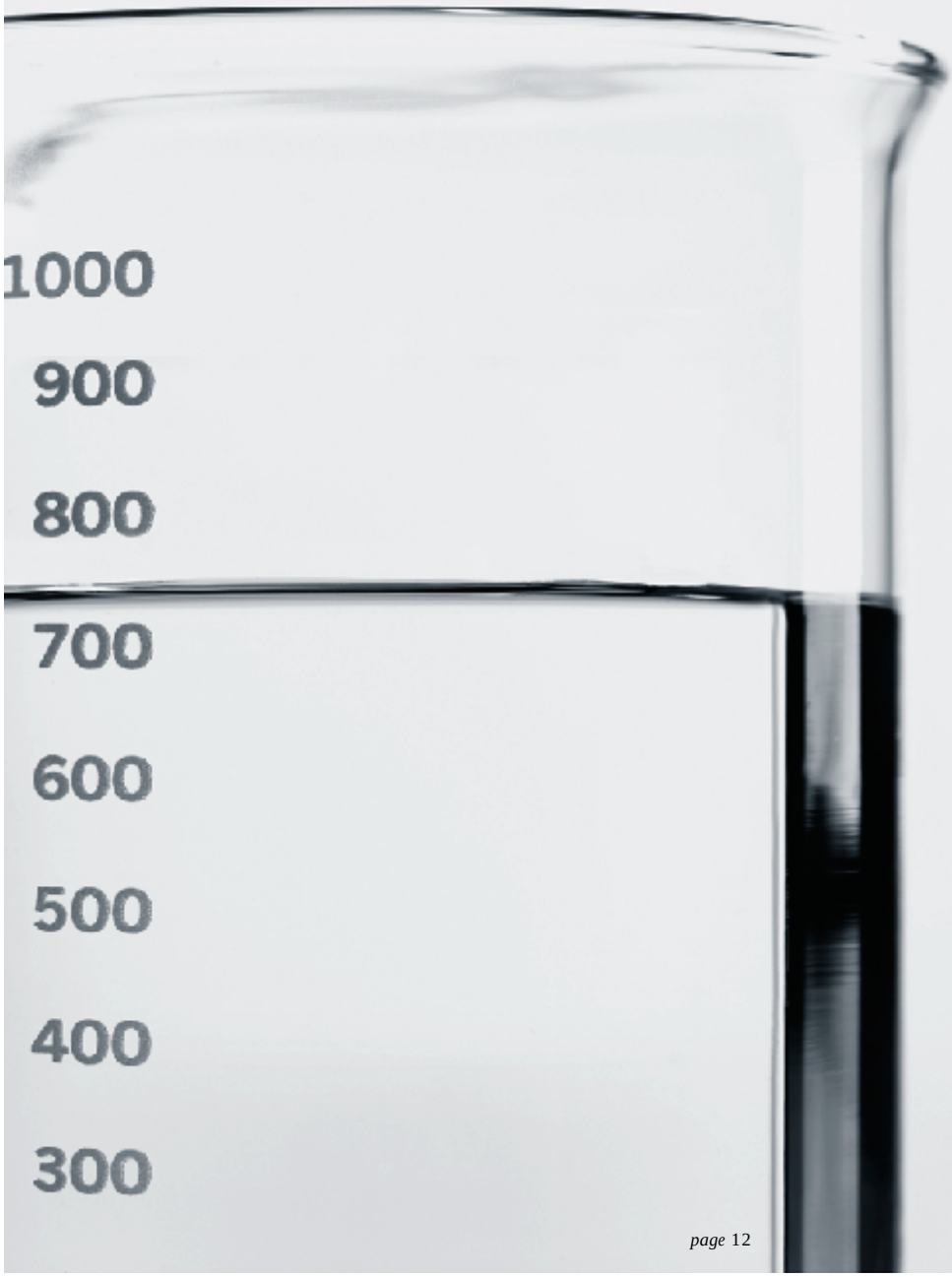
OUR PERFORMANCE

This management's discussion and analysis ("MD&A") should be read in conjunction with the Company's consolidated financial statements and related notes and 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 January 27, 2006.



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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This management discussion and analysis of financial condition and results of operations ("MD&A") contains forward-looking statements which reflect management's expectations regarding the Company's future growth, results of operations, performance (both operational and financial), and business prospects and opportunities. Wherever possible, words such as "plans," "expects" or "does not expect," "forecasts," "anticipates" or "does not anticipate," "believes,""intends" and similar expressions or statements that certain actions, events or results "may," "could," "would," "might" or "will" be taken, occur or be achieved have been used to identify these forward-looking statements. Although the forward-looking statements contained in this MD&A reflect management's current assumptions based upon information currently available to management and based upon what management believes to be reasonable assumptions, the Company cannot be certain that actual results will be consistent with these forward-looking statements. Forward-looking statements necessarily involve significant known and unknown risks, assumptions and uncertainties that may cause the Company's actual results, performance, prospects and opportunities in future periods to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things: the market demand for client products; dependence on key clients; the ability to identify and secure new contracts; regulatory matters, including compliance with pharmaceutical regulations; management of expanded operations; international operations risks; currency risks; competition; product liability claims; integration of new operations; financing risks and interest rate risks. Although the Company has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date of this MD&A and, except as required by law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

ABOUT PATHEON

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 development services of prescription ("R_x") and over-the-counter ("OTC") drugs to the international pharmaceutical industry. The Company is organized and managed as a single business segment, being the provider of commercial manufacturing and pharmaceutical development services ("PDS").

VISION AND STRATEGY

Patheon's vision is to be the leader in pharmaceutical manufacturing. Patheon strives to be the preferred manufacturing and pharmaceutical development services partner to the global pharmaceutical industry. Patheon's strategy is to offer strategic benefits to its clients by providing comprehensive, high-quality and integrated manufacturing services throughout the product lifecycle.

Patheon expects 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 is using its position as a comprehensive provider of commercial manufacturing services to establish and maintain long-term and strategic relationships with clients on a global basis.

The development of Patheon's business in recent years has been guided by a plan to expand capacity, expertise and capabilities, positioning the Company to be the preferred manufacturing services partner to the pharmaceutical industry. This has led to the acquisition of several pharmaceutical manufacturing facilities and the entry into long-term manufacturing relationships in conjunction with certain of these acquisitions. In addition to this strategic growth, Patheon is focused on growing the business internally, by expanding the level of business from existing clients, attracting new clients, and entering into commercial manufacturing agreements for newly approved products for which the Company has provided development services.

In implementing its strategy, the Company will continue to maximize capacity utilization and improve efficiency, broaden its services to include other manufacturing capabilities, and seek to increase the percentage of more profitable products manufactured at its facilities. 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, are increasingly being restructured or outsourced to third-party service providers such as Patheon.

In addition, more 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 rising costs of launching new pharmaceutical products.

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 therefore, are turning to third-party service providers to provide manufacturing services.

Patheon's target markets include the global market for the manufacture of finished dosage forms and for dosage form research and development. Patheon management estimates that annual global expenditures for finished dosage form commercial pharmaceutical manufacturing are currently approximately $83 billion, of which about $8 billion to $12 billion is currently outsourced. In 2004, the global pharmaceutical industry spent approximately $50 billion on research and development, and the global biotech industry, approximately $20 billion. Patheon management estimates that this amount includes $3 billion spent on dosage form development, of which about $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, Patheon management believes that growth of pharmaceutical industry outsourcing will be driven by the following factors:

- growth of the global pharmaceutical industry. According to leading market research firm IMS Health, global pharmaceutical industry revenues have grown from $354 billion in 2000 to approximately $550 billion in 2004;
- global research and development expenditures are increasing;
- the number of product candidates in development continues to expand;
- consolidation of the pharmaceutical industry, and supply chain restructuring, are providing new opportunities as companies seek to reduce excess capacity in their manufacturing networks;
- increased demand for specialized manufacturing capabilities in key technical niches (for example, lyophilization);
- increased demand for back-up sources of supply.

COMPETITORS

Commercial Manufacturing

In North America and Europe, Patheon's competition includes:

- companies, both private and public, that are not focused exclusively on contract manufacturing, but provide this service as part of a range of services to the pharmaceutical industry;
- companies that focus on contract manufacturing, but tend to be small and privately owned firms that offer services in a limited number of dosage forms or serve only their local or national markets; and
- large pharmaceutical companies that offer third-party manufacturing services to fill excess capacity.

Pharmaceutical Development

The pharmaceutical development services market is composed of a range of participants:

- small laboratories, which offer only a small number of development services, generally on a small scale;
- providers focused on specific technologies and/or dosage forms; and
- a few fully integrated companies that can provide the full complement of services necessary to develop, scale up and manufacture a wide range of dosage forms.

OVERVIEW OF PATHEON

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

Patheon commercially manufactures R_x and OTC products in solid, semi-solid and liquid dosage forms and manufactures R_x products in various sterile dosage forms. Conventional dosage forms include compressed tablets, hard-shell capsules, powders, ointments, creams, gels, syrups, suspensions, solutions and suppositories. Sterile dosage forms include liquids and powders filled in ampoules, vials, bottles or pre-filled syringes. Sterile lyophilized products are also manufactured in both vials and ampoules.

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.

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 2005, Patheon's facilities were audited by 186 separate client audit teams, representing both prospective and existing clients. Audits by prospective clients permit them 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 requirements. These audits contribute to Patheon's ongoing improvement of manufacturing and development practices. In addition, there were 19 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 five facilities in North America and Europe. In addition to having 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, controlled release, and sterile liquids). At October 31, 2005, the Company was working on a total of 147 of its clients' projects in the development pipeline, including six drug candidates at the New Drug Application ("NDA") stage. Since the beginning of fiscal 2001, 15 new pharmaceutical products developed by Patheon's PDS unit have progressed to commercial manufacturing, including one which was launched subsequent to year-end 2005. Four products were launched in fiscal 2005, all of which have contributed to Patheon's commercial manufacturing revenues. At the end of fiscal 2005, the growing PDS team included more than 500 scientists and technical staff, with 69 holding doctoral degrees. Patheon's development scientists have extensive development experience with a wide variety of pharmaceutical dosage forms.

Key Performance Drivers

Since 1992, the Company has grown from a contract OTC pharmaceutical manufacturer with two facilities to become a leading provider of R_x and OTC manufacturing and PDS services to the international pharmaceutical industry, operating 14 sites in five countries in North America and Europe at the end of the 2005 fiscal year. In 2005, prescription manufacturing services and pharmaceutical development services comprised 84% of total revenues, compared with 78% in 2004. In implementing its strategy, the Company will continue to increase the percentage of more profitable prescription products at its facilities. It also will continue to expand its PDS capabilities in North America and Europe, as PDS services are an important source of new business for commercial manufacturing of prescription pharmaceuticals.

The Company's operating sites' cost structure is largely fixed in the short term. Therefore, unanticipated fluctuations in manufacturing activity can have a significant impact on EBITDA margins. The Company currently has capacity for sale at all of its sites.

Since 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 the revenues and approximately 15% to 25% of the operating expenses of its Canadian operations 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 the Canadian dollar expenses of its Canadian sites. A one-cent change in the U.S./Canadian dollar exchange rate is estimated to impact earnings by approximately $0.6 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.

USE OF NON-GAAP FINANCIAL MEASURES

Except as otherwise indicated, references in this MD&A to "EBITDA" are to earnings before depreciation and amortization, gain on sale of land, interest, write-off of deferred financing costs, and income taxes. Free cash flow is defined as cash provided by operating activities in excess of additions to capital assets in the period. "EBITDA margin" is EBITDA as a percentage of revenues. EBITDA, EBITDA margin and free cash flow are measures of earnings, earnings margin and cash flows that are not recognized by Canadian generally accepted accounting principles ("GAAP"). Since each of these measures is a non-GAAP measure that does not have a standardized meaning, it may not be comparable to similar measures presented by other issuers. Prospective investors are cautioned that these and other non-GAAP measures should not be construed as alternatives to net earnings determined in accordance with GAAP as indicators of performance, or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows. The Company has included these measures because it believes that this information is used by certain investors to assess financial performance.

ACQUISITION OF MOVA

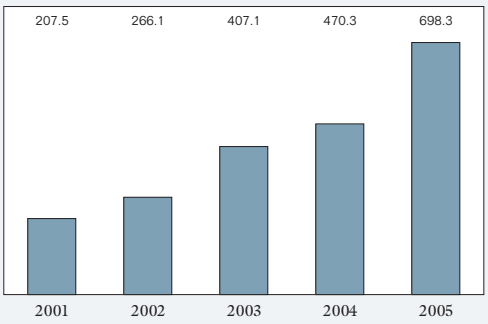
On December 23, 2004, the Company completed the acquisition of MOVA Pharmaceutical Corporation and MOVA Investments, Inc. (collectively "MOVA"), a leading U.S. prescription pharmaceutical contract manufacturer located in Puerto Rico, U.S.A. The acquisition has been accounted for using the purchase method, and the accompanying consolidated financial statements include the results of operations from the date of purchase.

The purchase price for the shares of MOVA was based on an enterprise value for MOVA at closing of $350.0 million. The Company issued 12,684,866 common shares to the shareholders of MOVA in satisfaction of $81.5 million of the purchase price. The Company assumed approximately $133.3 million in debt and paid $135.2 million in cash at closing.

The agreement also provided for two earn-out arrangements relating to MOVA's operating results for two specific periods. The maximum amounts for the first and second earn-outs were $65.0 million and $26.0 million, respectively. An agreement was reached with the former MOVA shareholders to pay the full amount of the first earn-out arrangement and $65.0 million was paid on June 23, 2005. An additional $8.3 million was paid as a result of other post-closing adjustments relating to working capital and assumed debt. It was determined that no amount was payable under the second earn-out.

Please refer to note 2 to the audited financial statements for further details on the acquisition of MOVA.

REVENUES
(in millions of U.S. dollars)



RESULTS OF OPERATIONS

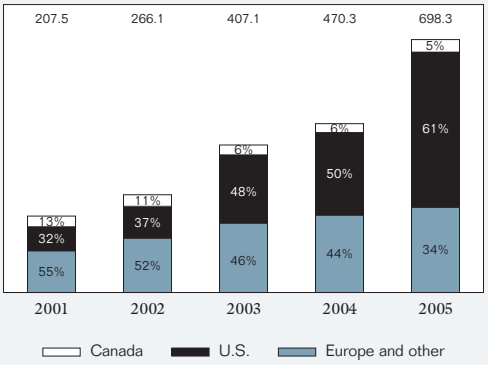
Revenues by Geographic Region and Service Activity

Years ended October 31 *(in thousands of U.S. dollars, except percentages)*	2005 $	2004 $	% CHANGE
NORTH AMERICA			
Commercial Manufacturing			
Prescription	313,078	141,539	121%
Over-the-counter	107,337	100,613	7%
	420,415	242,152	74%
Development Services	73,119	53,530	37%
	493,534	295,682	67%
EUROPE			
Commercial Manufacturing			
Prescription	185,035	160,776	15%
Over-the-counter	1,816	1,552	17%
	186,851	162,328	15%
Development Services	17,933	12,249	46%
	204,784	174,577	17%
TOTAL			
Commercial Manufacturing			
Prescription	498,113	302,315	65%
Over-the-counter	109,153	102,165	7%
	607,266	404,480	50%
Development Services	91,052	65,779	38%
CONSOLIDATED REVENUES	698,318	470,259	48%

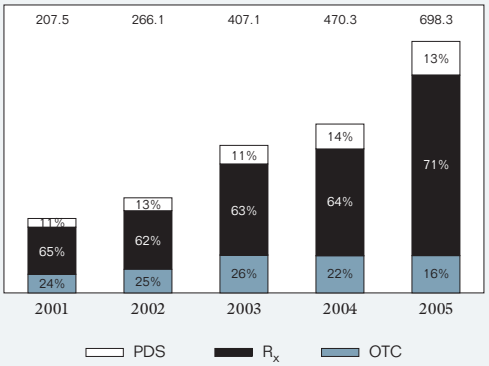
Revenues

Consolidated revenues for the year ended October 31, 2005 increased 48%, or $228.1 million, to $698.3 million from the same period in 2004. In 2005, all service activities contributed to the growth. On a consolidated basis, commercial manufacturing revenues grew 50%, with R_x manufacturing up 65% and OTC manufacturing up 7%, while PDS revenues were up 38%.

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)



Strategic growth in 2005 was $149.3 million, related to MOVA. Internal growth, or new business from existing sites, was $78.8 million, or 17%, in 2005, 16% in North America and 17% in Europe. On a consolidated basis, internal revenue growth was 17% in R_x manufacturing, 30% in PDS (20% on a combined basis for these two service activities), and 7% in OTC.

All service activities contributed to strong internal growth in North America, where internal revenue growth was $28.0 million or 20% in R_x manufacturing, $13.9 million or 26% in PDS (21% on a combined basis), and $6.7 million or 7% in OTC. In Europe, growth was attributable principally to R_x manufacturing and PDS services, which were up $24.3 million, or 15%, and $5.7 million, or 46%, respectively, compared with the same period in 2004.

Prescription manufacturing and development services represented 84% of revenues, compared with 78% for the comparable period in 2004, a result of internal growth in R_x and PDS services and strategic growth from MOVA, where all commercial services are R_x.

PDS revenues increased 38% in 2005, reflecting continuing momentum at PDS sites in North America and Europe. The revenue growth in PDS was 37% in North America and 46% in Europe in 2005, compared with the same period a year ago. Growth in PDS revenues reflects the continuing favourable financing environment for drug development, as well as the Company's enhanced reputation in the marketplace for providing formulation development and commercialization services for its clients' newly approved products.

OTC revenues increased 7% in 2005, compared with the same period a year ago. While the Company reported double-digit growth in OTC revenues in North America in the first and second quarters of 2005, OTC revenues declined 3% in the third quarter of 2005 and were comparable in the fourth quarter, compared with the same periods a year ago. This segment of the pharmaceutical market is highly competitive, price-sensitive, and subject to volatility in consumer demand.

Geographically, North American revenue growth was $197.9 million or 67% over the same period in the prior year. Of the revenue increase, $149.3 million was strategic growth related to the acquisition of the MOVA operations. Net internal growth was $48.7 million, or 16%, reflecting strong growth in R_x manufacturing services, principally from the Toronto high-potency operations. In North America, the Whitby site faced challenges as a result of significantly lower-than-anticipated volumes in connection with a new product launch as well as capacity constraints related to increased demand for certain OTC products. Lower-than-anticipated volumes at MOVA were principally due to a shortage of client-supplied API for the large-volume Omnicef® product and the suspension of manufacturing of that same product in response to a U.S. Food and Drug Administration ("FDA") Warning Letter, combined with a decrease in volumes for a newly launched product. In Europe, significant year-over-year increases in R_x internal growth revenues came principally from the Italian operations, reflecting continuing strong growth in the commercial business, and the improved performance of the Swindon, U.K. operations. Strong growth in PDS was reported at the Canadian, European and Cincinnati sites.

Revenues from sites in North America represented 71% of total revenues in 2005, compared with 63% in 2004. This reflects the inclusion of revenues related to the MOVA operations and growth in all service activities from the other operations in North America.

In Europe, revenues in 2005 were 17% higher than in 2004. European currencies remained strong against the U.S. dollar in 2005 compared with the prior year. The euro strengthened approximately 4% and U.K. sterling strengthened approximately 2% against the U.S. dollar, increasing reported revenues by approximately $5.2 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 14% higher than the same period in 2004. Net earnings in 2005 would have been higher by approximately 0.7¢ per share on a constant exchange rate ("CER") basis.

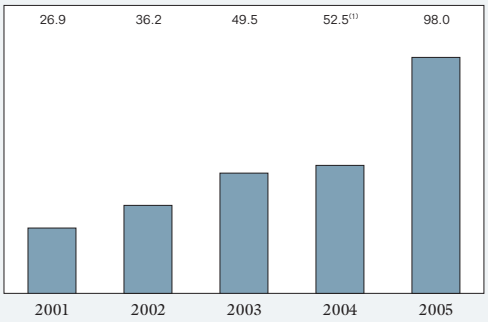
Results of Consolidated Operations

Years ended October 31 *(in thousands of U.S. dollars, except percentages and per-share amounts)*	2005 $	2004 $	% CHANGE
Revenues	698,318	470,259	48.5%
Operating expenses	598,828	416,374	43.8%
Repositioning expenses	—	4,407	
Stock-based compensation	1,528	1,373	11.3%
Earnings before the following:	97,962	48,105	103.6%
(as a % of revenues)	14.0%	10.2%	
Depreciation and amortization	33,351	22,765	46.5%
Amortization of intangible assets	11,188	—	
Gain on sale of land	(4,587)	—	
Interest	16,449	5,609	193.3%
Amortization of deferred financing costs	4,824	—	
Write-off of deferred financing costs	2,010	—	
Earnings before income taxes	34,727	19,731	76.0%
Provision for income taxes			
Current	10,464	6,669	56.9%
Future	2,642	2,384	10.8%
Provision for income taxes	13,106	9,053	44.8%
Net earnings for the year	21,621	10,678	102.5%
(as a % of revenues)	3.1%	2.3%	
Earnings per share			
Basic	25¢	21¢	20.3%
Diluted	25¢	21¢	20.4%

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

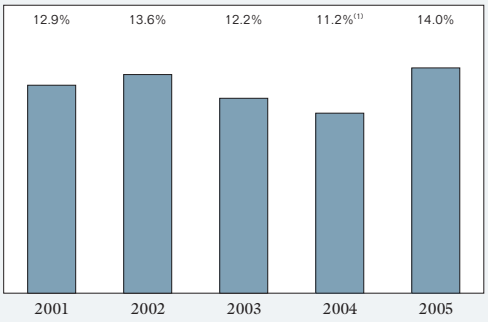
	2005		2004	
Years ended October 31 *(in thousands of U.S. dollars, except per-share amounts)*	EARNINGS $	EPS ¢	EARNINGS $	EPS ¢
Net earnings	21,621	24.9¢	10,678	20.7¢
Repositioning expenses	—	—	4,407	8.6¢
Income taxes related to repositioning expenses	—	—	(1,322)	(2.6¢)
Net earnings before repositioning expenses	21,621	24.9¢	13,763	26.7¢

EBITDA
(in millions of U.S. dollars)



[1] Before Swindon, U.K. repositioning expenses of $4.4 million

EBITDA MARGIN
(% of revenues)



[1] Before Swindon, U.K. repositioning expenses of $4.4 million

Operating Expenses

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support and administrative expenses. In the year ended October 31, 2005, operating expenses were $600.4 million, compared with $422.2 million in the same period a year ago, an increase of 42.2%. Operating expenses as a percentage of revenues were 86.0%, compared with 89.8% in the prior year. Excluding the impact of the MOVA operations, operating expenses as a percentage of revenues were 87.5% in 2005. Excluding the impact of repositioning expenses, operating expenses as a percentage of revenues were 88.8% in 2004.

EBITDA and EBITDA Margin

In 2005, EBITDA, representing earnings before depreciation and amortization, gain on sale of land, interest, write-off of deferred financing costs, and income taxes was $98.0 million, an increase of $49.9 million, or 104%, from the comparable period in 2004. As a percentage of revenues, EBITDA was 14.0% in 2005, compared with 10.2% in 2004. Excluding the impact of repositioning expenses, EBITDA as a percentage of revenues was 11.2% in 2004. The growth in EBITDA was attributable principally to the contribution of the MOVA business and increases in R_x and PDS services in North America and Europe. As expected, the Swindon, U.K. operations were EBITDA-positive in 2005.

Depreciation and Amortization Expense

Depreciation and amortization expense, excluding amortization of intangibles and deferred financing costs, was $33.4 million in 2005, compared with $22.8 million in 2004, an increase of $10.6 million, or 46.5%. Of the increase, $7.0 million was attributable to additional amounts relating to depreciation of the MOVA assets, $1.6 million was attributable to the effect of translation to U.S. dollars of depreciation related to Canadian and European sites, and the remainder was principally related to capital programs at the Italian sites and in North America, primarily at the Toronto, Canada, and Cincinnati, U.S.A. sites. Depreciation and amortization expense also includes the amortization of deferred pre-operating costs.

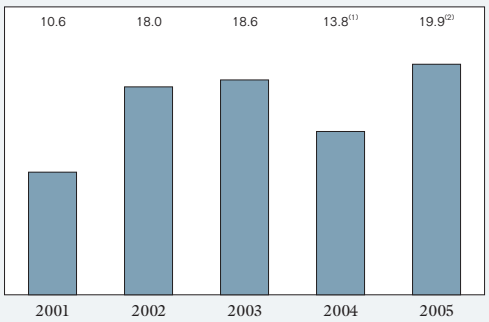
Amortization of Intangible Assets

The amortization of intangible assets of $11.2 million in 2005 relates to the MOVA operations. Intangible assets, which represent the value assigned to client contracts and relationships, are being amortized on a straight-line basis over nine years.

Gain on Sale of Land

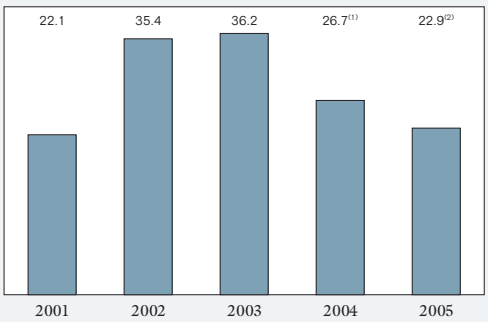
On October 17, 2005, the Company disposed of a parcel of land owned by its subsidiary in France. This land was not considered to be integral to the long-term operations or expansion plans for the site. The proceeds received on the sale were $4.7 million and the Company recorded a gain on the sale of $4.6 million.

NET EARNINGS
(in millions of U.S. dollars)



(1) Before Swindon, U.K. repositioning expenses of $3.1 million after tax
(2) Before one-time gain of $3.0 million from sale of land after tax and write-off of deferred financing costs of $1.3 million after tax

EPS - BASIC
(in U.S. cents)



(1) Before Swindon, U.K. repositioning expenses of 6.0 cents per share after tax
(2) Before one-time gain of 3.5 cents per share from sale of land after tax and write-off of deferred financing costs of 1.5 cents per share after tax

Interest Expense

Interest expense in 2005 was $16.4 million compared with $5.6 million in 2004, an increase of $10.8 million. Approximately $9.3 million of the year-over-year increase is related to new debt associated with the acquisition of the MOVA operations in December 2004. The remainder of the year-over-year increase is principally related to increased spending to finance the capital programs in North America and Europe.

Amortization and Write-Off of Deferred Financing Costs

Amortization of deferred financing costs in the year ended October 31, 2005 was $4.8 million. No amounts were recorded for the same period in the prior year. The write-off of $2.0 million relates to the write-off of deferred financing costs recorded in the first quarter of 2005 and is of a non-recurring nature.

Earnings Before Income Taxes

Earnings before income taxes increased 76% to $34.7 million in 2005, from $19.7 million in the same period a year ago. The increase is attributed to the inclusion of the results of the MOVA operations, increased volumes from certain North American operations and the European operations, compared with the same period in the prior year. This was offset by increased depreciation and amortization charges, related to the MOVA acquisition, and increased depreciation and interest expense in North America and Europe, related to ongoing capital and growth support programs.

Income Taxes

The effective income tax rate for the year ended October 31, 2005 was 37.7% versus 45.9% in the same period in 2004. The effective tax rate in 2004 was significantly impacted by the losses incurred at the U.K. operations, which were taxed at 30%, a lower rate than the Company's other operations in 2004. The lower effective tax rate in 2005 reflects the positive impact of the improved financial performance of the U.K. operations, as well as the inclusion of earnings from the MOVA operations as of December 23, 2004. The effective tax rate for the MOVA operations in Puerto Rico, U.S.A. is approximately 3%. As a result, the amount of earnings from operations in Puerto Rico, relative to earnings for operations outside of Puerto Rico, can significantly impact the consolidated effective tax rate.

Net Earnings and Earnings Per Share

Net earnings for the year ended October 31, 2005 were $21.6 million, compared with $10.7 million in 2004, an increase of $10.9 million, or 102.5%. Basic earnings per share in 2005 were 24.9¢ compared with 20.7¢ in the same period of 2004, an increase of 20%. Excluding the impact of repositioning expenses, basic earnings per share in the twelve months of 2004 were 26.7¢. Results were negatively impacted by significantly lower-than-anticipated volumes in connection with a new product launch at the Whitby operations, as well as capacity constraints relating to increased demand for certain OTC products at the site. Results were impacted positively by improved operating performance, principally at the Toronto high-potency site, the European operations, and the year-over-year growth in PDS. The MOVA operations were not accretive to earnings for the year ended October 31, 2005, for the reasons noted previously.

The average number of shares outstanding during the twelve-month period, determined on the basic and diluted bases, increased 69% and 68%, respectively. The increase is the result of shares issued in connection with the acquisition of MOVA, as described in notes 2 and 13 to the audited financial statements.

Diluted earnings per share were 24.8¢ compared with 20.6¢ in the year ended October 31, 2004, an increase of 20%. Dilution arises solely from options issued under the Company's stock option plan.

SEASONAL VARIABILITY OF RESULTS

Typically, Patheon's manufacturing and PDS revenues are lower in the first fiscal quarter. While commercial revenues in Europe followed this pattern, this was not the case for European PDS revenues or for North American PDS and commercial volumes. This is principally attributable to higher-than-anticipated commercial volumes at the Canadian sites and MOVA related to new business and product launches, and to continuing strong demand for PDS related to existing contracts in the first quarter.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

The following table summarizes the cash flows for the years indicated:

(in thousands of U.S. dollars)	2005 $	2004 $
Net earnings	21,621	10,678
Depreciation and amortization	49,363	22,765
Write-off of deferred financing costs	2,010	—
Employee future benefits	1,639	2,688
Future income taxes	2,642	2,384
Gain on sale of land	(4,587)	—
Stock-based compensation	1,528	1,373
Amortization of deferred revenues	(898)	—
Other	217	704
Working capital	(4,640)	(173)
Cash provided by operating activities	68,895	40,419
Cash used in investing activities	(266,476)	(62,994)
Cash provided by financing activities	219,415	20,952
Other	(6,953)	79
Net increase (decrease) in cash and cash equivalents	14,881	(1,544)

Free Cash Flow

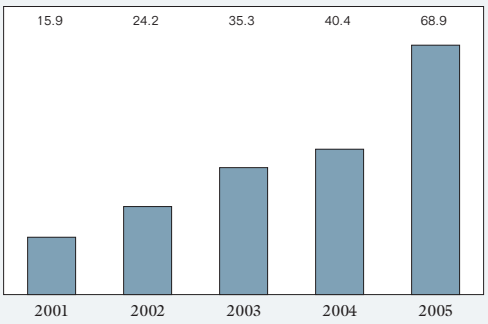
Free cash flow is defined as cash provided by operating activities in excess of additions to capital assets in the period. Free cash flow is a non-GAAP measure. Please refer to the section describing the use of non-GAAP measures in this MD&A. Free cash flow generated in 2005 was $12.1 million. In 2004, capital spending exceeded cash provided by operating activities by $22.2 million. The following table summarizes free cash flow for the years indicated:

(in thousands of U.S. dollars)	2005 $	2004 $
Cash provided by operating activities	68,895	40,419
Less additions to capital assets	56,792	62,604
Free cash flow	12,103	(22,185)

Cash Provided by Operating Activities

Cash provided by operating activities increased by $28.5 million to $68.9 million in 2005. Improvement was driven principally by net earnings before depreciation and amortization.

CASH PROVIDED BY OPERATING ACTIVITIES
(in millions of U.S. dollars)



Cash Used in Investing Activities

Cash used in investing activities for 2005 was $266.5 million, compared with $63.0 million in 2004. The year-over-year increase is principally related to the MOVA acquisition on December 23, 2004. The following table summarizes the cash used in investing activities for the years indicated:

(in thousands of U.S. dollars)	2005 $	2004 $
Acquisition of MOVA, net of cash acquired	211,178	—
Additions to capital assets		
Sustaining	16,062	11,232
Project-related	40,730	51,372
Total additions to capital assets	56,792	62,604
Proceeds on sale of land	(4,748)	—
Proceeds on sale of investment	—	(265)
Increase in deferred pre-operating costs	3,254	655
Cash used in investing activities	266,476	62,994

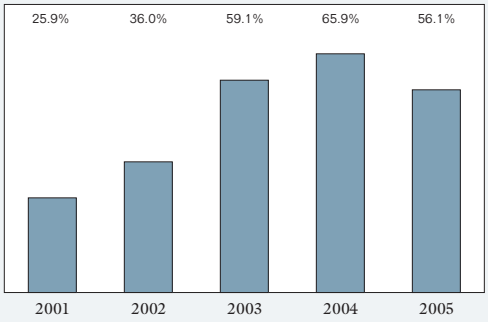
The Company's principal ongoing investment activities comprise sustaining and project-related capital programs at its network of sites. The majority of the Company's capital allocation is invested in project-related programs, which are defined as outlays that will generate growth in capacity and revenues, while sustaining expenditures relate to the preservation of existing assets and capacity. The Company invested $56.8 million in capital expenditures in 2005 compared with $62.6 million in 2004, of which project-related expenditures were $40.7 million in 2005 and $51.4 million in 2004.

During 2005, the Company's major project-related programs involved:

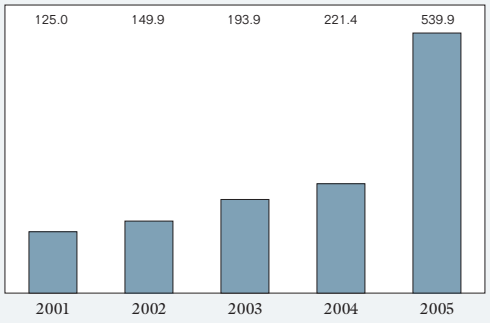
- the Monza and Ferentino facilities in Italy, in connection with the expansion of sterile lyophilization and large volume parenteral services;
- the Swindon facility in U.K., in connection with the expansion of sterile cephalosporin lyophilization services;
- the Cincinnati facility in U.S.A., in connection with the relocation of certain production facilities; and
- the Whitby facility in Canada, in connection with packaging capability upgrades.

The amount required to complete authorized capital projects was $8.6 million at October 31, 2005. The majority of these expenditures are expected to be incurred during the fiscal year ending October 31, 2006.

INTEREST-BEARING DEBT
TO SHAREHOLDERS' EQUITY



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



The major project-related capital programs currently anticipated consist of approximately *(in millions)*:

Swindon, U.K. facility, establishment of sterile cephalosporin lyophilization capability	$19.5
Expansion of PDS capacity in North America	$ 7.4
Bourgoin-Jallieu, France facility, establishment of high-potency capability	$ 6.9

Additions to deferred pre-operating costs of $3.3 million in 2005 comprised deferred costs related principally to the start-up of certain new sterile lyophilization facilities at Monza, Italy. Deferred pre-operating costs are amortized over a period of five years once commercial operations have commenced.

Cash Provided by Financing Activities

The principal financing activities for the year ended October 31, 2005 were the completion of a common share offering and the negotiation of new debt facilities in connection with the acquisition of MOVA. Proceeds from the common share offering were $199.2 million, before costs, and $190.3 million after costs. Proceeds were used to finance a portion of the purchase price of MOVA of $350.0 million and to finance, in escrow, approximately 90% of the maximum amount of $91.0 million potentially payable under the earn-out agreements. The Company placed $87.8 million into escrow to support potential payments under the earn-out arrangements. An agreement was reached with the former MOVA shareholders to pay the full amount of the first earn-out arrangement, and $65.0 million was disbursed from escrow on June 23, 2005. It was determined that no amount was payable under the second earn-out, and the remaining funds held in escrow were released to the Company and applied to reduce debt.

The following table summarizes the cash provided by financing activities for the years indicated:

(in thousands of U.S. dollars)	2005 $	2004 $
Increase (decrease) in bank indebtedness	(6,195)	8,246
Increase in long-term debt	341,445	74,588
Repayment of long-term debt	(304,838)	(61,137)
Increase in deferred revenues	8,271	—
Increase in restricted cash	(116)	—
Proceeds on issue of common shares before costs	199,241	22
Share issue costs	(8,947)	—
Increase in deferred financing costs	(9,446)	(767)
Cash provided by financing activities	219,415	20,952

Financing Arrangements and Ratios

At October 31, 2005, the Company's consolidated ratio of interest-bearing long-term debt (including current portion) to shareholders' equity was 53.4% compared with 56.1% at October 31, 2004. At October 31, 2005, the Company's consolidated ratio of interest-bearing debt (including current portion and bank indebtedness) to shareholders' equity was 56.1%, compared with 65.9% at the end of the 2004 fiscal year.

On December 23, 2004, the Company completed a financing agreement for a new $169.0 million committed facility, comprising a three-year revolving credit facility of up to $55.0 million and a 12-month bridge facility of $114.0 million. At the signing of the financing agreement, $116.0 million 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 $63.0 million. At October 31, 2005, the amount drawn under this bridge facility was $81.5 million and is classified as long-term debt, as it was refinanced by a new long-term debt facility on December 15, 2005, as further described below.

In connection with the acquisition of MOVA, the Company assumed $133.3 million of debt. Some of the loan agreements required MOVA to maintain certain financial covenants. Since December 31, 2004, MOVA has not been in compliance with certain of the financial covenants. The lending institutions have waived their rights under the terms of the loan agreements for the non-compliance of these covenants for a period of time up to November 1, 2006, and any cross-default provisions of the $169.0 million credit facility, referred to above, have also been remedied.

Restricted cash is held in support of certain debt agreements of MOVA. A total of $7.8 million is shown as restricted cash as at October 31, 2005. With the refinancing of the debt subsequent to year end, this amount is no longer restricted.

On December 15, 2005, the Company completed new credit facilities in North America in the aggregate amount of $290.0 million to refinance existing debt of the Company and its U.S. subsidiaries, including its subsidiaries in Puerto Rico. The new facilities replace: (i) existing credit facilities that were available to the Company's North American operations including those that were established at the time of acquisition of MOVA in December 2004; and (ii) debt of MOVA that was assumed at the time of acquisition by the Company. The new credit facilities comprise two term loans in the aggregate amount of $215.0 million and three-year revolving facilities in the aggregate totaling $75.0 million. The term loans consist of a five-year term loan of $50.0 million and a six-year term loan of $165.0 million. The new credit facilities bear interest at floating rates based on bankers' acceptances, Canadian and U.S. prime, U.S. base rate, or U.S. LIBOR, plus spreads between 0.75% and 2.5%. The Company has entered into a hedge agreement that has effectively fixed the interest rate on one-half of the principal of the new term credit facilities, at an interest rate of approximately 7.25%. The new facilities are collateralized by the North American assets of the Company and its subsidiaries, including those in Puerto Rico.

As a result of the refinancing, in 2006 there will be a charge of approximately $8.0 million associated with the write-off of deferred financing costs and pre-payment penalties. The Company will also incur costs of approximately $2.7 million associated with completing the refinancing, which will be amortized over the term of the new facilities. It is expected that future operations will benefit from the lower after-tax borrowing costs under the new financing arrangements.

On December 22, 2005, the Company's Italian subsidiary entered into a new long-term debt facility. The new loan replaced four separate term loans it had with an Italian bank. The new loan in the amount of €28.5 million ($34.2 million), bearing interest at floating rates based on three-month Euribor, maturing in 2014, has equal semi-annual principal payments over the term of the nine-year loan, and is collateralized by a mortgage over land and buildings.

Contractual repayments of long-term debt, commitments under operating leases and purchase obligations are summarized in the following table and reflect the refinancing in December 2005 as further described in note 22 to the audited financial statements:

	PAYMENTS DUE BY PERIOD				
CONTRACTUAL OBLIGATIONS	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER 5 YEARS
Long-term debt	288,541,000	11,360,000	40,065,000	31,407,000	205,709,000
Operating leases	4,748,000	1,328,000	1,749,000	845,000	826,000
Purchase obligations	8,648,000	8,648,000	—	—	—
Total contractual obligations	301,937,000	21,336,000	41,814,000	32,252,000	206,535,000

Long-term debt includes capital lease obligations. Purchase obligations relate to capital commitments to complete authorized capital projects.

The following table summarizes the fixed and variable percentages of debt outstanding at October 31, 2005 reflecting the refinancing in December 2005 (note 22 to the audited financial statements), and the applicable interest rates at quarter ends in 2005:

	% OF DEBT OUSTANDING		INTEREST RATES AT QUARTER ENDS IN 2005			
	2005	2004	Q4	Q3	Q2	Q1
Fixed rate	40%	19%				
Variable rate based on:						
Prime – Canada	—	14%	4.75%	4.25%	4.25%	4.25%
Bankers' acceptances (1 month)	—	23%	3.04%	2.55%	2.55%	2.54%
U.S. base rate	—	4%	7.25%	6.75%	6.50%	5.75%
U.S. LIBOR (1 month)	35%	—	4.09%	3.52%	3.09%	2.59%
Euribor (3 months)	22%	34%	2.26%	2.13%	2.13%	2.14%
U.K. LIBOR	2%	—	4.61%	4.65%	4.94%	4.87%
U.K. base rate	1%	6%	4.75%	4.25%	4.25%	4.25%

Adequacy of Financial Resources

The Company believes that its financial resources are sufficient to fund projected capital expenditures and debt service requirements in the normal course of business.

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

The Accounting Policies have been reviewed and discussed with the Company's Audit Committee and are described in note 1 to the audited consolidated financial statements. The most critical of these policies are those related to revenue recognition, deferred revenues, intangible assets, goodwill, employee future benefits, and income taxes (notes 1, 6, 8, 12 and 16 to 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.

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 when all costs connected with providing these services have been incurred, the price is fixed or determinable and collectibility is reasonably assured. Customer deposits on pharmaceutical development services in progress are included in accounts payable and accrued liabilities.

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.

Deferred Revenues

The costs of certain capital assets are reimbursed to the Company by the pharmaceutical companies that are to benefit from the improvements in connection with the manufacturing and packaging agreements in force. These reimbursements are recorded as deferred revenues and are recognized as earnings over the remaining minimum term of the agreements. During 2005, $0.9 million was recognized as earnings.

The policy was adopted for the first time in 2005 as a result of the MOVA acquisition (note 2 to the audited financial statements), and client contributions in connection with the sterile cephalosporin lyophilization facility being built at the Swindon, U.K. facility.

Intangible Assets

Intangible assets represent the values assigned to acquired client contracts and relationships. They are amortized on a straight-line basis over nine years. During 2005, $11.2 million was charged to earnings.

On an annual basis, the Company reviews whether there are any indicators of impairment. If such indicators are present, the Company assesses the recoverability of intangible assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to net earnings. No amounts in connection with impairment were charged to net earnings in 2005.

The policy was adopted for the first time in 2005 as a result of the MOVA acquisition (note 2 to the audited financial statements).

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 of $180.7 million shown on the financial statements relates to the acquisition of Global Pharm Inc., which now operates as Toronto York Mills Operations, and from the acquisition of MOVA on December 23, 2004. Goodwill relating to the Toronto York Mills acquisition was $2.9 million, and goodwill relating to the MOVA acquisition was $177.8 million.

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 sheet.

Future tax assets of $21.4 million have been recorded at October 31, 2005. These assets are primarily composed of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, the tax benefit of net operating loss carryforwards related to the U.K. operations, and share issue costs in relation to the acquisition of MOVA. 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 $36.8 million have been recorded at October 31, 2005. This liability has arisen primarily on 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 other post-employment benefits, including medical benefits and dental care. The determination of the obligation and expense for defined benefit pensions and other post-employment benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are disclosed in note 12 to the audited financial statements.

RISK MANAGEMENT

Overview and Risk Management Practices

The Company applies rigorous assessment, mitigation and management practices to reduce the nature and extent of the operational, financial, regulatory and legal risks affecting its business, which are described in more detail below.

Contractual Arrangements

The Company has commercial manufacturing services contracts with its clients, typically with multi-year terms. These contracts formalize the standard business arrangements, 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 the Company's major client agreements are not determinable with any precision, as volumes are based on the client's market demands from time to time.

The Company's pharmaceutical development services are provided on a fee-for-service basis. The Company typically responds to a request for proposals and, if its 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 business activities are conducted in several currencies – Canadian dollars and U.S. dollars for the Canadian operations, U.S. dollars for the U.S. operations and euros and U.K. sterling for the European operations.

Since the European and U.S. operations conduct business principally in their respective local currencies, the exposure to foreign currency gains and losses is not significant. However, 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. Based on the Company's current U.S.-denominated net inflows, for each one-cent change in the Canadian-U.S. rate, the impact on annual net earnings is approximately $0.6 million.

The Company mitigates its foreign exchange risk by engaging in foreign currency hedging activities using derivative financial instruments. The Company does not purchase any derivative instruments for speculative purposes. The Company has entered into forward exchange contracts to sell U.S. dollars and purchase Canadian dollars. The mark-to-market value of these financial instruments as at October 31, 2005 was an unrealized gain of $0.2 million (2004 – $2.4 million).

Translation gains and losses related to the carrying value of the Company's foreign operations, and certain foreign denominated debt held by the Company as a hedge against the carrying value of certain foreign operations, are deferred and included in the cumulative translation account in shareholders' equity. At October 31, 2005, the balance in the account was a $38.1 million gain compared with a $24.4 million gain at October 31, 2004.

Management of Expanded Operations

The Company has experienced significant growth in a relatively short period of time. Managing such growth places a significant burden on the managerial, financial and other resources of the combined business. The ability of the Company to manage future growth depends on its ability to attract, train, motivate and manage key employees and to continue to implement and improve operating, 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 materially adverse effect on its business, financial condition and results of operations.

International Operations

The Company'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 the Company's business, financial conditions and results of operations.

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 loss of client patent protection, 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 end consumers of the clients' products that it manufactures. Historically, the Company 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 materially 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, 2005, approximately 83% (2004 – 81%) of the Company's total debt portfolio was subject to movements in floating interest rates. With the new interest rate hedges put in place on December 15, 2005, approximately 60% of the Company's total debt portfolio will be subject to movements in floating interest rates. Assuming no change to the structure of the debt portfolio, the sensitivity to interest rate changes is as follows:

	APPROXIMATE IMPACT ON CASH FLOW AND NET EARNINGS
Change of 1% in floating interest rates	$1.2 million (1.3¢ per share)

Credit and Client Concentration

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. During the year ended October 31, 2005, two (2004 – two) clients accounted for more than 10% of the Company's total revenues. As a percentage of total revenues, revenues from these clients amounted to 16% and 12%, respectively, (2004 – 20% and 13%).

The Company 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) 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, the Company is increasing its client base, thereby lowering the risk of depending on a small number of clients for a significant portion of its revenues.

Environmental and Health and Safety 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 all material environmental and occupational health and safety regulations.

Regulatory Matters Affecting Manufacturing and Pharmaceutical Development Services

The Company is required to comply with the regulatory requirements of the national and international regulatory bodies having jurisdiction in the countries where it manufactures products or where its clients' products are distributed. As a result, most of the Company's facilities are subject to regulation by the FDA, and certain facilities are subject to regulation by the Health Products and Food Branch (Canada), the Medicines and Healthcare Products Regulatory Agency (United Kingdom), the European Medicines Evaluation Agency (Europe) and other regulatory bodies. These regulatory requirements impact many aspects of the Company's operations, including manufacturing, labeling, packaging, adverse event reporting, storage and record-keeping related to clients' products. In addition, if new legislation or regulations are enacted or existing legislation or regulations are amended or are interpreted or enforced differently, the Company may be required to obtain additional approvals or operate according to different manufacturing standards. This may require the Company to change its manufacturing techniques or make capital improvements to its facilities. There can be no assurance that the Company will be able to meet all of the applicable regulatory requirements in the future.

To mitigate this risk, the Company employs highly qualified technical staff at all of its facilities dedicated to maintaining and improving policies and programs to ensure compliance with global quality standards. The Company also strives to meet quality standards through comprehensive and rigorously applied Standard Operating Procedures ("SOPs"), the ongoing training of employees in current Good Manufacturing Practices ("cGMPs") and required investment in its facilities, equipment and systems.

FDA Warning Letter

On September 16, 2005, CEPH International Corporation, a part of the MOVA group, received a Warning Letter from the U.S. Food and Drug Administration ("FDA"). The Warning Letter claimed that variations in assay, fill-weight, content uniformity and related issues for a suspension product manufactured by CEPH indicated a failure by CEPH to comply with cGMPs of the U.S. Federal Food, Drug and Cosmetic Act. The affected product was powder for oral suspension, Omnicef® OP 250mg/5mL and 125mg/5mL. The capsule product was not affected. After receipt of the Warning Letter, CEPH voluntarily suspended production of the Omnicef® powder for oral suspension product while it resolved the matter.

After filing a response letter to the FDA on October 6, 2005, the FDA responded to CEPH on October 11, 2005 (received by CEPH on October 18, 2005) stating that it had found that the commitments to the corrective actions outlined in CEPH's response letter would address the FDA's concerns raised in the Warning Letter.

On December 12, 2005, Patheon confirmed that CEPH had resumed normal production and shipments to its client of Omnicef® oral powder for suspension at its facility in Carolina, Puerto Rico. This followed qualification of new equipment and validation of processes for manufacturing of the product in accordance with the plan proposed by CEPH in its response of October 6, 2005. The Company expects the FDA to conduct a re-inspection of the Carolina facility in connection with CEPH's plan.

EFFECTIVENESS OF INTERNAL DISCLOSURE CONTROLS

The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures as of October 31, 2005 and have concluded that the Company's disclosure controls and procedures provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, would be made known to them by others within those entities, particularly during the period in which this report was being prepared.

SELECTED ANNUAL FINANCIAL INFORMATION

The following is selected financial information for the three most recent years:

Years ended October 31 *(in thousands of U.S. dollars, except per-share amounts)*	2005 $	2004 $	2003 $
Revenues	698,318	470,259	407,144
Net earnings before repositioning expenses	21,621	13,763	18,578
Earnings per share before repositioning expenses			
Basic	24.9¢	26.7¢	36.2¢
Diluted	24.8¢	26.5¢	35.6¢
Net earnings	21,621	10,678	18,578
Earnings per share			
Basic	24.9¢	20.7¢	36.2¢
Diluted	24.8¢	20.6¢	35.6¢
Total assets	1,051,568	522,583	436,860
Total long-term liabilities	351,283	163,018	132,024
Cash dividends	—	—	—

Changes in revenues, net earnings before repositioning expenses, net earnings and related basic and diluted earnings per share between 2005 and 2004 are explained in this MD&A. The increase in assets and long-term liabilities in 2005 compared with 2004 is principally due to the acquisition of MOVA as explained in note 2 to the Company's 2005 audited financial statements.

SELECTED QUARTERLY FINANCIAL INFORMATION

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

				EARNINGS PER SHARE	
	REVENUES	EBITDA	NET EARNINGS	BASIC	DILUTED
(in thousands of U.S. dollars, except per-share amounts)	$	$	$	¢	¢
2005					
January 31	153,947	21,647	6,004	8.7	8.7
April 30	184,088	24,286	3,783	3.4	3.4
July 31	178,390	25,826	3,455	3.5	3.4
October 31	181,893	26,203	8,379	9.3	9.3
	698,318	97,962	21,621	24.9	24.8
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

Revenues from some of Patheon's services are traditionally lower in the Company's first fiscal quarter, that is, the three months ending January 31. Please see **Seasonal Variability of Results** for additional information.

In 2004, results were 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 the Swindon, U.K. 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 9, 2005, the Company had outstanding 92,845,688 common shares and no remaining Class I preferred shares. At year end, the Company had 3,886,840 stock options outstanding, of which 3,145,990 were exercisable. Please refer to note 13 to the audited financial statements for further information.

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, 2005 with respect to employee future benefit plans were:

(in thousands of U.S. dollars)	DEFINED BENEFIT PENSION PLANS	OTHER BENEFIT PLANS	TOTAL
Projected benefit obligations	58,365	10,258	68,623
Less plan assets	(38,916)	—	(38,916)
Unfunded amount	19,449	10,258	29,707
Less unamortized past service costs and net actuarial loss	(9,970)	(4,046)	(14,016)
Amount included in other long-term liabilities	9,479	6,212	15,691

The Company also provides retirement benefits for the majority of its employees at its Canadian, U.S. and Puerto Rican sites under a defined contribution pension plan. The total expense for the plan amounted to $3.9 million in 2005 (2004 – $3.2 million). Please refer to note 12 to the audited financial statements for further information with respect to the Company's employee future benefit plans.

Related Party Transactions

Revenues from companies controlled by a director and significant shareholder of the Company were in the amount of $2.3 million (2004 – nil). These transactions were conducted in the normal course of business at fair value. Accounts receivable at October 31, 2005 include a balance of $0.3 million (2004 – nil) resulting from these transactions.

Public Securities Filings

Other information about the Company, including the Annual Information Form ("AIF") 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 EVENTS

On December 15, 2005, the Company completed new credit facilities in North America in the aggregate amount of $290.0 million to refinance existing debt of the Company and its U.S. subsidiaries, including its subsidiaries in Puerto Rico. The new facilities replace: (i) existing credit facilities that were available to the Company's North American operations including those that were established at the time of acquisition of MOVA in December 2004, and (ii) debt of MOVA that was assumed at the time of acquisition by Patheon. The new credit facilities comprise two term loans in the aggregate amount of $215.0 million and three-year revolving facilities in the aggregate totaling $75.0 million. The term loans consist of a five-year term of $50.0 million and a six-year term loan of $165.0 million. The new credit facilities bear interest at floating rates based on bankers' acceptances, Canadian and U.S. prime, U.S. base rate, or U.S. LIBOR, plus spreads between 0.75% and 2.5%. The Company has entered into a hedge agreement that has effectively fixed the interest rate on one-half of the principal of the new term credit facilities, at an interest rate of approximately 7.25%. The new facilities are collateralized by the North American assets of the Company and its subsidiaries, including those in Puerto Rico.

As a result of the refinancing, in 2006 there will be a charge of approximately $8.0 million associated with the write-off of deferred financing costs and pre-payment penalties. The Company will also incur costs of approximately $2.7 million associated with completing the refinancing, which will be amortized over the term of the new facilities.

On December 22, 2005, the Company's Italian subsidiary entered into a new long-term debt facility. The new loan replaced four separate term loans it had with an Italian bank. The new loan in the amount of €28.5 million ($34.2 million), bearing interest at floating rates based on three-month Euribor, maturing in 2014, has equal semi-annual principal payments over the term of the nine-year loan, and is collateralized by a mortgage over land and buildings.

OUTLOOK FOR 2006

The Company expects modest improvement in operating results in fiscal 2006, with the second half of the year stronger than the first. Net earnings and earnings per share in 2006 are expected to be similar to 2005 levels, excluding the impact of the gain on the sale of land in the fourth quarter of 2005 and the write-off of deferred financing costs and pre-payment penalties in the first quarter of 2006.

The Company anticipates that the first quarter of 2006 will be impacted by normal seasonality and production shut-downs, as well as lower production levels caused by the temporary suspension of production of the Omnicef® product that is expected to have an additional impact of approximately three cents per share. In addition, the write-off of deferred financing costs and pre-payment penalties of approximately $8.0 million will have a negative impact on earnings. First-quarter results, before the impact of the write-off of deferred financing costs and pre-payment penalties, will also reflect a full quarter of amortization, depreciation and interest expenses related to the MOVA acquisition, compared with five weeks in the first quarter of 2005.

The Company expects 2006 to be a transition year. Initiatives for 2006 will include addressing the short-term challenges at MOVA, expanding cephalosporin capacity in Swindon, completing the transfer of two groups of products to the European operations, addressing the challenges faced by the Canadian OTC sites and Whitby, and expanding PDS operations in Puerto Rico. The Company is also actively pursuing a number of new business opportunities to increase production volumes and revenues at both MOVA and its other operations in fiscal 2007 and beyond.

The combination of oral cephalosporin capabilities at the Carolina facility, the existing sterile cephalosporin capabilities at Swindon, and the new lyophilization plant dedicated to cephalosporin products that the Company is constructing in Swindon will facilitate providing services in a full range of dosage forms for this important category of antibiotics. The new facility at Swindon, scheduled for completion by the end of fiscal 2006, represents an investment of approximately €22 million. The client is providing a substantial portion of the financing for this investment.

In Europe, the Company will continue to integrate new R_x products into sites in Italy and France as part of the transfer of two groups of products from two clients who are restructuring their respective facilities in Europe. As part of this initiative, the Company will be establishing high-potency capabilities in Bourgoin-Jallieu by investing approximately €10 million at this site in 2006 and 2007.

In Canada, sites that focus on manufacturing OTC products are facing significant challenges to achieve or maintain satisfactory levels of profitability. This will be an area of particular focus for management in fiscal 2006.

The Company expects to continue to expand its successful PDS operations by establishing a presence in India, initially to explore opportunities to provide PDS services from that country and opportunities to source equipment and components used in the manufacturing process. This initiative in India is not expected to generate positive financial benefits in fiscal 2006.

Year ended October 31 *(in thousands of U.S. dollars, except share information, per-share amounts and percentages)*	2005 $	2004 $	2003 $	2002 $	2001 $
REVENUES AND NET EARNINGS					
Revenues	698,318	470,259	407,144	266,078	207,495
EBITDA[1]	97,962	48,105	49,545	36,162	26,857
(% of revenues)	14.0%	10.2%	12.2%	13.6%	12.9%
Depreciation, amortization, and write-off of deferred financing costs	51,373	22,765	16,330	10,354	8,227
Gain on sale of land	(4,587)	—	—	—	—
Interest	16,449	5,609	4,508	1,999	1,955
Provision for income taxes	13,106	9,053	10,129	5,832	6,100
Net earnings	21,621	10,678	18,578	17,977	10,575
(% of revenues)	3.1%	2.3%	4.6%	6.8%	5.1%
Earnings per share					
Basic	$0.25[6]	$0.21	$0.36	$0.35	$0.22
Diluted	$0.25[6]	$0.21	$0.36	$0.35	$0.21
Number of shares					
Outstanding at October 31	92,846	51,556	51,506	50,913	50,296
Weighted average for the year	86,828	51,521	51,384	50,727	47,924
FINANCIAL POSITION					
Current assets	251,034	165,491	149,258	88,487	71,872
Current liabilities	160,434	138,167	110,913	80,650	64,434
Working capital	90,600	27,324	38,345	7,837	7,438
Total assets	1,051,568	522,583	436,860	285,568	222,584
Book value per share at year end[2]	$5.81	$4.29	$3.77	$2.94	$2.48
Interest-bearing debt	302,898	145,792	114,626	54,003	32,408
Interest-bearing long-term debt	288,541	124,262	102,353	38,576	17,255
Shareholders' equity	539,851	221,398	193,923	149,908	124,974
Return on shareholders' equity[3]	5.4%	5.2%	11.4%	13.2%	9.7%
Interest-bearing debt to shareholders' equity	56.1%	65.9%	59.1%	36.0%	25.9%
Interest-bearing long-term debt to shareholders' equity	53.4%	56.1%	52.8%	25.7%	13.8%
Total capitalization[4]	842,749	367,190	308,549	203,911	157,382
Interest-bearing debt to total capitalization	35.9%	39.7%	37.2%	26.5%	20.6%
Interest-bearing long-term debt to total capitalization	34.2%	33.8%	33.2%	18.9%	11.0%
CASH FLOW					
Cash provided from operations[5]	73,535	40,592	39,663	31,296	21,420
Cash provided by operating activities	68,895	40,419	35,307	24,153	15,860
Additions to capital assets					
– sustaining	16,062	11,232	14,436	5,938	10,458
– project-related	40,730	51,372	39,233	35,058	17,110
Total additions to capital assets	56,792	62,604	53,669	40,996	27,568
Acquisitions	211,823	—	28,220	—	22,712
Net proceeds from equity issues	190,261	—	—	—	35,213

(1) Earnings before depreciation and amortization, gain on the sale of land, interest, write-off of deferred financing costs, and income taxes.
(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 by operating activities before net change in non-cash working capital balances related to operations.
(6) FY05 shares outstanding increased 80% in connection with the financing of the acquisition of MOVA.

(in thousands of U.S. dollars except per-share amounts)		Q1 $	Q2 $	Q3 $	Q4 $	YEAR $
Revenues	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
	FY05	153,947	184,088	178,390	181,893	698,318
EBITDA	FY01	5,163	6,357	6,419	8,918	26,857
	FY02	6,884	8,052	10,520	10,706	36,162
	FY03	7,967	12,073	15,442	14,063	49,545
	FY04	10,972	12,613	11,035	13,485	48,105
	FY05	21,647	24,286	25,826	26,203	97,962
Depreciation, amortization and write-off of deferred financing costs	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
	FY05	11,670	13,688	13,463	12,552	51,373
Interest	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
	FY05	2,333	4,681	4,783	4,652	16,449
Net earnings	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
	FY05	6,004	3,783	3,455	8,379	21,621
Basic EPS *(US¢)*	FY01	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	5.0	6.0	3.9	5.8	20.7
	FY05[1]	8.7	3.4	3.5	9.3	24.9
Diluted EPS *(US¢)*	FY01	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	5.0	5.9	3.9	5.8	20.6
	FY05[1]	8.7	3.4	3.4	9.3	24.8

[1] FY05 shares outstanding increased 80% in connection with the financing of the acquisition of MOVA.