



**ANNUAL INFORMATION FORM**  
**for the Fiscal Year Ended October 31, 2007**

January 22, 2008

## PRESENTATION OF INFORMATION

As used in this Annual Information Form, the term "Patheon" or "Company" means Patheon Inc. and its subsidiaries as of the most recent financial year ended on October 31, 2007 on a consolidated basis, unless the context otherwise requires, and "Patheon Inc." refers to Patheon Inc. on an unconsolidated basis.

*Unless otherwise stated, all information is as of October 31, 2007 and all currency references are in U.S. dollars.*

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### *FORWARD-LOOKING STATEMENTS*

This Annual Information Form contains forward-looking statements which reflect management's expectations regarding Patheon's future growth, results of operations, performance (both operational and financial) and business prospects and opportunities. Where possible words such as "plans," "expects" or "does not expect," "budget," "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 Annual Information Form reflect management's current assumptions based upon information currently available to management and based upon that which management believes to be reasonable assumptions, Patheon cannot be certain that actual results will be consistent with these forward-looking statements. A number of factors could cause actual results, performance, or achievements to differ materially from the results expressed or implied in the forward-looking statements, including those listed in the "*Description of the Business – Risk Factors*" section of this Annual Information Form. These factors should be considered carefully and readers should not place undue reliance on the forward-looking statements. Forward-looking statements necessarily involve significant known and unknown risks, assumptions and uncertainties that may cause Patheon'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: risks related to the market demand for client products; credit and client concentration; the ability to identify and secure new contracts; regulatory matters, including compliance with manufacturing and pharmaceutical regulations; international operations risks; foreign currency; competition; product liability claims; intellectual property; environmental, health and safety liabilities; significant shareholders; substantial financial leverage; interest rates; conditions of the tax exemptions for the Company's Puerto Rican subsidiary, MOVA Pharmaceutical Corporation; the divestiture of the Carolina site in Puerto Rico; Patheon's information systems; and supply arrangements. (See "*Description of the Business – Risk Factors*".) Although Patheon 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, as noted above, readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date of this Annual Information Form and, except as required by law, Patheon assumes no obligation to update or revise them to reflect new events or circumstances.

## **CORPORATE STRUCTURE**

### *NAME, ADDRESS AND INCORPORATION*

Patheon Inc. is a corporation existing under the *Canada Business Corporations Act*. The registered office of Patheon Inc. is located at 7070 Mississauga Road, Suite 350, Mississauga, Ontario, Canada, L5N 7J8.

### *INTER-CORPORATE RELATIONSHIPS*

Set out below is a list of the principal subsidiaries of Patheon Inc. and their respective jurisdictions of incorporation. All subsidiaries referred to in the list below are wholly-owned subsidiaries of Patheon Inc.

<b>Name of Corporation</b>	<b>Jurisdiction</b>
<b>Patheon Inc.</b>	Canada
Patheon International Inc.	Ontario, Canada
Patheon Pharmaceuticals Inc.	Delaware, U.S.A.
Patheon Pharmaceuticals Services Inc.	Delaware, U.S.A.
Patheon Italia S.p.A.	Italy
Patheon UK Limited	England
Patheon France S.A.S.	France
MOVA Pharmaceutical Corporation	Puerto Rico, U.S.A.
CEPH International Corporation	Puerto Rico, U.S.A.
MOVA Real Estate Corporation	Puerto Rico, U.S.A.

### **GENERAL DEVELOPMENT OF THE BUSINESS**

Patheon's goal is to be the preferred pharmaceutical development services (“PDS”) and commercial manufacturing services partner to the global pharmaceutical industry. Patheon's strategy is focused on providing "best-in-class" manufacturing and development services, effectively balancing high product quality and reliability of supply with cost.

The three fiscal years ended October 31, 2007 included the acquisition of MOVA Pharmaceutical Corporation ("MOVA Pharmaceutical" or "MOVA"), the largest acquisition in Patheon's history, and a subsequent period of difficulty and transition. The Company has taken several steps during fiscal 2007 to improve the operating structure of the Puerto Rican operations and it believes that it is now positioned to begin to emerge from this difficult period. The most significant corporate development of the 2007 fiscal year was the completion of the strategic and financial alternatives review process commenced in September 2006. This resulted in a \$150 million investment in the Company by JLL Partners and a refinancing of the Company's remaining indebtedness under its North American credit facilities, which provided Patheon with a stable long-term capital structure.

Subsequent to year-end, effective December 3, 2007, Wesley P. Wheeler was appointed as the Chief Executive Officer of the Company. Mr. Wheeler joined Patheon from Valeant Pharmaceuticals International, a California-based global specialty pharmaceutical company, where he served most recently as President, North America, R&D and Global Manufacturing. Prior to joining Valeant in 2003, Mr. Wheeler served as President and Chief Executive Officer of DSM Pharmaceuticals Inc. (“DSM”), a contract pharmaceutical manufacturer. Prior to DSM, Mr. Wheeler was Senior Vice-President of Logistics and Strategy for GlaxoSmithKline plc. Previous to his manufacturing role, Mr. Wheeler was Vice President of Marketing for Glaxo Wellcome. Mr. Wheeler joined Glaxo Wellcome in 1989 after a 12-year career at Exxon Research & Engineering Co.

#### *MOVA PHARMACEUTICAL ACQUISITION*

Patheon acquired its Puerto Rican operations, MOVA Pharmaceutical, on December 23, 2004 for cash and shares. MOVA Pharmaceutical is a prescription pharmaceutical contract manufacturer with three facilities in Puerto Rico that are approved by the U.S. Food and Drug Administration (“FDA”). In

connection with the acquisition, Patheon assumed \$131.3 million in debt and related costs, and entered into a new \$169 million credit facility to fund part of the cash portion of the purchase price.

Overall, MOVA Pharmaceutical's operating results, since it was acquired by the Company, have been materially worse than that which the Company expected when it made the acquisition. The Puerto Rican operations' revenues, operating margins and EBITDA have been adversely affected by a series of issues affecting high-volume products. As at July 31, 2006, in light of the deterioration of MOVA Pharmaceutical's financial results and forecasted future results, Patheon determined that the carrying value of certain assets, principally goodwill, depreciable intangible assets and tangible capital assets related to MOVA Pharmaceutical, were impaired, and the Company recognized a \$253.9 million non-cash asset impairment charge in respect of these assets. In addition, in the fiscal 2007 third quarter ended July 31, 2007, Patheon recognized a \$48.6 million non-cash asset impairment charge in respect of depreciable intangible assets and tangible capital assets related to its operations in Carolina, Puerto Rico. The effect of these charges was to write down the book value of these assets to their then-current, estimated fair market value. Subsequent to fiscal 2007 year-end, the Company announced its intention to divest its facility in Carolina, and to continue to streamline its other Puerto Rican facilities in Caguas and Manatí. (See "*General Development of the Business – Restructuring of the Puerto Rican Site Network*".)

#### *2005 CREDIT FACILITIES*

The assumed and additional indebtedness incurred in connection with the MOVA Pharmaceutical acquisition, together with indebtedness of Patheon's U.S. subsidiaries, was refinanced under new North American credit facilities in the aggregate amount of \$290 million in December 2005. In anticipation of lower-than-expected earnings and EBITDA for the third quarter of fiscal 2006, in July 2006 the Company commenced negotiations with its lenders in respect of amendments to certain financial covenants under these North American credit facilities because of concern that, based on its latest internal forecast at that time, the Company would not be in compliance with its debt-to-EBITDA ratio and fixed charge coverage financial covenants as at July 31, 2006. During the fourth quarter of fiscal 2006, the Company entered into a further agreement with its lenders to amend these credit facilities, establishing amended financial covenants, including trailing 12-month debt-to-EBITDA covenants, to be satisfied monthly over a six-month period ending on March 31, 2007. If the indebtedness outstanding under these credit facilities had not been repaid, the original financial ratio covenants would have applied as at April 30, 2007. The Company repaid the indebtedness outstanding under these facilities and entered into new credit arrangements effective April 27, 2007. (See "*General Development of the Business – 2007 Credit Facilities*".)

#### *STRATEGIC AND FINANCIAL ALTERNATIVES REVIEW*

The Board initiated the strategic and financial alternatives review process in September 2006, forming a special committee on September 10, 2006, composed of four independent directors of the Company (the "Special Committee"). RBC Capital Markets and Greenhill & Co. were engaged as financial advisors to the Company and the Special Committee, respectively.

In late September 2006, the Special Committee conducted a review of various potential financial and strategic alternatives for Patheon, including a potential sale of the Company, a sale of equity or equity-related securities and asset sales, and determined that Patheon should explore a potential sale of the Company as the preferred alternative. Patheon received several non-binding written expressions of interest in respect of a potential sale of Patheon but did not receive a binding proposal for the acquisition of the Company. In January 2007, Patheon solicited detailed proposals in respect of an equity or equity-related investment from several parties who had expressed an interest in such a transaction. The strategic

and financial alternatives review process culminated in the Company entering into a definitive agreement with JLL Partners on March 1, 2007 providing for a \$150 million investment in the Company.

#### *INVESTMENT BY JLL PARTNERS*

On March 1, 2007, the Company entered into a definitive agreement with JLL Partners, under which its affiliate, JLL Patheon Holdings, LLC, purchased convertible preferred shares and special voting preferred shares of Patheon through a private placement with aggregate gross proceeds of \$150 million. The private placement was approved by the shareholders of Patheon on April 19, 2007 and was completed on April 27, 2007.

Founded in 1988, JLL Partners is a New York-based private equity investment firm. Since inception, JLL Partners has managed a series of funds aggregating approximately \$4 billion in committed capital. JLL Partners has invested across a variety of industries, including healthcare, financial services and building products, among others. JLL Partners' investments in the healthcare industry include AdvancePCS, IASIS Healthcare Corp., Medical Card System, Inc., Kendall International, Inc. and OrNda HealthCorp.

Patheon used the net proceeds of the private placement to repay part of the indebtedness under its North American credit facilities, allowing it to refinance the remaining indebtedness outstanding under those facilities and avoid a default that would have otherwise occurred as at April 30, 2007. Patheon believes that this has provided it with critical financial certainty and stability going forward.

The convertible preferred shares are currently convertible into approximately 32.8 million restricted voting shares of the Company, which would represent approximately 27% of the restricted voting shares outstanding as at December 31, 2007, after giving effect to such conversion. JLL Partners also acquired a number of rights in connection with the private placement, including the right to elect up to three directors to the Board of Directors pursuant to the provisions of the special voting preferred shares.

#### *2007 CREDIT FACILITIES*

The JLL Partners investment was conditional on Patheon concurrently refinancing the remaining indebtedness outstanding under its North American credit facilities. The Company entered into an agreement as of March 28, 2007 with J.P. Morgan Securities Inc. and GE Commercial Finance for this refinancing, and entered into the new credit arrangements contemporaneously with the completion of the JLL Partners investment on April 27, 2007.

The 2007 credit facilities are in the aggregate amount of \$225 million, consisting of a seven-year \$150 million senior secured term loan facility and a five-year \$75 million asset-based revolving credit facility. The proceeds of the term loan facility were used to repay the remaining indebtedness outstanding under Patheon's North American credit facilities and a smaller credit facility in the United Kingdom.

#### *MANAGEMENT CHANGES*

Patheon underwent substantial management changes during the three fiscal years ended October 31, 2007. Subsequent to year-end, effective December 3, 2007, Wesley P. Wheeler was appointed Chief Executive Officer of the Company.

The Company's Chief Executive Officer and Chief Financial Officer at the time of the completion of the MOVA Pharmaceutical acquisition were Robert C. Tedford and Ronald B. Mitchell, respectively.

Robert C. Tedford retired in May 2006 after 10 years as Patheon's Chief Executive Officer. On an interim basis, the Board of Directors established the Office of the Chief Executive Officer, consisting of the Chairman of the Board, the Chief Operating Officer and the Chief Financial Officer, to carry out the Chief Executive Officer's responsibilities. At the time of the formation of the Special Committee on September 10, 2006, the Office of the Chief Executive Officer was disbanded and Riccardo C. Trecroce, the Company's General Counsel and Executive Vice-President, Administration, was appointed Chief Executive Officer on an interim basis. In March 2007, the Board of Directors determined that this appointment would be made for an indefinite period. Following the completion of the JLL Partners investment, however, the Board of Directors determined to resume the search process for a permanent Chief Executive Officer, which led to the announcement in November 2007 of Mr. Wheeler's appointment.

Ronald B. Mitchell resigned as Chief Financial Officer on September 1, 2005. Shortly thereafter, Rodger Roden was appointed as his successor but his employment was terminated on March 6, 2006. At that time, Douglas L. Ludwig, the former Chief Financial Officer of Four Seasons Hotels Inc. was appointed. Mr. Ludwig resigned on September 10, 2006, being the same day as the appointment of Riccardo C. Trecroce as interim Chief Executive Officer and the formation of the Special Committee. The current Chief Financial Officer, John H. Bell, was appointed on September 25, 2006.

#### *PERFORMANCE ENHANCEMENT PROGRAM*

In response to the Company's disappointing financial results during fiscal 2006, Patheon initiated its Performance Enhancement Program during the third quarter of fiscal 2006, implementing certain immediate operational improvements identified in consultation with external specialists and determining additional cost-reduction proposals that could be implemented in the future. The Program consists of three main initiatives:

- a global procurement program;
- a manufacturing efficiency review process; and
- a workforce reduction program.

The objective of the global procurement program is to leverage the Company's global purchasing power to reduce costs. The Company is seeking to achieve this objective by negotiating with its vendors to permit Patheon to reduce its investment in working capital through better payment terms and vendor-managed inventory in connection with a reduction of the number of vendors. The Company successfully negotiated a number of agreements in fiscal 2006 and fiscal 2007 resulting in cost savings to the Company. These savings were derived from lower pricing and volume rebates on inventory items, such as excipients and packaging components, as well as non-inventory consumables and services, including laboratory supplies and waste management services.

During 2006, Patheon undertook a manufacturing efficiency review process in respect of its Whitby operations and implemented a number of operational improvements that led to significant gains in production throughput and labour efficiency. Subsequently, this manufacturing efficiency review process was expanded to other sites in the Company's network, including the Mississauga, Cincinnati and Swindon sites. During 2007, Patheon continued to implement an operational efficiency review process by continuing the work begun in Swindon in late 2006 and reviewing project management practices within the PDS business in Canada. In 2007, follow-up audits were conducted in Whitby, Mississauga, and Cincinnati which verified that the improvements in production throughput and labour efficiency gained in 2006 were maintained in 2007. A similar audit is planned for Swindon and the PDS business in Canada in 2008. As well, by late 2007, planning had begun to identify future improvement initiatives in 2008.

Since the third quarter of fiscal 2006, Patheon has been working to reduce the size of its workforce, through retirements, attrition and terminations with severance packages, in order to implement a lower cost structure and adjust for declining business volumes at some sites. The Company's full-time equivalent employee headcount has been reduced from approximately 6,100 at April 30, 2006 to approximately 4,900 as at December 31, 2007.

#### *RESTRUCTURING OF THE CANADIAN SITE NETWORK*

In April 2007, Patheon announced that, as part of its strategy to focus on developing and manufacturing prescription, rather than over-the-counter, products and to improve the Company's profitability, it planned to restructure its Canadian network of six pharmaceutical manufacturing facilities. The planned restructuring included the sale of the Company's Niagara-Burlington operations and the eventual closure of the Company's York Mills operations.

The Company entered into an agreement on December 5, 2007 for the sale of the Niagara-Burlington operations to Pharmetics Inc. for a purchase price of Cdn. \$5.75 million plus working capital, subject to closing adjustments. Under the agreement, Pharmetics will acquire the assets, including equipment, facilities and land, at Patheon's facility in Fort Erie and at one of the Company's two facilities in Burlington (namely, Gateway Drive). Pharmetics will provide employment to the entire active workforce of about 250 at these facilities and, subject to the assignment of third-party contracts, will continue to manufacture and supply all of the products currently manufactured at these sites. Based on the completion of documentation to date, the transaction is expected to be completed on or about January 31, 2008, subject to closing conditions, including regulatory approvals, the assignment of client and other contracts, and the completion of financing arrangements by the purchaser. The Company is retaining its leased facility in Burlington (namely, Burlington Century) where its central quality-control laboratory is based.

To improve capacity utilization and profitability of the Whitby facility, Patheon is in the process of transferring all commercial production and development services currently undertaken at its York Mills facility in Toronto to, primarily, the Whitby facility. A smaller portion of the York Mills operations will be transferred to the Mississauga and Cincinnati facilities. Based on current internal projections, this decommissioning of the York Mills facility is expected to be completed by the end of the first half of fiscal 2009. On December 31, 2007, the Company entered into a binding agreement of purchase and sale for the sale of the York Mills property for a purchase price of Cdn. \$12.5 million, including a non-refundable deposit of Cdn. \$1 million. Subject to obtaining the required closing documentation, the sale is scheduled to close by March 31, 2008 with Patheon leasing back the facility for up to two years in order to facilitate the decommissioning process. Based on current deployment plans, the Company expects that most, if not all, of the employees at the York Mills facility will have an opportunity to transfer to the Whitby facility or to another site in the Patheon network.

#### *RESTRUCTURING OF THE PUERTO RICAN SITE NETWORK*

During fiscal 2007, the Company conducted a comprehensive review of its Puerto Rican operations, with a focus on restructuring the operations, eliminating operating losses and developing a long-term plan for the business.

In April 2007, Luis Albors was appointed Vice-President and General Manager of the Puerto Rican operations. This was followed by changes in the operating management at the Caguas facility, including the release of the site director and a number of operations directors. On September 4, 2007, Janet Maldonado was appointed Site Director of the Caguas operations.

Subsequent to the end of fiscal 2007, on December 14, 2007, the Company announced that, as a result of its review of the Puerto Rican operations, it had decided to divest its facility in Carolina, Puerto Rico. The decision also follows the genericization of Omnicef® in May 2007 and the resulting significant drop in revenues at the facility.<sup>1</sup> The Carolina facility is a 230,000 square foot facility that specializes in the manufacture of oral cephalosporin solid dosage forms. The Company currently manufactures four products on behalf of six clients at the site. Based on current divestiture plans and subject to future negotiations, the Company expects to provide that any purchaser of the Carolina facility in Puerto Rico will assume the 200 employees currently employed at that facility. Patheon has retained an advisor to manage the sale of the Carolina facility. However, there is no certainty that the Company will be able to complete the proposed sale of the Carolina facility on terms acceptable to it, or at all.

Based on the above-mentioned review of operations, Patheon plans to retain its facilities at Caguas and Manatí, Puerto Rico. The Company plans to continue an extensive program designed to improve operating performance, improve quality and training systems, reduce overhead costs, and pursue new business opportunities for these sites. Since the beginning of the third quarter of fiscal 2006, the aggregate full-time equivalent employee headcount at the Caguas and Manatí facilities has been reduced from approximately 1,050 employees to approximately 670 as at December 31, 2007.

### *BUSINESS DEVELOPMENT*

Prior to the completion of the MOVA acquisition in December 2004, expanding the Company's capacity, geographic reach, expertise and breadth of service capabilities through acquisitions was a key aspect of Patheon's strategy. More recently, the Company has been focused on growing its business internally, achieving growth through expanding the level of business of existing clients, attracting new clients, entering into commercial manufacturing agreements for newly approved products for which the Company has provided development services and broadening the Company's service offering to include differentiated and specialized technologies and capabilities (e.g. high potency and lyophilisation), especially in respect of R<sub>x</sub> drugs and pharmaceutical development services.

There has been a trend on the part of global pharmaceutical companies to restructure, and on the part of specialty pharmaceutical companies and virtual pharmaceutical companies to limit internal manufacturing capacity. For example, over the last approximately eighteen months, several global pharmaceutical companies have publicly announced intentions to restructure their site networks to increase operating efficiencies and to outsource more of their production. As this trend could lead to increased demand for Patheon's services, it is expected to be favourable for the Company, but the extent of any positive effect may be tempered due to competition from low-cost jurisdictions in Asia, such as India (see "*Description of the Business — Risk Factors — Competition*").

Another trend has been the establishment of long-term strategic relationships by multi-national pharmaceutical companies with high quality external service providers, including Patheon. For example, the Company has entered into numerous master service agreements with clients. These agreements contemplate long-term multi-product and multi-site commercial manufacturing and/or pharmaceutical development services. Overall, Patheon believes, based on its internal analysis and experience, that as the pharmaceutical outsourcing industry matures, the Company's relationships with clients will continue to become broader and longer term. Three examples of this trend are discussed below.

During fiscal 2007, the Company entered into a seven-year manufacturing agreement with Cilag, a subsidiary of Johnson & Johnson, under which Patheon has built a new manufacturing facility for the

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<sup>1</sup> Omnicef® is a registered trademark of Astellas Pharma, Inc.

manufacture of lyophilized cephalosporins at the Company's Swindon operations site, with significant financing from the client.

A second example is Patheon's implementation of "carve-out" arrangements at its facilities in France and Italy. These are arrangements where sizeable parts of current production have been transferred to the Company from facilities owned by two clients which are slated for closure or downsizing.

Thirdly, during fiscal 2006, Patheon entered into a five-year master supply agreement with Merck & Co., Inc. ("Merck") to provide commercial manufacturing and pharmaceutical development services. Merck selected Patheon as one of Merck's strategic partners for commercial manufacturing and pharmaceutical development services. The new master supply agreement is designed to facilitate the inclusion of additional products and projects as Merck implements a new strategic plan, which includes leveraging external capabilities and capacity. As a strategic partner for Merck, Patheon will be provided the opportunity to participate in future commercial manufacturing and appropriate product development projects.

Merck awarded Patheon three new projects as the first step in this new relationship. One project was a late-stage development product for Patheon's Caguas, Puerto Rico, facility. A second project involves activity at Patheon's Cincinnati facility and a third project involves activity at Patheon's Mississauga operations. Two of these projects were commercially approved in fiscal 2007 and the third, based on the most recent advice from Merck, is expected to be launched in fiscal 2008. These projects generated significant revenue for Patheon in fiscal 2007.

Finally, in terms of general business development, the Company's Puerto Rican operations have been materially adversely affected during the past three years by significant declines in client sales of certain key products, most notably Zocor®, which lost patent protection in 2006, and Omnicef®, which began to face generic competition in May 2007.<sup>2</sup> During the second half of fiscal 2007, however, the Company secured commitments to manufacture four additional products at the Puerto Rican operations on behalf of three clients.

#### *NORMAL COURSE ISSUER BID*

In October 2007, Patheon commenced a normal course issuer bid, pursuant to which it may acquire from time to time through the facilities of the Toronto Stock Exchange up to 4.6 million restricted voting shares, representing approximately 5% of the restricted voting shares outstanding at the time of the bid's commencement. The Company commenced the normal course issuer bid because the Board of Directors and management believed that from time to time the market price of the restricted voting shares could be such that their repurchase might be an attractive and appropriate use of corporate funds. As at December 31, 2007, the Company had repurchased and cancelled 2,334,000 restricted voting shares at purchase prices ranging from \$3.36 to \$4.00. The normal course issuer bid will expire in October 2008.

### **DESCRIPTION OF THE BUSINESS**

#### *GENERAL*

Patheon is a leading provider of pharmaceutical development and commercial manufacturing services to the international pharmaceutical industry, employing more than 4,900 people as at December 31, 2007. Patheon produces both prescription ("R<sub>x</sub>") and over-the-counter ("OTC") drugs for its clients. Patheon

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<sup>2</sup> Zocor® is a registered trademark of Merck & Co., Inc.

owns or leases and operates: (i) 10 manufacturing facilities in North America: four facilities in the U.S., comprising three in Puerto Rico and one in Cincinnati, Ohio, and six facilities in and around Toronto, Ontario, Canada, together comprising approximately 2,208,000 square feet of capacity; and (ii) four manufacturing facilities in Europe: Monza (near Milan) and Ferentino (near Rome), Italy; Swindon (near London), U.K.; and Bourgoin-Jallieu (near Lyon), France, which together comprise approximately 1,126,000 square feet of capacity. Patheon is in the process of selling two of its Canadian facilities and shifting production to other facilities from a third Canadian facility in anticipation of its closure. Patheon has also announced its intention to divest itself of one of its three facilities in Puerto Rico (namely, the Carolina facility). (See "*General Development of the Business – Restructuring of the Canadian Site Network*" as well as "*General Development of the Business – Restructuring of the Puerto Rican Site Network*".) The six North American (including Puerto Rican) facilities that will be retained by Patheon after this is completed together comprise approximately 1,662,700 square feet of capacity.

#### *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. Background information on the new drug development process is described in Appendix A. In providing its pharmaceutical development services, Patheon is able to: (i) develop an appropriate dosage form; (ii) develop analytical methods; (iii) manufacture to client specifications the proposed new drug product 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. Since the beginning of fiscal 2001, 19 new pharmaceutical products developed on behalf of clients by Patheon's PDS operations have been approved by regulators and launched through Patheon's commercial manufacturing facilities, including two in fiscal 2007. A third new product developed by PDS received regulatory approval during the third quarter of fiscal 2007 and, based on advice from Patheon's client, is expected to be commercialized in fiscal 2008.

Patheon offers pharmaceutical development services at five 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, lyophilisation and controlled-release). As at October 31, 2007, Patheon was working on a total of approximately 197 projects for its clients, including nine drug candidates at the New Drug Application ("NDA") stage. The growing PDS team included, at the end of fiscal 2007, more than 500 scientists and technical staff, with approximately 70 holding doctoral degrees. Patheon's development scientists have extensive development experience with a wide variety of pharmaceutical dosage forms.

#### *COMMERCIAL MANUFACTURING*

Patheon provides manufacturing services for a broad range of products in several 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 raw materials and packaging components to delivering the finished product in consumer-ready form to the client.

Patheon's commercial manufacturing activities relate primarily to Rx products in solid, semi-solid, and liquid dosage forms as well as various sterile dosage forms. Conventional dosage forms include both coated and uncoated compressed tablets, hard shell gelatin capsules, powders, ointments, creams, gels, syrups, suspensions, solutions and suppositories. Conventional sterile dosage forms include aseptically filled and terminally sterilized liquids and powders filled in ampoules, vials, bottles or pre-filled syringes.

Sterile lyophilized products are also manufactured in both vials and ampoules. Patheon's manufacturing-operations personnel are experienced in working on a wide variety of dosage forms. Patheon also operates a segregated sterile (injectable) cephalosporin powder filling and lyophilisation facility at its Swindon operations site in the United Kingdom. The combination of oral cephalosporin capabilities at the Carolina facility (Puerto Rico), the existing sterile cephalosporin capabilities at Swindon and the new 65,000 sq. ft. lyophilisation plant dedicated to lyophilized cephalosporin products that Patheon constructed in Swindon in fiscal 2006 will allow it to provide a full range of dosage forms for this important category of antibiotics. The new facility in Swindon represented an investment of \$29 million during fiscal 2006, which was shared with Patheon's client.

After the anticipated sale of the Niagara-Burlington over-the-counter pharmaceutical manufacturing business, the percentage of revenue related to the manufacturing of over-the-counter products throughout Patheon will be approximately 7% compared to approximately 25% five years ago. This reduction in the percentage of over-the-counter manufacturing by Patheon is consistent with its focus on manufacturing higher-margin R<sub>x</sub> drugs and utilizing specialized capabilities.

In fiscal 2007, Patheon's facilities were audited by 201 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 requirements. These audits contribute to Patheon's ongoing improvement of manufacturing and development practices. In addition, 18 regulatory audits were conducted at Patheon's sites in North America and Europe during fiscal 2007.

#### *CLIENTS*

##### *Client Mix*

Patheon serves a client base of over 250 pharmaceutical and biotechnology companies, including 20 of the world's 20 largest pharmaceutical companies (such as sanofi-aventis, Novartis AG and Roche Holdings AG); 10 of the 20 largest biotechnology companies (such as Amgen Inc. and Gilead Sciences, Inc.); and nine of the 20 largest specialty pharmaceutical companies (such as Watson Pharmaceuticals, Inc. and Sepracor, Inc.).

During the fiscal year ended October 31, 2007, one client accounted for more than 10% of Patheon's total revenues. As a percentage of revenues from continuing operations, this client amounted to 13%. In the fiscal year ended October 31, 2006, two clients each had accounted for more than 10% of Patheon's total revenues (13% and 12% respectively). In addition, in fiscal 2007, approximately 57% (62% in fiscal 2006) of revenues were derived from Patheon's 10 largest clients.

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 diversity of products and projects undertaken by Patheon: in fiscal 2007, Patheon manufactured approximately 650 products in connection with more than 2,000 stock keeping units across a wide range of therapeutic categories and dosage forms; and

- (c) the expansion of PDS units in both Europe and North America: by increasing the variety of service activities, Patheon is increasing its client base, thereby lowering the risk of depending on a small number of clients for a significant portion of its revenues.

#### *Client Purchase-Commitment Process*

Patheon's commercial manufacturing clients generally provide a yearly forecast of anticipated product demand. Clients also deliver firm purchase orders, typically three months prior to scheduled production, after which time clients may adjust contract quantities or delivery dates within certain limits, provided that Patheon is reimbursed for any expenses incurred in connection with the adjustment. Upon delivery to Patheon of a client purchase order confirming the quantity and delivery date, the order is scheduled for production.

Patheon has commercial manufacturing services contracts, typically with multi-year terms, with its clients. 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 actual revenues to be generated by Patheon's major client agreements are based on volumes which are subject to 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 proposals 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.

#### *COMPETITION*

Pharmaceutical and biotechnology companies looking to outsource commercial manufacturing services evaluate several factors in determining whether to outsource, including whether there is adequate in-house capacity or capability and the comparative costs between manufacturing internally or outsourcing. Some specialty pharmaceutical companies make a strategic decision not to develop in-house manufacturing capabilities, preferring to focus their capital and human resources on research and development of potential new products and sales and marketing of existing products.

If a company is considering outsourcing commercial manufacturing services, several factors go into choosing the preferred service provider. These factors include security of supply (quality record, regulatory compliance record and financial stability of the service provider), service (on-time delivery record and flexibility in manufacturing) and cost-effective manufacturing (prices and a commitment to continuous improvement). Competition in the OTC commercial manufacturing and packaging market has a greater emphasis on price and service than other factors. Competition in the R<sub>x</sub> manufacturing market tends to have a greater emphasis on security of supply and service factors.

Pharmaceutical and biotechnology companies looking to outsource product development services evaluate several factors in selecting a service provider. These factors include scientific personnel, knowledge and experience of the organization in dosage form development, availability of a broad range of equipment from small to large scale, timely delivery of clinical materials, compliance with Current

Good Manufacturing Practices (“cGMP”), regulatory compliance record, cost effective services and financial stability of the service provider.

#### *Commercial Manufacturing*

In North America and Europe, Patheon's competition includes: (i) companies, both public and private, that are not focused on contract manufacturing, but provide this service as part of a range of services to the pharmaceutical industry; (ii) companies that focus on contract manufacturing, but offer services in a limited number of dosage forms; and (iii) large pharmaceutical companies that offer third-party manufacturing services to fill excess capacity. In addition, in Europe there are a large number of privately owned, dedicated outsourcing companies that serve only their local or national markets. (See also "*Description of the Business — Risk Factors — Competition*".)

#### *Pharmaceutical Development*

The pharmaceutical development services market is composed of a range of participants: (i) a large number of laboratories, which offer only a limited range of development services generally at a small scale; (ii) providers focused on specific technologies and/or dosage forms; and (iii) 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. (See also "*Description of the Business — Risk Factors — Competition*".)

#### *SUPPLY ARRANGEMENTS*

Patheon's clients specify the components, raw materials and packaging materials required for products and, in some cases, specify the suppliers from which Patheon must purchase these inputs. Materials for the Cincinnati operations originate primarily in the U.S. For production at the Canadian sites, Patheon obtains packaging components from Canadian suppliers, but, due to limited availability in Canada, most raw materials originate from U.S. sources. Components and packaging materials for production at the Monza and Ferentino (Rome) operations are sourced primarily in Italy but also from other European sources. Materials for the Swindon and Bourgoin-Jallieu operations are primarily sourced in the U.K. and France, respectively, along with other European markets. Materials for the Puerto Rican sites are sourced primarily from Puerto Rico and mainland U.S.A. Most of the materials required by Patheon for its commercial manufacturing business are readily available. In most cases, the clients supply the active pharmaceutical ingredient to Patheon at no cost to Patheon. Any failure by a client to supply an active pharmaceutical ingredient to Patheon on a timely basis may have a negative impact on Patheon's ability to produce the product that requires such active pharmaceutical ingredient as an input.

#### *ENVIRONMENTAL AND HEALTH & SAFETY MATTERS*

Patheon is subject to environmental legislation and health and safety legislation in the jurisdictions in which it operates. These environmental laws regulate air emissions, water discharges and the storage, handling and disposal of solid and hazardous wastes. These health and safety laws regulate working conditions, safety procedures, training, exposure to hazardous materials, first aid requirements and injury reporting. Patheon is in material compliance with all environmental, health and safety legislation in the various jurisdictions that Patheon operates. Patheon's business requirements periodically change and as a result required environmental licences, permits, certificates of approval and other authorizations are periodically updated to reflect these changes. As a result of this process, a few applications are in the process of being reviewed by regulatory agencies; however, based on feedback to date, no issues are anticipated and updated permits/licences are expected to be issued in due course.

Patheon has an environmental, health and safety management system consisting of comprehensive programs and procedures, which ensure that Patheon's environmental, health and safety policies are fully implemented in accordance with applicable legislative requirements. Patheon has dedicated the required resources to implement and monitor the environmental, health and safety management system to ensure compliance.

Patheon has incurred and will continue to incur costs relating to compliance with applicable environmental and health and safety laws and regulations. Although compliance with these laws and regulations has not had a material adverse effect on Patheon's operations or financial condition, there can be no assurance that such compliance in the future will not have such an effect.

#### *INTELLECTUAL PROPERTY*

Patheon does not normally obtain or own patents or trademarks with respect to its manufacturing processes, other than standard protections with respect to trade names and Patheon logos. Many of the formulations used by Patheon in manufacturing products to client specifications are subject to patents or other protections owned or licensed by the relevant client. Patheon typically enters into mutual confidentiality agreements with clients that own or are registered users of patented formulations.

Patheon has developed and continues to develop knowledge and expertise in the provision of pharmaceutical development and commercial manufacturing services ("know-how"). This know-how is normally not patentable, but it is valuable in that it enhances Patheon's ability to provide high-quality services to its clients.

#### *SEASONAL VARIABILITY OF RESULTS*

Revenues from some of Patheon's OTC and R<sub>x</sub> 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) the Patheon-wide plant shutdown during a portion of the traditional holiday period in December and January. Revenues in Patheon's fourth fiscal quarter, being the three months ended October 31, are also typically impacted by shutdowns during August in the European operations.

#### *SOCIAL POLICIES*

Integrity, respect and excellence are the core principles that govern the way Patheon operates its business. These principles are documented in a Code of Business Conduct developed to communicate Patheon's values and to provide guidelines for addressing issues and questions related to Patheon's business practices. The Code of Business Conduct was adopted by the Board of Directors of Patheon Inc. to serve as a guide to Patheon personnel worldwide, including employees, consultants, board members and agents. Patheon continues to communicate the Code of Business Conduct to employees at each of its facilities by distributing copies to all new employees, complemented by presentations as necessary to reinforce the principles of the Code of Business Conduct and their application.

In 2005, Patheon engaged EthicsPoint, Inc. to act as Patheon's external service provider with respect to a confidential whistleblower program, and the program was rolled out to employees during fiscal 2006. The program is both telephone- and web-based. Employees may use this service to report any activities

they suspect may be in violation of Patheon's Code of Business Conduct, including matters relating to accounting, internal accounting controls and auditing. The EthicsPoint reporting system is available to Patheon employees in all jurisdictions except Italy and France, where certain laws preclude Patheon from offering an anonymous reporting service to its employees, and where, instead, employees may report violations to management only on a non-anonymous basis.

#### *RISK FACTORS*

Certain risk factors that may affect Patheon are described below. These risks and uncertainties are not the only ones facing Patheon. Additional risks and uncertainties not currently known to Patheon, or that Patheon currently considers immaterial, may also impair the operations of Patheon.

#### *Market Demand for Clients' Products*

Patheon is dependent on demand for the products it 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 adversely affected by, among other things, the loss of patent protection, the emergence of competing products, the degree to which health authorities subsidize payment for a particular product and changes in the marketing strategies for such products. In addition, any reduction in spending by Patheon's clients on outsourcing of products or services offered by Patheon could have a material adverse effect on its business, financial condition and results of operations.

Competing generic products often emerge as a product approaches the end of its patent-protection period. Patheon's revenues for fiscal 2006 and 2007 were negatively impacted by the loss of patent protection for Zocor<sup>®</sup> and the emergence of generic competition for Omnicef<sup>®</sup> in May 2007.

Patheon may be materially adversely affected by any reduction in market demand for any significant products that Patheon manufactures for its clients. There can be no assurance that production volumes of key products and related revenues will be maintained or that changes in product mix will not materially adversely affect profitability.

#### *Credit and Client Concentration*

A substantial portion of the Company's services are provided to a relatively small number of clients. During the fiscal year ended October 31, 2007, one client accounted for more than 13% of the Company's total revenues (in fiscal 2006, two clients each accounted for 13.0% and 12.8% of total revenues respectively). In addition, approximately 57% (62.0% in fiscal 2006) of revenues were derived from Patheon's 10 largest clients. This client concentration increases credit risk and other risks associated with particular clients and particular products, including risks related to market demand for client products, and including regulatory and other operating risks. The Company's earnings were significantly adversely affected in fiscal 2007 as a result of the significant loss of revenues from products manufactured at the Caguas and Carolina facilities in Puerto Rico, including a product that lost significant market share as a result of stability-related issues and another product that lost significant market share as a result of the emergence of generic competition. Disruptions in the production of major products could materially adversely impact Patheon's results of operations in the future.

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 diversity of products and projects undertaken by Patheon: in fiscal 2007, Patheon manufactured approximately 650 products in connection with more than 2,000 stock keeping units across a wide range of therapeutic categories and dosage forms; and
- (c) the expansion of PDS units in both Europe and North America: by increasing the variety of service activities, Patheon is increasing its client base, thereby lowering the risk of depending on a small number of clients for a significant portion of its revenues.

#### *Potential New Manufacturing Services/Development Agreements*

There can be no assurance that Patheon will be able to continue to identify and secure new opportunities to enter into acceptable long-term manufacturing services agreements or that it will be able to fund any required capital expenditures related to such opportunities. Additionally, Patheon's pharmaceutical development services projects are primarily short-term projects of one to two years, and there can be no assurance that Patheon will be able to continue to identify and secure new projects.

#### *Regulatory Matters Affecting Manufacturing and Pharmaceutical Development Services*

Patheon is required to comply with the regulatory requirements of the national and international regulatory bodies having jurisdiction in the countries where the Company manufactures products or where its clients' products are distributed. In particular, Patheon is subject to laws and regulations concerning good manufacturing practices and drug safety. As a result, most of Patheon's facilities are subject to regulation by the FDA of the U.S., and certain of Patheon's facilities are subject to regulation by the Health Products and Food Branch ("HPFB") of Canada, the Medicines and Healthcare Products Regulatory Agency ("MHRA") of the U.K., the European Medicines Evaluation Agency ("EMA") of the European Union, and other regulatory bodies. These regulatory requirements impact many aspects of Patheon's operations, including manufacturing, labelling, 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, Patheon may be required to obtain additional approvals or operate according to different manufacturing standards. This may require Patheon to change its manufacturing techniques or make capital improvements to its facilities. There can be no assurance that Patheon will be able to meet all of the applicable regulatory requirements in the future. If Patheon fails to comply with applicable regulatory requirements, it may be subject to warning letters, fines, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, debarment, exclusion, disgorgement of profits, operating restrictions and criminal prosecution, as well as the loss of contracts and resulting revenue losses. In addition, such failure to comply could expose Patheon to contractual and product liability claims, including claims by clients for reimbursement for lost or damaged active pharmaceutical ingredients, the cost of which could be significant.

Patheon's pharmaceutical development projects often involve products that must undergo safety and clinical evaluations before they are approved as commercial therapeutic products. The regulatory authorities having jurisdiction in the countries in which the Company's clients intend to market their products may delay approval of a product or determine that the product is not approvable. There can be no assurance that the pharmaceutical development projects and their related revenues for Patheon will be maintained.

Pharmaceutical products commercially manufactured by Patheon are subject to ongoing regulatory review following the receipt of marketing authorization. The regulatory authorities having jurisdiction in the country in which the product is marketed may withdraw the marketing authorization, either temporarily or permanently, for health or safety concerns related to the use of the product. The subsequent discovery of

previously unknown problems with any of Patheon's clients' products may result in restrictions on the product, including withdrawal of the product from sale. There can be no assurance that production volumes of key products and related revenues for Patheon will be maintained.

Although Patheon believes that it is in compliance, in all material respects, with applicable laws and regulations, there can be no assurance that a regulatory agency or tribunal would not reach a different conclusion concerning the compliance of Patheon's operations with applicable laws and regulations. In addition, there can be no assurance that Patheon will be able to maintain or renew existing permits, licences or other approvals or obtain, without significant delay, future permits, licences or other approvals needed for the operation of its businesses. Any noncompliance by Patheon with applicable laws and regulations, or the failure to maintain, renew or obtain necessary permits and licences, could have an adverse effect on its results of operations and financial condition.

### *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, supply chain disruption and the burdens and costs of compliance with laws of a variety of countries. There can be no assurance that these factors will not have an adverse effect on business, financial conditions and results of operations of Patheon.

### *Exposure to Foreign Currency Risk*

The activities of Patheon 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 British sterling for the European countries.

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, revenues and operating expenses of the Canadian operations are transacted in Canadian and U.S. dollars. As a result, significant long-term strengthening of the Canadian dollar against the U.S. dollar could adversely affect the profitability of the Canadian operations of Patheon and its consolidated financial results, subject to the ability to increase prices for services or to reduce costs. As a result of the benefits of Patheon's cash flow hedging program, the strengthening of the Canadian dollar relative to the U.S. dollar did not adversely affect Patheon's EBITDA margins in fiscal 2007. The Canadian operations carry a significant amount of U.S. dollar denominated debt, part of which is designated as a hedge against its investments in subsidiaries in the U.S. and Puerto Rico. Foreign exchange gains and losses on the revaluation of debt that is not considered to be a hedge are recorded in operating expenses. Patheon has entered into a forward foreign exchange contract designed to reduce its exposure to future fluctuations between the Canadian dollar and the U.S. dollar. This contract matures in January 2010. There can be no assurances that this contract or future hedging transactions, if entered into, will eliminate foreign currency risk.

### *Competition*

Some of Patheon's competitors may have substantially greater financial, marketing, technical or other resources than Patheon. Additional competition may emerge and may, among other things, result in a decrease in the fees paid for services, which would affect profitability of Patheon. One of the many factors affecting competition is the current excess of capacity, within the pharmaceutical industry generally, of facilities capable of manufacturing drugs in solid and semi-solid dosage forms, and, thus, customers have a wide range of supply alternatives for these dosage forms. Another factor is a relatively

recent development, where an increasing number of companies in Asia, particularly India, have been entering the pharmaceutical contract manufacturing and PDS sectors over the last few years and have been proceeding with obtaining FDA approval for some of their plants as well as acquiring additional plants in Europe and North America; one or more of these companies may become a significant competitor to Patheon.

#### *Product Liability Claims*

Patheon is subject to significant product liability and other liability risks that are inherent in the design, development, manufacture and marketing, as the case may be, of its products and services. Patheon may be named as a defendant in product liability lawsuits, which may allege that products or services it has provided have resulted or could result in an unsafe condition or injury to consumers. Such lawsuits could be costly to defend and could result in reduced sales, significant liabilities and diversion of management's time, attention and resources. Even claims without merit could subject Patheon to adverse publicity and require it to incur significant legal fees.

Historically, Patheon has sought to manage this risk through the combination of product liability insurance and contractual indemnities and liability limitations in its agreements with clients and vendors. In the past, Patheon has been able to obtain liability insurance for the operation of its businesses. 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 Patheon will be covered by insurance. A partially or completely uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on Patheon's financial condition and its results of operations.

#### *Intellectual Property*

Patheon relies on unpatented proprietary know-how and continuing technological innovation in providing pharmaceutical development and commercial manufacturing services. Although Patheon requires its employees to enter into confidentiality agreements prohibiting them from disclosing its proprietary information or technology, these agreements may not provide meaningful protection for Patheon's trade secrets and proprietary know-how. Further, people who are not party to confidentiality agreements may obtain access to Patheon's trade secrets or know-how. Others may independently develop similar or equivalent trade secrets or know-how. If Patheon's proprietary information is divulged to third parties, including its competitors, Patheon's competitive position could be harmed.

#### *Potential Environmental, Health and Safety Liabilities*

Patheon's operations are subject to a variety of environmental, health and safety laws and regulations in each of the jurisdictions in which it operates. These laws and regulations govern, among other things, air emissions, wastewater discharges, the handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety. Any failure by Patheon to comply with environmental, health and safety requirements could result in the limitation or suspension of production or subject the Company to monetary fines or civil or criminal sanctions, or other future liabilities.

The facilities in Puerto Rico have been utilized over a period of years as manufacturing facilities and have certain known or potential conditions that may require remediation in the future. Management believes that the potential remediation costs for the Caguas and Carolina facilities in Puerto Rico are not likely to be material. With respect to the Manatí facility, where there may be greater potential for remediation costs to be incurred, management believes that these costs are likely to be covered by a contractual indemnity and guarantee for contamination that was granted to MOVA at the time it acquired the site from the prior owner, a global pharmaceutical company. There can be no assurance, however, that remediation costs will

not be material or that these costs will be covered by a contractual indemnity or that Patheon will be able to successfully enforce this indemnity in the future.

#### *Significant Shareholder*

An affiliate of JLL Partners owns convertible preferred shares of the Company with voting rights in respect of matters to be voted on by Patheon shareholders other than the election of directors. These convertible preferred shares are currently convertible into approximately 32.8 million restricted voting shares of the Company, which would represent approximately 27% of the restricted voting shares outstanding as at December 31, 2007, after giving effect to such conversion. The affiliate of JLL Partners also owns special voting preferred shares that currently entitle it to elect three members of Patheon's Board of Directors. In addition, in connection with the investment by JLL Partners in Patheon shares, the Company entered into an investor agreement with the investor. For additional information about this agreement, please see "*Material Contracts – Investor Agreement*". Under the investor agreement, the Company currently requires the approval of the affiliate of JLL Partners before the Company undertakes certain actions, including share issuances, the payment of dividends, share repurchases, any merger, consolidation or sale of all or substantially all of the Company's assets or a similar business combination transaction, and the incurrence of certain indebtedness in excess of \$20 million.

JLL Partners exercises significant influence over Patheon as a result of its voting rights and its rights under the investor agreement, and, as a result, JLL Partners may have the ability to influence strategic decisions of Patheon. As a significant shareholder of Patheon, JLL Partners is focussed on the enhancement of shareholder value generally. However, the interests of JLL Partners could conflict with the interests of other shareholders. This concentration of ownership and JLL Partners' rights may prevent a change of control of the Company that might be considered to be in the interests of shareholders. In addition, if Patheon is unable to obtain requisite approvals from JLL Partners, the Company may be prevented from executing critical elements of its business strategy.

#### *Substantial Financial Leverage*

Patheon's total interest-bearing debt as at October 31, 2007 was \$363.7 million, including the debt component of the convertible preferred shares of \$139.9 million, and its consolidated financial leverage ratio (the ratio of total interest-bearing debt to equity) was 1.8:1.0. Under Canadian generally accepted accounting principles, the \$150 million of convertible preferred shares issued in April, 2007 are considered a compound financial instrument; accordingly, a portion has been reflected in the consolidated financial statements as debt, and interest expense includes an accretive interest charge related to the debt component of the convertible preferred shares. There is no obligation to pay cash dividends on the convertible preferred shares until after October 27, 2009, and the terms of the convertible preferred shares allow the Company to elect to accrue dividends beyond that date through an increase in the restricted voting shares conversion rate. (See "*Description of Capital Structure – Preferred Shares – Preferred Shares, Series C*".)

While the Company believes that the investment by JLL Partners and its 2007 credit facility have provided it with critical financial certainty and stability going forward, the Company's substantial financial leverage poses risks to it. Debt service requirements in future periods may be higher than in prior years as a result of a number of factors, including increased borrowing and increases in floating interest rates (see "*Description of the Business – Risk Factors – Interest Rate Risks*"). In addition, the Company may incur substantial fees from time to time in connection with debt amendments or refinancing. If Patheon's cash flow is not sufficient to service its debt and adequately fund its business, it may be required to seek further additional financing or refinancing, or to dispose of assets. There is no assurance that any of these alternatives could be effected on satisfactory terms, or at all. In addition,

Patheon's financial leverage could adversely affect its ability to raise additional capital to fund its operations and could impair its ability to respond to operational challenges, changing business and economic conditions and new business opportunities, and may make it vulnerable in the event of a downturn in its business.

#### *Interest Rate Risks*

The Company has exposure to movements in interest rates. The Company has entered into interest rate swaps to convert the interest expense on the \$150 million senior secured term loan from a floating interest rate to a fixed interest rate until March 2010. Taking this interest rate swap into account, as at October 31, 2007, 19% of the Company's total debt portfolio, including the debt component of the convertible preferred shares, was 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:

	<u>Approximate Impact on Annual Pre-Tax Earnings</u>
Change of 1% in floating interest rates	\$0.7 million

#### *Conditions of MOVA's Tax Exemptions*

MOVA's operations benefit from tax exemption grants under the *Puerto Rico Tax Incentives Act of 1998*. The terms of these grants include commitments with respect to total employment levels (on a combined and aggregate basis) of all three of MOVA's facilities. The applicable income tax rates vary depending on the employment levels. MOVA has obtained a new Commercial Tax Grant and a new Product Development and Research Activities Tax Grant, both of which cover the Caguas, Manatí and Carolina sites. These tax grants are effective as of December 31, 2007, but permit MOVA to elect commencement dates within two years of the effective date. These new grants effectively extend the current grants, from the commencement dates elected by MOVA, for a 10-year period, as regards Caguas and Carolina, and for a 15-year period, as regards Manatí. MOVA has submitted applications to have the Commercial Tax Grant amended to lower the aggregate annual minimum employment requirement. Although Patheon expects to be able to continue to renew or replace these grants in the future, there can be no assurance that it will be able to do so on terms favourable to Patheon, or at all. The proposed sale of the Carolina site and the resulting lower employment levels may adversely affect MOVA's tax exemption grants. However, MOVA is not expected to be in a taxable position in 2008.

#### *Divestiture of Carolina Site*

Subsequent to the end of fiscal 2007, on December 14, 2007, the Company announced that, as a result of a review of the Puerto Rican operations in fiscal 2007, it had decided to divest its facility in Carolina, Puerto Rico. The decision also follows the genericization of Omnicef® in May 2007 and the resulting significant drop in revenues at the facility. The Carolina facility is a 230,000 square foot facility that specializes in the manufacture of oral cephalosporin solid dosage forms. The Company currently manufactures four products on behalf of six clients at the site. Patheon has retained an advisor to manage the sale of the Carolina facility. However, there is no certainty that the Company will be able to complete the proposed sale of the Carolina facility on terms acceptable to it, or at all.

#### *Risks Associated with Information Systems*

Patheon relies on information systems in its business to obtain, rapidly process, analyze and manage data to:

- facilitate the manufacture and distribution of thousands of inventory items to and from its facilities;
- receive, process and ship orders on a timely basis;
- manage the accurate billing of and collections from clients;
- manage the accurate accounting for and payment to vendors; and
- schedule and operate its global network of manufacturing and development facilities.

Its results of operations could be adversely affected if these systems are interrupted, damaged by unforeseen events or fail for any extended period of time, including due to the actions of third parties.

#### *Supply Arrangements*

In many instances, Patheon relies on its clients to supply the active pharmaceutical ingredients necessary to manufacture pharmaceutical products. Any failure by a client to supply an active pharmaceutical ingredient for a pharmaceutical product on a timely basis may negatively impact Patheon's ability to produce such product and may negatively impact the revenues that Patheon generates from such product.

### **DIVIDEND POLICY**

Patheon Inc. has not paid dividends on its restricted voting shares during the three fiscal years ended October 31, 2007, October 31, 2006 and October 31, 2005. Patheon Inc.'s current policy is to not pay dividends on its restricted voting shares, preferring to reinvest its cash to enhance its growth.

Patheon's credit facilities include covenants that limit the ability to pay dividends. The Investor Agreement entered into between Patheon Inc. and JLL Patheon Holdings, LLC ("JLL Holdings") dated April 27, 2007 (the "Investor Agreement") also prevents Patheon Inc. from declaring or paying any dividends without the approval of JLL Holdings for so long as JLL Holdings holds 52,500 Class I Preferred Shares, Series C or the corresponding number of restricted voting shares. (See "*Material Contracts – The Investor Agreement*".) In addition, the terms governing Patheon Inc.'s Class I Preferred Shares, Series C prevent the payment of dividends on the restricted voting shares after October 31, 2010 until dividends on such shares have been declared and paid.

Patheon Inc. has not paid any cash dividends on its Class I Preferred Shares, Series C and its Class I Preferred Shares, Series D since the issuance of such shares in April 2007. Dividends are payable to holders of Class I Preferred Shares, Series C. However, the conversion rate of such shares has been adjusted in lieu of any cash payment. (See "*Description of Capital Structure – Preferred Shares – Preferred Shares, Series C*".)

### **DESCRIPTION OF CAPITAL STRUCTURE**

Patheon Inc.'s authorized share capital consists of an unlimited number of restricted voting shares and an unlimited number of class I preferred shares, issuable in series, of which, as at December 31, 2007, 90,624,388 restricted voting shares, 150,000 Class I Preferred Shares, Series C and 150,000 Class I Preferred Shares, Series D were issued and outstanding. As at December 31, 2007, Patheon Inc. had 5,675,916 stock options outstanding, of which 4,192,582 were exercisable.

#### *RESTRICTED VOTING SHARES*

Holders of restricted voting shares are entitled to dividends on a *pro rata* basis if, as and when declared by Patheon Inc.'s Board of Directors. Subject to the rights of the holders of any other class of Patheon

Inc.'s shares entitled to receive dividends in priority to or rateably with the holders of restricted voting shares, Patheon Inc.'s Board of Directors may declare dividends on the restricted voting shares to the exclusion of any other class of Patheon Inc.'s shares. On the liquidation, dissolution or winding-up of Patheon Inc., holders of restricted voting shares are entitled to participate rateably in any distribution of Patheon Inc.'s assets, subject to the rights of holders of any other class of Patheon Inc.'s shares entitled to receive Patheon Inc.'s assets on such a distribution in priority to or rateably with the holders of restricted voting shares. Holders of restricted voting shares are entitled to receive notice of and attend all annual and special meetings of Patheon Inc.'s shareholders, other than separate meetings of holders of any other class or series of shares, and to one vote at shareholders' meetings in respect of each restricted voting share. Holders of restricted voting shares are not entitled to vote in respect of the election of all of the directors of Patheon Inc. The holders of the Class I Preferred Shares, Series D are entitled to elect up to three directors of Patheon Inc. (See "*Description of Capital Structure – Preferred Shares – Preferred Shares, Series D*".)

### *PREFERRED SHARES*

Class I Preferred Shares ("Preferred Shares") in the capital of Patheon Inc. may be issued from time to time in one or more series, each series comprising the number of shares and having the designation, rights, privileges, restrictions and conditions determined by Patheon Inc.'s Board of Directors. The Preferred Shares rank prior to the restricted voting shares with respect to the payment of dividends and distributions in the event of the liquidation, dissolution or winding-up of Patheon. Except as otherwise indicated below in respect of specific series of Preferred Shares, or as required by law, or, in particular, as may be allowed in respect of specific series of Preferred Shares when dividends are in arrears, the holders of the Preferred Shares are not entitled to receive notice of, to attend or to vote at any meeting of Patheon Inc.'s shareholders.

#### *Preferred Shares, Series C*

Holders of Preferred Shares, Series C ("Convertible Preferred Shares"), in addition to the rights attaching to Preferred Shares generally, are entitled to receive notice of and attend all annual and special meetings of the shareholders of Patheon Inc. which the holders of restricted voting shares are entitled to attend, and to one vote at all such meetings in respect of all matters to be voted on by the holders of restricted voting shares, except for the election of directors, for each restricted voting share into which a Convertible Preferred Share held is then convertible. Convertible Preferred Shares are convertible into restricted voting shares at a designated conversion rate (the "Conversion Rate") (218.7154 per \$1,000 principal amount as at December 31, 2007). On the liquidation, dissolution or winding-up of Patheon Inc., holders of Convertible Preferred Shares are entitled to, in priority to any payment to be made to shareholders of Patheon Inc., an amount equal to the issue price of the Convertible Preferred Shares adjusted for dividends payable on such shares (as described below) or the amount that each restricted voting shareholder is entitled to receive multiplied by the Conversion Rate. Patheon Inc. is entitled to require holders of Convertible Preferred Shares to convert their shares into restricted voting shares if, at any time after October 27, 2009, the market price of the restricted voting shares on the Toronto Stock Exchange exceeds a price equivalent to US\$7.87 for a period of at least 60 days. This price is to be adjusted if the number of outstanding restricted voting shares is subdivided, re-divided, reduced, combined or consolidated, or if restricted voting shares or securities convertible into restricted voting shares are issued to the holders of all or substantially all of the then outstanding restricted voting shares. Patheon Inc. is required to redeem the Convertible Preferred Shares on the tenth anniversary of their issuance or on a change of control of Patheon Inc.

The Convertible Preferred Shares are entitled to receive a dividend of 8.5%. During the first 30 months after issuance of the Convertible Preferred Shares, in lieu of a cash payment, the Conversion Rate of the

shares or the amount that will be paid on their liquidation will be adjusted. Thereafter, Patheon Inc. may elect to pay a cash dividend or continue to adjust the Conversion Rate and liquidation rate of the Convertible Preferred Shares.

All of the issued and outstanding Convertible Preferred Shares are held by JLL Holdings and are not transferable except (i) to an affiliate of JLL Partners Fund V, L.P. (being an affiliate of JLL Holdings and of JLL Partners), (ii) to a purchaser that has also offered or has made a follow-up offer to purchase all the restricted voting shares on the same terms and on an economically-equivalent basis or (iii) pursuant to a transaction that would, if the Convertible Preferred Shares were restricted voting shares, be an exempt take-over bid or otherwise would not require that an offer or follow-up offer be made to all shareholders.

#### *Preferred Shares, Series D*

Holders of Preferred Shares, Series D (the "Special Voting Preferred Shares"), in addition to the rights attaching to Preferred Shares generally, are entitled to receive notice of and attend all annual and special meetings of the shareholders of Patheon Inc. which the holders of restricted voting shares and Convertible Preferred Shares are entitled to attend. The holders of the Special Voting Preferred Shares are entitled to elect up to three directors of Patheon Inc. based on the number of Convertible Preferred Shares held by JLL Holdings.

Holders of Special Voting Preferred Shares are not entitled to receive any dividends. On the liquidation, dissolution or winding-up of Patheon Inc., holders of each Special Voting Preferred Share will receive Cdn. \$0.0001 and, thereafter, shall not be entitled to participate in any further distribution of the property or assets of Patheon Inc.

JLL Holdings is the sole holder of all of the issued and outstanding Special Voting Preferred Shares.

### **MARKET FOR SECURITIES**

#### *TRADING PRICE AND VOLUME*

Patheon Inc.'s restricted voting shares are traded on the Toronto Stock Exchange ("TSX") under the trading symbol "PTI". The following table sets forth the reported high and low trading prices (in Canadian dollars) and trading volumes of the restricted voting shares of Patheon Inc. on the TSX for each month of the fiscal year ending October 31, 2007.

**Patheon Inc. Restricted Voting Shares**

Month	High (\$)	Low (\$)	Volume Traded
November, 2006	6.72	5.17	4,505,881
December, 2006	6.06	4.67	6,983,896
January, 2007	5.54	4.85	5,219,095
February, 2007	5.45	4.51	3,294,432
March, 2007	5.24	4.49	5,926,863
April, 2007	5.07	4.51	7,455,855
May, 2007	4.99	4.35	3,662,818
June, 2007	4.58	3.72	8,797,409
July, 2007	4.49	3.70	6,233,851
August, 2007	4.11	3.31	2,938,342
September, 2007	3.73	2.85	8,640,271
October, 2007	4.05	3.03	9,513,221

**DIRECTORS AND OFFICERS**

*EXECUTIVE OFFICERS*

The names and municipalities of residence of Patheon Inc.'s executive officers and the offices held by them in Patheon Inc. as of January 22, 2008 are set out below.

Name & Municipality of Residence	Office
<b>WESLEY P. WHEELER</b> <sup>(1)</sup> Corona del Mar, California, U.S.A.	Chief Executive Officer
<b>NICK A. DIPIETRO</b> <sup>(2)</sup> St. Catharines, Ontario, Canada	President and Chief Operating Officer
<b>JOHN H. BELL</b> <sup>(3)</sup> Toronto, Ontario, Canada	Chief Financial Officer
<b>CLIVE V. BENNETT</b> <sup>(4)</sup> Niagara-on-the-Lake, Ontario, Canada	President, Patheon U.S.A.
<b>ALDO BRACA</b> <sup>(5)</sup> Latina, Italy	President, Patheon Europe
<b>SHABBIR T. ANIK, PH.D.</b> <sup>(6)</sup> Los Altos, California, U.S.A.	President, Global PDS & Chief Scientific Officer

Name & Municipality of Residence	Office
<b>MICHAEL S. HARDING</b> <sup>(7)</sup> St. Catharines, Ontario, Canada	Executive Vice-President, Global Quality Operations and Chief Operating Officer of MOVA Pharmaceutical Corporation
<b>KEVIN D. DUFFY</b> <sup>(8)</sup> Philadelphia, Pennsylvania, U.S.A.	Executive Vice President, Global Sales and Marketing and Business Development
<b>STEVEN LIBERTY</b> <sup>(9)</sup> Oakville, Ontario, Canada	Senior Vice-President, Operations, Canada
<b>TOM L. FERGUSON</b> <sup>(10)</sup> Fort Erie, Ontario, Canada	Senior Vice-President, Global Information Technology
<b>ROY WIESCHKOWSKI</b> <sup>(11)</sup> Kleinburg, Ontario, Canada	Senior Vice-President, Corporate Human Resources and Environmental, Health & Safety
<b>NICHOLAS DOWD</b> <sup>(12)</sup> Mississauga, Ontario, Canada	Vice-President and Controller
<b>COLIN MINCHOM, PH.D.</b> <sup>(13)</sup> Mississauga, Ontario, Canada	Vice-President, PDS Canada
<b>JACQUELINE LE SAUX</b> <sup>(14)</sup> Toronto, Ontario, Canada	General Counsel, North America & Corporate Secretary

Notes:

1. Mr. Wheeler joined Patheon as Chief Executive Officer on December 3, 2007. Prior to that, Mr. Wheeler was President, North America, R&D and Engineering of Valeant Pharmaceuticals International from March to December 2007, President, North America and Research and Development of Valeant from April 2006 to March 2007 and President, North America and Global Commercial Development of Valeant from February 2003 to April 2006. Prior to that, Mr. Wheeler was President and Chief Executive Officer of DSM Pharmaceuticals Inc. from January 2002 to February 2003.
2. Mr. DiPietro was appointed President and Chief Operating Officer in 1996.
3. Mr. Bell joined Patheon as Chief Financial Officer on September 25, 2006. Prior to that, Mr. Bell was the Chief Financial Officer of BBi Enterprises LP from 2001 to 2005.
4. Mr. Bennett was also President and Chief Operating Officer of MOVA Pharmaceutical Corporation from August 1, 2005 until July 31, 2006. Prior to being appointed as President, Patheon U.S.A., Mr. Bennett was President, Patheon North America.
5. Mr. Braca was appointed President, Patheon Europe effective January 6, 2004. Prior to that, Mr. Braca was Executive Vice-President, European Business Development and President, Patheon Italia S.p.A.
6. Dr. Anik was appointed as President, Global PDS & Chief Scientific Officer on April 11, 2005. Prior to that, he was Executive Vice President, PDS & Chief Scientific Officer of Patheon.

7. Mr. Harding was appointed Chief Operating Officer of MOVA Pharmaceutical Corporation on August 24, 2006. Prior to that, Mr. Harding was Executive Vice-President, Global Quality Operations, before which he was Senior Vice-President, Global Quality Operations.

8. Mr. Duffy joined Patheon as Executive Vice-President, Global Sales, Marketing and Business Development on October 16, 2006. Prior to that, Mr. Duffy was Chief Relations Officer and Executive Vice President, Global Business Development with Omnicare Clinical Research in Philadelphia.

9. Mr. Liberty joined Patheon as Senior Vice-President, Operations, Canada on November 1, 2005. Prior to that, Mr. Liberty was Executive Director & General Manager of AstraZeneca Pharmaceuticals' Westborough Supply Site in Massachusetts, U.S.A.

10. Mr. Ferguson was appointed Senior Vice-President, Global Information Technology effective January 6, 2004. Prior to that, he was Vice-President, Information Technology.

11. Mr. Wieschkowski was appointed Senior Vice-President, Corporate Human Resources and Environment, Health & Safety on September 26, 2006. Prior to that, Mr. Wieschkowski was Vice-President, Corporate Human Resources. Prior to that, Mr. Wieschkowski was Senior Director, Corporate Human Resources, before which he was Director, Human Resources - North America.

12. Mr. Dowd was appointed Vice-President and Controller on December 13, 2005. Prior to that, he was Director, Corporate Development.

13. Dr. Minchom was appointed Vice-President, PDS, Canada effective June 2, 2004. Prior to that, he was Group Director, PDS Operations.

14. Ms. Le Saux joined Patheon as General Counsel, North America on January 2, 2008 and was appointed Corporate Secretary effective the same date. Prior to that, Ms. LeSaux was Vice-President, Corporate & Legal Affairs of Vasogen Inc. Prior to 2005, she was a contract executive for sanofi-aventis Canada responsible for legal affairs and business development. Prior to 2004, Ms. Le Saux was a contract executive for Zinc Therapeutics, where she was responsible for legal affairs and business development.

*DIRECTORS*

The names and municipalities of residence of the directors of Patheon Inc., including their terms of office and committee memberships as at January 22, 2008, are set out below together with their principal occupations during the past five years. Each of the director's term of office shall expire immediately prior to the election of directors at the Annual General Meeting of Shareholders to be held on March 27, 2008.

<b>Name &amp; Municipality of Residence</b>	<b>Director Since</b>	<b>Committee Membership</b>	<b>Principal Occupation During Past Five Years</b>
<b>PETER A.W. GREEN</b> Campbellville, Ontario, Canada	<b>1996</b>	<ul style="list-style-type: none"><li>• Compensation and Human Resources</li></ul>	Corporate Director

Name & Municipality of Residence	Director Since	Committee Membership	Principal Occupation During Past Five Years
<b>WESLEY P. WHEELER</b> Corona del Mar, California, U.S.A.	<b>2007<sup>(1)</sup></b>	<i>Not Applicable<sup>(2)</sup></i>	From December 2007 to present: Chief Executive Officer of Patheon; from March to December 2007: President, North America, R&D and Global Manufacturing, Valeant Pharmaceuticals International (pharmaceutical company); from April 2006 to March 2007: President, North America and Research and Development, Valeant Pharmaceuticals International; from February 2003 to April 2006: President, North America and Global Commercial Development, Valeant Pharmaceuticals International.
<b>JOAQUIN B. VISO</b> San Juan, Puerto Rico, U.S.A.	<b>2004</b>	<i>None</i>	From August 2005 to December 2006: Chairman, MOVA Pharmaceutical Corporation (pharmaceutical company); prior to August 2005: President and Chief Executive Officer, MOVA Pharmaceutical Corporation.
<b>DEREK J. WATCHORN</b> Schomberg, Ontario, Canada	<b>1998</b>	<ul style="list-style-type: none"> <li>• Corporate Governance</li> <li>• Compensation and Human Resources</li> </ul>	From January 2007 to present: President & Chief Executive Officer, PSPiB Destiny Inc. (“Destiny”) (provider of accommodation and care for seniors); from October 2004 to January 2007: President & Chief Executive Officer, Retirement Residences Real Estate Investment Trust (provider of accommodation and care for seniors) (acquired by Destiny in January 2007); from October 2004 to December 2007: Trustee of IPC US Real Estate Investment Trust (asset and property management); from January 2003 to June 2004: Executive Vice-President, Strategic Initiatives, Canary Wharf Group plc (commercial property company).

<b>Name &amp; Municipality of Residence</b>	<b>Director Since</b>	<b>Committee Membership</b>	<b>Principal Occupation During Past Five Years</b>
<b>GREGORY C. WILKINS</b> Toronto, Ontario, Canada	<b>2003</b>	<ul style="list-style-type: none"> <li>• Audit</li> <li>• Corporate Governance</li> </ul>	From February 2003 to present: Chief Executive Officer & President, Barrick Gold Corporation (international gold mining company); prior to February 2003: Financial Consultant.
<b>PAUL S. LEVY</b> Scarsdale, New York, U.S.A.	<b>2007</b>	<i>None</i>	Managing Director, JLL Partners, Inc. (private equity investment firm)
<b>RAMSEY A. FRANK</b> Greenwich, Connecticut, U.S.A.	<b>2007</b>	<ul style="list-style-type: none"> <li>• Corporate Governance</li> <li>• Compensation and Human Resources</li> <li>• Audit</li> </ul>	Managing Director, JLL Partners, Inc. (private equity investment firm)
<b>THOMAS S. TAYLOR</b> New York, New York, U.S.A.	<b>2007</b>	<ul style="list-style-type: none"> <li>• Audit</li> </ul>	From May 2005 to present: Senior Principal, JLL Partners, Inc. (private equity investment firm); from July 2004 to May 2005: Business Strategy Consultant at The Hartford Financial Services Group, Inc. (insurance and financial service provider); prior to July 2004: President and Chief Executive Officer of EPIX Holdings Corporation (human resource outsourcer).

(1) Mr. Wheeler was appointed a director effective December 3, 2007.

(2) Members of management are not members of any Committees of the Board.

*SHAREHOLDINGS OF DIRECTORS AND EXECUTIVE OFFICERS*

As at December 31, 2007, Patheon's directors and executive officers as a group beneficially owned, directly or indirectly, approximately 11,328,021 restricted voting shares of Patheon Inc., representing 12.5% of the outstanding restricted voting shares.

*CEASE TRADE ORDERS, BANKRUPTCIES, PENALTIES OR SANCTIONS*

Mr. Green has previously been appointed as a director and officer of companies that have financial difficulties to assist such companies with financial restructuring, proposals or compromise arrangements. In this capacity, Mr. Green was appointed a director of Phillip Services Corp., which made a proposal under chapter 11 of the U.S. Bankruptcy Code and the *Companies Creditors' Arrangement Act* (Canada) in 1999, and briefly became the Chairman and Chief Executive Officer of Norigen Inc., which went into receivership in August, 2001.

Mr. Levy previously served as a director of Hayes Lemmerz International, Inc., which made a proposal under chapter 11 of the U.S. Bankruptcy Code in 2001, and as a director of New World Pasta Company, which made a proposal under chapter 11 of the U.S. Bankruptcy Code in 2004.

Mr. Frank previously served as a director of New World Pasta Company, which made a proposal under chapter 11 of the U.S. Bankruptcy Code in 2004.

## **AUDIT COMMITTEE INFORMATION**

### *COMPOSITION OF THE AUDIT COMMITTEE*

The Audit Committee is comprised of the following three members: Gregory C. Wilkins (Chairman), Ramsey A. Frank and Thomas S. Taylor. The Board of Directors has determined that each member of the Audit Committee is independent of management and free from any interest and any business or other relationship that could, or could reasonably be perceived to, reasonably interfere with the director's ability to exercise his independent judgment and act in the best interests of Patheon.

### *RELEVANT EDUCATION AND EXPERIENCE*

Mr. Frank is an investment banker of over 25 years experience, Mr. Taylor is an investment banker and former Chief Financial Officer of several corporations and Mr. Wilkins is a chartered accountant and former Chief Financial Officer of Barrick Gold Corporation, and, as such, all of the members of the Audit Committee are financially literate. Each of the Audit Committee members: (i) is fully cognizant of the accounting principles used by Patheon to prepare its financial statements; (ii) has the ability to assess the general application of such accounting principles in connection with the accounting for estimates, accruals and reserves; (iii) has practical experience preparing, auditing, analyzing or evaluating financial statements; and (iv) has an understanding of internal controls and procedures for financial reporting.

In determining whether a director: (i) is "financially literate," the Board of Directors considers whether the director has the ability to read and understand a balance sheet, an income statement, a cash flow statement and the notes attached thereto; and (ii) has "accounting or related financial experience", the Board of Directors considers whether the director has the ability to analyze and interpret a full set of financial statements, including the notes attached thereto, in accordance with Canadian generally accepted accounting principles.

### *PRE-APPROVAL POLICIES AND PROCEDURES*

On an annual basis, the Audit Committee pre-approves a specified list of non-audit related services that may be performed during a particular fiscal year and establishes maximum fee levels for the various types of services listed. Amounts to be expended above these levels require specific Audit Committee approval.

*EXTERNAL AUDITOR SERVICE FEES*

All amounts indicated in the table immediately below are in Canadian dollars.

<b>FISCAL YEAR</b>	<b>AUDIT FEES</b>	<b>AUDIT-RELATED FEES</b>	<b>TAX FEES</b>	<b>ALL OTHER FEES</b>
<b>2007</b>	\$957,000	\$228,000	\$19,000	\$35,000
<b>2006</b>	\$1,074,000	\$155,000	\$28,000	\$37,000

*AUDIT COMMITTEE CHARTER*

Patheon Inc.'s Audit Committee Charter was most recently updated on June 2, 2005 and a copy is provided in Appendix C to this Annual Information Form.

**INTERESTS OF MANAGEMENT IN MATERIAL TRANSACTIONS**

Mr. Joaquin B. Viso, who, together with his wife, jointly owns approximately 12% of the issued and outstanding restricted voting shares of Patheon Inc. and is a director of Patheon Inc., is a controlling shareholder of Alara Pharmaceutical Corporation ("Alara") which has two contractual commercial relationships with MOVA Pharmaceutical Corporation. One of these agreements involves a significant product for MOVA. According to the terms of the commercial manufacturing agreement, the right to place orders for such product has been assigned to a third party who purchases this product directly from MOVA; however, the NDA for such product remains the property of Alara. This commercial manufacturing agreement has a 17-year term, expiring in 2019, and grants MOVA the right to manufacture 85% of the worldwide requirements for such product for the term of the agreement.

The Company indirectly holds, through Patheon Italia S.p.A. and Patheon BV, an equity interest of 18% in BSP Pharmaceuticals S.r.l. ("BSP"). The Company has an option to acquire an additional 6% equity interest in BSP. BSP is an oncology production facility in Latina, Italy that will specialize in the provision of third-party manufacturing of cytotoxic products. Mr. Aldo Braca, President, Patheon Europe, and/or his immediate family members, either directly or indirectly through entities controlled by Mr. Braca and/or his immediate family members, hold(s) an aggregate equity interest of 47% in BSP.

**TRANSFER AGENT AND REGISTRAR**

The registrar and transfer agent for Patheon Inc.'s restricted voting shares is Computershare Investor Services Inc., with transfer facilities in the cities of Halifax, Montreal, Toronto, Winnipeg, Calgary and Vancouver.

**MATERIAL CONTRACTS**

Other than contracts entered into in the ordinary course of business and the agreement described below, Patheon did not enter into any material contracts during fiscal 2007, nor did Patheon enter into any material contracts prior to fiscal 2007 that remain in effect.

*INVESTOR AGREEMENT*

JLL Holdings (being an affiliate of JLL Partners; both entities hereafter collectively referred to as "JLL Partners") and Patheon entered into the Investor Agreement, dated April 27, 2007, in connection with the

purchase by JLL Partners of the Convertible Preferred Shares and Special Voting Preferred Shares for gross proceeds of \$150 million. The following is a summary of the key terms of the Investor Agreement and is not complete. Interested persons should refer to the Investor Agreement, a copy of which has been filed on SEDAR ([www.sedar.com](http://www.sedar.com)).

The key terms of the Investor Agreement relate to:

- special approval rights of JLL Partners;
- standstill provisions;
- coat-tail protection;
- restrictions on transfer of the Special Voting Preferred Shares; and
- registration rights.

*Special Approval Rights:* JLL Partners' approval is required if Patheon wants to do any of the following (provided that JLL Partners holds at least 52,500 Convertible Preferred Shares or the corresponding number of restricted voting shares issued upon conversion of the Convertible Preferred Shares):

- (a) create or issue any shares of capital stock ranking *pari passu* with or senior to the Convertible Preferred Shares, or issue any additional restricted voting shares or other equity securities of Patheon, or securities convertible for or exchangeable into such securities, other than pursuant to Patheon's incentive stock option plan or any other security-based compensation arrangement consented to by JLL Partners;
- (b) declare or pay dividends or other distributions (including capital) on the restricted voting shares or other equity securities;
- (c) redeem, repurchase or acquire any restricted voting shares or other equity securities;
- (d) change the articles of Patheon;
- (e) change the rights of the existing classes of shares of Patheon;
- (f) merge, consolidate or sell all or substantially all of the assets of Patheon or undertake any similar business combination transaction;
- (g) incur any indebtedness for borrowed money in excess of \$20 million, excluding borrowings under Patheon's credit facilities and any indebtedness incurred to fund all or part of the redemption price for all of the Convertible Preferred Shares;
- (h) initiate any insolvency, restructuring or reorganization process, voluntary liquidation, dissolution or winding-up of Patheon;
- (i) change the Chief Executive Officer of Patheon; or
- (j) change the size of the Board of Directors of Patheon.

*Standstill:* Unless JLL Partners is making an offer to acquire all of the outstanding restricted voting shares of Patheon by way of a take-over bid circular and in compliance with the terms of Patheon's shareholder rights plan (if then in effect), JLL Partners will not acquire or offer to acquire, directly or indirectly, any restricted voting shares or Convertible Preferred Shares or direct or indirect rights or options to acquire any restricted voting shares, other than restricted voting shares received through: (i) a stock dividend or recapitalization of Patheon, (ii) any dividend reinvestment plan, (iii) a rights offering to all holders of restricted voting shares, (iv) Patheon's shareholders rights plan or (v) conversion of the Convertible Preferred Shares. JLL Partners will not act jointly or in concert with any third party to propose or effect any take-over bid, amalgamation, merger, arrangement or other business combination with respect to Patheon or to propose or effect any acquisition or purchase of any of the assets of Patheon. JLL Partners will not solicit votes or proxies to attempt to alter the structure of the Board of Directors as it existed on April 27, 2007. The standstill provisions will expire on the earliest of (i) April 27, 2012, (ii) the date upon which JLL Partners or any of its affiliates (A) ceases to own beneficially, directly or indirectly, restricted voting shares and Convertible Preferred Shares that represent at least 20% of the number of restricted voting shares then issued and outstanding and (B) no longer has the right to nominate a representative to the Board, and (iii) the date on which the Board approves any of the following actions, or approves the entering into by Patheon of an agreement in respect of any transaction involving: (A) the sale of restricted voting shares or Convertible Preferred Shares representing more than 35% of the fully-diluted shares held by JLL Partners to any third party other than a member of JLL Partners and its affiliates or any person acting jointly or in concert with any member of JLL Partners and its affiliates, (B) a consolidation, merger, arrangement or amalgamation (statutory or otherwise) of Patheon with any such third party, or (C) the acquisition by any such third party or group of such third parties of restricted voting shares or Convertible Preferred Shares representing more than 35% of the fully-diluted shares held by JLL Partners.

*Coat-tail Protection:* In addition to any restrictions under applicable law, the Convertible Preferred Shares may only be transferred (i) to an affiliate of JLL Partners, (ii) to a purchaser that has also offered or has made a follow-up offer to purchase all the restricted voting shares on the same terms and on an economically-equivalent basis, or (iii) pursuant to a transaction that would, if the Convertible Preferred Shares were restricted voting shares, be an exempt take-over bid or otherwise would not require that an offer or follow-up offer be made to all holders.

*Transfer of Special Voting Preferred Shares:* The Special Voting Preferred Shares are not transferable, except to an affiliate of JLL Partners.

*Registration Rights:* JLL Partners may request Patheon to effect a qualification under Canadian securities laws of the distribution to the public in any or all of the provinces of Canada of all or part of the Convertible Preferred Shares (or restricted voting shares received on conversion) held by JLL Partners (a "Demand Registration"), subject to a maximum of two Demand Registrations. In addition, each time Patheon elects to proceed with the preparation and filing of a prospectus under any Canadian securities laws in connection with a proposed distribution of any of its securities for cash, JLL Partners shall be entitled to request that Patheon cause any or all of the shares held by JLL Partners to be included in such prospectus (an "Incidental Registration"). All registration expenses (excluding underwriting or placement discounts and commissions) will be borne by Patheon. The Demand Registration rights terminate when JLL Partners and its affiliates no longer beneficially own Convertible Preferred Shares (or restricted voting shares received on conversion) representing at least 12,500,000 fully-diluted restricted voting shares, and the Incidental Registration rights terminate when JLL Partners and its affiliates no longer beneficially own Convertible Preferred Shares (or restricted voting shares received on conversion) representing at least 6,250,000 fully-diluted restricted voting shares.

## **INTERESTS OF EXPERTS**

### *NAMES OF EXPERTS*

The auditors of Patheon are Ernst & Young LLP, Chartered Accountants. Patheon's consolidated financial statements as at October 31, 2007 and for the year then ended have been filed under National Instrument 51-102 in reliance on the report of Ernst & Young LLP, Chartered Accountants, given on their authority as experts in auditing and accounting.

### *INTERESTS OF EXPERTS*

Patheon's audit committee obtained written confirmation from Ernst & Young LLP confirming that they are independent with respect to the Company within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario.

## **ADDITIONAL INFORMATION**

Additional information, including information regarding directors' and officers' remuneration and indebtedness, principal holders of Patheon's securities and options to purchase securities, is contained in Patheon's Management Information Circular in respect of Patheon's annual general meeting held on April 19, 2007, and filed on SEDAR ([www.sedar.com](http://www.sedar.com)) in compliance with securities regulations and prior to such meeting. Additional financial information is provided in the consolidated financial statements and management's discussion and analysis for the fiscal year ended October 31, 2007, filed on SEDAR.

Patheon will provide to any person, upon request to the Secretary, the following documents:

1. (a) when the securities of Patheon are in the course of a distribution under a preliminary short-form prospectus or a short-form prospectus:
  - (i) one copy of the latest annual information form, together with one copy of any document, or the pertinent pages of any document, incorporated therein by reference;
  - (ii) one copy of the comparative financial statements of Patheon for its most recently completed financial year for which financial statements have been filed, together with the accompanying report of the auditor, and one copy of the most recent interim financial statements of Patheon that have been filed, if any, for any period after the end of Patheon's most recently completed financial year;
  - (iii) one copy of the information circular of Patheon in respect of its most recent annual meeting of shareholders that involved the election of directors or one copy of any annual filing prepared instead of that information circular, as appropriate; and
  - (iv) one copy of any other documents that are incorporated by reference into the preliminary short-form prospectus or the short-form prospectus and are not required to be provided under paragraphs (i) to (iii) above; or
2. at any other time, one copy of any of the documents referred to in paragraphs (a)(i), (ii) and (iii) above, provided that Patheon may require the payment of a reasonable charge if the request is made by a person or company who is not a security holder of Patheon.

Additional information about Patheon may be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **APPENDIX A - BACKGROUND ON THE DRUG DEVELOPMENT PROCESS**

In order for a new drug to be sold in any country it must meet the country's regulatory standards, which ensure that the drug product is both safe and effective. In North America and Europe, the regulatory agencies that must approve a new drug's use include the U.S. Food and Drug Administration ("FDA"), the Health Products and Food Branch of Health Canada ("HPFB") and the European Medicines Evaluation Agency ("EMA") representing the European Union, as well as the national regulatory agencies of member states. Both the drug and the processes by which it is developed, tested and manufactured must meet stringent regulatory requirements.

The process for a drug requiring FDA approval is described below, and this process is substantially similar for other regulatory agencies:

### ***Discovery***

The first step in the drug development process is the discovery of a new molecular entity ("NME") to treat a targeted disease. The drug discovery process requires a significant amount of time and financial investment.

### ***Pre-Clinical Studies***

Prior to evaluation in humans, pre-clinical studies are carried out on the NME. Pre-clinical studies involve laboratory evaluations of the NME characteristics and animal studies to assess the safety of the NME and to demonstrate the effectiveness of the NME against the targeted disease.

### ***Investigation New Drug Application (IND)***

This application is submitted to the FDA after completion of pre-clinical studies. The IND contains the results of pre-clinical studies and describes how a drug will be evaluated in human subjects. The IND must be approved before human clinical trials can be conducted.

### ***Clinical Trials & Pharmaceutical Development***

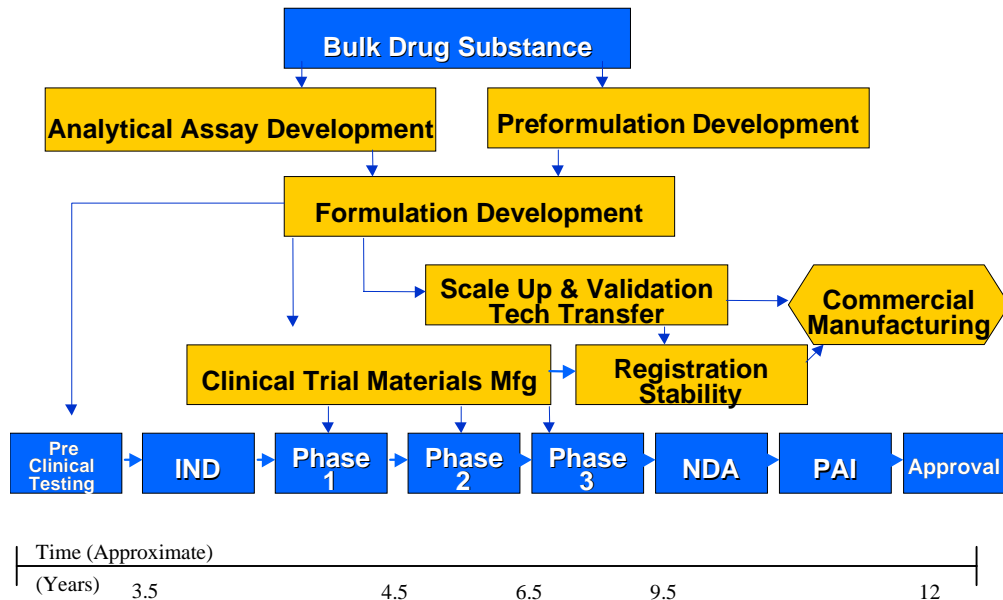
During the drug development process, an NME must undergo safety and clinical evaluation before it is approved as a commercial therapeutic product. The NME must pass through Phase I, Phase II and Phase III clinical trials prior to receiving approval. An essential part of this process is the development of an appropriate dosage form (for example, tablets, capsules or injectables).

The development of a dosage form moves in tandem with the clinical evaluation of the drug. Early formulations are used to establish therapeutic safety and efficacy. Commercial dosage formulations are developed as the NME enters Phase II clinical trials. Scale-up to commercial manufacturing batch sizes culminates in the manufacture of registration and validation batches to support regulatory filings and the launch of the commercial product.

Developing an appropriate dosage form, preparing necessary clinical trial materials and scaling-up the dosage form manufacturing to commercial scale are all part of the development process. Through these activities, it must be demonstrated that the drug can be consistently manufactured at commercial batch sizes in accordance with applicable regulatory requirements. The data recorded during development activities are included in the Chemistry, Manufacturing and Controls section of the required New Drug

Application ("NDA") for the FDA. A drug must meet regulatory requirements at all phases of the clinical trial and drug development processes or it will not be approved for human use.

The following chart shows the phases of pharmaceutical development as they relate to the clinical trial approval process:



### ***Pre-Approval Inspection ("PAI")***

Following the completion of the clinical trials, an NDA is submitted to the FDA for marketing approval. During the review process, a PAI may be conducted on the manufacturing facility listed in the NDA for the commercial manufacturing of the new drug. Those portions of the facility involved in the manufacture of the new drug may be inspected for compliance with cGMP and approved before the new drug can be marketed. Upon approval, the new drug is available for physicians to prescribe.

### ***Post-Marketing Approval (Phase IV)***

In certain cases, additional post-marketing studies are required to evaluate the long-term effects of the new drug. In all cases, companies must continue to monitor and report any adverse reactions.

### ***Commercial Manufacturing***

Commercial manufacturing in the case of Patheon relates to the manufacturing and packaging of finished dosage forms of approved drug products destined for consumer use.

## APPENDIX B - GLOSSARY OF TECHNICAL TERMS

The text following the technical terms reproduced in this glossary does not in any way modify the meanings of such terms and is explanatory only.

Analytical Assay	Analytical assay is a laboratory procedure used to measure the amount of a drug substance or other component of interest contained in a drug product or pharmaceutical ingredient.
cGMP:	Current Good Manufacturing Practices. This is a constantly evolving system of manufacturing practices adopted and implemented by companies in the pharmaceutical industry. These practices, when taken in conjunction with quality control testing, are designed to ensure that each dosage unit of every drug performs as expected when used by a patient. From time to time, standards for good manufacturing practices are promulgated by regulatory agencies such as the FDA, HPFB, MHRA and EMEA.
Clinical Trials:	Studies of a drug product in humans designed to evaluate the safety and efficacy of a new drug in a particular disease condition. Clinical trials are only conducted after extensive pre-clinical studies.
Contract Research Organization (CRO):	An organization that manages clinical studies and related regulatory matters for pharmaceutical companies.
EMEA:	The European Medicines Evaluation Agency is the regulatory agency which controls all aspects of the development, manufacture and commercialization of drug products for the countries of the European Union. Each country of the European Union also has its own national regulatory agency which works within the umbrella of the EMEA.
FDA:	The Food and Drug Administration is the regulatory agency which controls all aspects of the development, manufacture and commercialization of drug products in the U.S. New drugs cannot be developed, or marketed for sale in the U.S. without FDA approval.
Health Products and Food Branch (HPFB):	HPFB is part of Health Canada and is the regulatory body that oversees the drug development process in Canada. New drugs cannot be marketed for sale in Canada without HPFB approval.
IND:	Investigational New Drug application. This application, submitted to the FDA, describes how a drug will be evaluated in human subjects and must be submitted before human clinical trials can be conducted. It also contains the results of pre-clinical studies.
MHRA:	The Medicines and Healthcare Products Regulatory Agency is the national drug regulatory agency of the U.K.
NDA:	New Drug Application. The document submitted to the FDA to approve a drug. The NDA is required to include, among other information, preclinical and clinical data; it includes a Chemistry, Manufacturing and Controls Section which describes the dosage form, the manufacturing process and information relating to the proposed manufacturer and packager of the drug.
NDS:	New Drug Submission. Submitted to the HPFB to approve a drug, an NDS is the Canadian equivalent of an NDA.

OTC drugs:	Over-the-Counter drugs are available for sale to the general public without a physician's prescription.
PAI:	Pre-Approval Inspection. This is the FDA's inspection of a proposed manufacturer's facilities and control system during that agency's review of an NDA. This inspection is carried out as part of the agency's decision making process as to the marketability of the drug.
Phase I clinical trials:	Studies conducted on a small number of healthy volunteers to determine a drug's safety in a healthy population.
Phase II clinical trials:	Studies carried out on a larger number of patient volunteers to determine a drug's safety, efficacy and dosage range in a patient population which demonstrates a particular disease condition.
Phase III clinical trials:	Studies carried out on a sufficiently large number of patient volunteers to prove statistically that the drug is safe and effective when taken as prescribed for the treatment of a specific disease condition.
Pre-clinical studies:	Laboratory evaluations and animal studies used to assess the safety of a new drug prior to evaluation in healthy human volunteers.
Preformulation:	The chemical and physical characterization of the drug substance and the selection of an appropriate dosage form.
R <sub>x</sub> drugs:	Prescription drugs are only available to the general public with a physician's prescription.
Scale-up and technology transfer:	The transfer of the manufacturing process from the development stage in the laboratory or pilot plant to commercial production.
Stock-keeping unit (SKU):	This refers to the particular package type and size used in the consumer distribution of a particular product.
Validation:	The planned and documented act of demonstrating that the operation of any equipment, use of any material or the implementation of any procedure, process or system will consistently lead to the expected results within pre-established limits.

## APPENDIX C - AUDIT COMMITTEE CHARTER

This charter governs the operations of the *audit committee* of Patheon Inc. (the "Corporation").

### 1. DEFINITIONS

1.1 Definitions of certain terms used in this charter are set out in Schedule A. Such terms are indicated in this charter in italics.

### 2. AUDIT COMMITTEE RESPONSIBILITIES

#### 2.1 Relationship with External Auditor

The external auditor must report directly to the *audit committee*.

#### 2.2 Audit Committee Responsibilities

(1) The *audit committee* is responsible for recommending to the board of directors:

- (a) the external auditor to be nominated for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Corporation; and
- (b) the compensation of the external auditor.

(2) The *audit committee* is directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Corporation, including the resolution of disagreements between management and the external auditor regarding financial reporting.

(3) The *audit committee* must pre-approve all *non-audit services* to be provided to the Corporation or its subsidiary entities by the Corporation's external auditor.

(4) The *audit committee* must review the Corporation's financial statements, *MD&A* and annual and interim earnings press releases before the Corporation publicly discloses this information.

(5) The *audit committee* must be satisfied that adequate procedures are in place for the review of the Corporation's public disclosure of financial information extracted or derived from the Corporation's financial statements, other than the public disclosure referred to in subsection (4), and must periodically assess the adequacy of those procedures.

(6) The *audit committee* must establish procedures for:

- (a) the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls, or auditing matters; and
- (b) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

(7) The *audit committee* must review and approve the Corporation's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of the Corporation.

### 2.3 De Minimis Non-Audit Services

The *audit committee* may satisfy the pre-approval requirement in subsection 2.2(3) if:

- (a) the aggregate amount of all the *non-audit services* that were not pre-approved is reasonably expected to constitute no more than five per cent of the total amount of fees paid by the Corporation and its subsidiary entities to the Corporation's external auditor during the fiscal year in which the services are provided;
- (b) the Corporation or the *subsidiary entity* of the Corporation, as the case may be, did not recognize the services as *non-audit services* at the time of the engagement; and
- (c) the services are promptly brought to the attention of the *audit committee* of the Corporation and approved, prior to the completion of the audit, by the *audit committee* or by one or more of its members to whom authority to grant such approvals has been delegated by the *audit committee*.

### 2.4 Delegation of Pre-Approval Function

(1) The *audit committee* may delegate to one or more independent members the authority to pre-approve *non-audit services* in satisfaction of the requirement in subsection 2.2(3).

(2) The pre-approval of *non-audit services* by any member to whom authority has been delegated pursuant to subsection (1) must be presented to the *audit committee* at its first scheduled meeting following such pre-approval.

### 2.5 Pre-Approval Policies and Procedures

The *audit committee* may satisfy the pre-approval requirement in subsection 2.2(3) if it adopts specific policies and procedures for the engagement of the *non-audit services*, if:

- (a) the pre-approval policies and procedures are detailed as to the particular service;
- (b) the *audit committee* is informed of each non-audit service; and
- (c) the procedures do not include delegation of the *audit committee's* responsibilities to management.

## 3. COMPOSITION OF THE AUDIT COMMITTEE

### 3.1 Composition

- (1) The *audit committee* must be composed of a minimum of three members.
- (2) Every *audit committee* member must be a director of the Corporation.

(3) Subject to sections 3.2, 3.3, 3.4 and 3.5, every *audit committee* member must be *independent*.

(4) Subject to sections 3.4 and 3.7, every *audit committee* member must be *financially literate*.

### 3.2 Controlled Companies

(1) An *audit committee* member that sits on the board of directors of an *affiliated entity* is exempt from the requirement in subsection 3.1(3) if the member, except for being a director (or member of a board committee) of the Corporation and the *affiliated entity*, is otherwise *independent* of the Corporation and the *affiliated entity*.

(2) Subject to section 3.6, an *audit committee* member is exempt from the requirement in subsection 3.1(3) if:

- (a) the member would be *independent* of the Corporation but for the relationship described in paragraph 1.4(1)(b) of Schedule A;
- (b) the member is not an *executive officer*, general partner or managing member of a person or company that
  - (i) is an *affiliated entity* of the Corporation, and
  - (ii) has its securities trading on a *marketplace*;
- (c) the member is not an *immediate family member* of an *executive officer*, general partner or managing member referred to in paragraph (b), above;
- (d) the member does not act as the chair of the *audit committee*; and
- (e) the board determines in its reasonable judgement that
  - (i) the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an *audit committee* member, and
  - (ii) the appointment of the member is required by the best interests of the Corporation and its shareholders.

### 3.3 Events Outside Control of Member

Subject to section 3.8, if an *audit committee* member ceases to be *independent* for reasons outside that member's reasonable control, the member is exempt from the requirement in subsection 3.1(3) for a period ending on the later of:

- (a) the next annual meeting of the Corporation, and

- (b) the date that is six months from the occurrence of the event which caused the member to not be *independent*.

### 3.4 Death, Disability or Resignation of Member

Subject to section 3.8, if the death, disability or resignation of an *audit committee* member has resulted in a vacancy on the *audit committee* that the board of directors is required to fill, an *audit committee* member appointed to fill such vacancy is exempt from the requirements in subsections 3.1(3) and (4) for a period ending on the later of:

- (a) the next annual meeting of the Corporation, and
- (b) the date that is six months from the day the vacancy was created.

### 3.5 Temporary Exemption for Limited and Exceptional Circumstances

Subject to section 3.6, an *audit committee* member is exempt from the requirement in subsection 3.1(3) if:

- (a) the member is not an individual described in subsection 1.4(1) of Schedule A;
- (b) the member is not an employee or officer of the Corporation, or an *immediate family member* of an employee or officer of the Corporation;
- (c) the board, under exceptional and limited circumstances, determines in its reasonable judgement that
  - (i) the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an *audit committee* member, and
  - (ii) the appointment of the member is required by the best interests of the Corporation and its shareholders;
- (d) the member does not act as chair of the *audit committee*; and
- (e) the member does not rely upon this exemption for a period of more than two years.

### 3.6 Majority Independent

The exemptions in subsection 3.2(2) and section 3.5 are not available to a member unless a majority of the *audit committee* members would be *independent*.

### 3.7 Acquisition of Financial Literacy

Subject to section 3.8, an *audit committee* member who is not *financially literate* may be appointed to the *audit committee* provided that the member becomes *financially literate* within a reasonable period of time following his or her appointment.

3.8 Restriction on Use of Certain Exemptions

The exemptions in sections 3.3, 3.4 and 3.7 are not available to a member unless the Corporation's board of directors has determined that the reliance on the exemption will not materially adversely affect the ability of the *audit committee* to act independently and to satisfy the other requirements of this charter.

**4. AUTHORITY OF THE AUDIT COMMITTEE**

4.1 Authority

The *audit committee* has the authority

- (a) to engage independent counsel and other advisors as it determines necessary to carry out its duties,
- (b) to set and pay the compensation for any advisors employed by the *audit committee*, and
- (c) to communicate directly with the internal and external auditors.

**5. GENERAL**

5.1 Subject to by-laws, etc.

The provisions of this charter are subject to the provisions of the by-laws of the Corporation and to the applicable provisions of the *Canada Business Corporations Act* and any other applicable legislation.

5.2 Annual Review of Charter

On an annual basis, the Board will review the recommendations of the Corporate Governance Committee with respect to this charter. The Board will approve those changes to this charter that it determines are appropriate.

Approved by the Board of Directors  
Patheon Inc.  
June 2, 2005

## SCHEDULE A

### DEFINITIONS AND INTERPRETATION

#### 1.1 Definitions

"audit committee" means the committee established by and among the board of directors of the Corporation for the purpose of overseeing the accounting and financial reporting processes of the Corporation and audits of the financial statements of the Corporation, and, if no such committee exists, the entire board of directors of the Corporation;

"audit services" means the professional services rendered by the Corporation's external auditor for the audit and review of the Corporation's financial statements or services that are normally provided by the external auditor in connection with statutory and regulatory filings or engagements;

"executive officer" of an entity means an individual who is:

- (a) a chair of the entity;
- (b) a vice-chair of the entity;
- (c) the president of the entity;
- (d) a vice-president of the entity in charge of a principal business unit, division or function including sales, finance or production;
- (e) an officer of the entity or any of its subsidiary entities who performs a policy-making function in respect of the entity; or
- (f) any other individual who performs a policy-making function in respect of the entity;

"immediate family member" means an individual's spouse, parent, child, sibling, mother or father-in-law, son or daughter-in-law, brother or sister-in-law, and anyone (other than an employee of either the individual or the individual's immediate family member) who shares the individual's home;

"marketplace" means

- (a) an exchange,
- (b) a quotation and trade reporting system,
- (c) a person or company not included in paragraph (a) or (b) that
  - (i) constitutes, maintains or provides a market or facility for bringing together buyers and sellers of securities,
  - (ii) brings together the orders for securities of multiple buyers and sellers, and

- (iii) uses established, non-discretionary methods under which the orders interact with each other, and the buyers and sellers entering the orders agree to the terms of a trade, or
- (d) a dealer that executes a trade of an exchange-traded security outside of a marketplace, but does not include an inter-dealer bond broker;

"MD&A" has the meaning ascribed to it in National Instrument 51-102;

"National Instrument 51-102" means National Instrument 51-102 *Continuous Disclosure Obligations*; and

"non-audit services" means services other than audit services.

## 1.2 Meaning of Affiliated Entity, Subsidiary Entity and Control

(1) For the purposes of this charter, a person or company is considered to be an affiliated entity of another person or company if

- (a) one of them controls or is controlled by the other or if both persons or companies are controlled by the same person or company, or
- (b) the person is an individual who is
  - (i) both a director and an employee of an affiliated entity, or
  - (ii) an executive officer, general partner or managing member of an affiliated entity.

(2) For the purposes of this charter, a person or company is considered to be a subsidiary entity of another person or company if

- (a) it is controlled by,
  - (i) that other, or
  - (ii) that other and one or more persons or companies each of which is controlled by that other, or
  - (iii) two or more persons or companies, each of which is controlled by that other; or
- (b) it is a subsidiary entity of a person or company that is the other's subsidiary entity.

(3) For the purpose of this charter, "control" means the direct or indirect power to direct or cause the direction of the management and policies of a person or company, whether through ownership of voting securities or otherwise.

(4) Despite subsection (1), an individual will not be considered to control the Corporation for the purposes of this charter if the individual:

- (a) owns, directly or indirectly, ten per cent or less of any class of voting securities of the Corporation; and
- (b) is not an executive officer of the Corporation.

### 1.3 Meaning of Independence

(1) An audit committee member is independent if the member has no direct or indirect material relationship with the Corporation.

(2) For the purposes of subsection (1), a "material relationship" is a relationship which could, in the view of the Corporation's board of directors, be reasonably expected to interfere with the exercise of a member's independent judgement.

(3) Despite subsection (2), the following individuals are considered to have a material relationship with the Corporation:

- (a) an individual who is, or has been within the last three years, an employee or executive officer of the Corporation;
- (b) an individual whose immediate family member is, or has been within the last three years, an executive officer of the Corporation;
- (c) an individual who:
  - (i) is a partner of a firm that is the Corporation's internal or external auditor,
  - (ii) is an employee of that firm, or
  - (iii) was within the last three years a partner or employee of that firm and personally worked on the Corporation's audit within that time;
- (d) an individual whose spouse, minor child or stepchild, or child or stepchild who shares a home with the individual:
  - (i) is a partner of a firm that is the Corporation's internal or external auditor,
  - (ii) is an employee of that firm and participates in its audit, assurance or tax compliance (but not tax planning) practice, or
  - (iii) was within the last three years a partner or employee of that firm and personally worked on the Corporation's audit within that time;
- (e) an individual who, or whose immediate family member, is or has been within the last three years, an executive officer of an entity if any of the Corporation's

current executive officers serves or served at that same time on the entity's compensation committee;

- (f) an individual who received, or whose immediate family member who is employed as an executive officer of the Corporation received, more than \$75,000 in direct compensation from the Corporation during any 12 month period within the last three years.

(4) Despite subsection (3), an individual will not be considered to have a material relationship with the Corporation solely because

- (a) he or she had a relationship identified in subsection (3) if that relationship ended before March 30, 2004; or
- (b) he or she had a relationship identified in subsection (3) by virtue of subsection (8) if that relationship ended before June 30, 2005.

(5) For the purposes of clauses (3)(c) and (3)(d), a partner does not include a fixed income partner whose interest in the firm that is the internal or external auditor is limited to the receipt of fixed amounts of compensation (including deferred compensation) for prior service with that firm if the compensation is not contingent in any way on continued service.

(6) For the purposes of clause (3)(f), direct compensation does not include:

- (a) remuneration for acting as a member of the board of directors or of any board committee of the Corporation, and
- (b) the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the Corporation if the compensation is not contingent in any way on continued service.

(7) Despite subsection (3), an individual will not be considered to have a material relationship with the Corporation solely because the individual or his or her immediate family member

- (a) has previously acted as an interim chief executive officer of the Corporation, or
- (b) acts, or has previously acted, as a chair or vice-chair of the board of directors or of any board committee of the Corporation on a part-time basis.

(8) For the purpose of section 1.3, the word "Corporation" includes a subsidiary entity of the Corporation and a parent of the Corporation.

#### 1.4 Additional Independence Requirements

(1) Despite any determination made under section 1.3, an individual who

- (a) accepts, directly or indirectly, any consulting, advisory or other compensatory fee from the Corporation or any subsidiary entity of the Corporation, other than as remuneration for acting in his or her capacity as a member of the board of

directors or any board committee, or as a part-time chair or vice-chair of the board or any board committee; or

- (b) is an affiliated entity of the Corporation or any of its subsidiary entities,

is considered to have a material relationship with the Corporation.

(2) For the purposes of subsection (1), the indirect acceptance by an individual of any consulting, advisory or other compensatory fee includes acceptance of a fee by

- (a) an individual's spouse, minor child or stepchild, or a child or stepchild who shares the individual's home; or
- (b) an entity in which such individual is a partner, member, an officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the Corporation or any subsidiary entity of the Corporation.

(3) For the purposes of subsection (1), compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the Corporation if the compensation is not contingent in any way on continued service.

#### 1.5 Meaning of Financial Literacy

For the purposes of this charter, an individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Corporation's financial statements.