-based compensation expense of \$1.4 million.

⁽⁴⁾ FY04 includes U.K. repositioning expenses of \$2.1 million in Q3 and \$2.3 million in Q4.