

Report of Management's Accountability

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

Management is responsible for ensuring that these statements, which include amounts based upon estimates and judgment, reflect the Company's business transactions and financial position.

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

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

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

(signed)

Wesley Wheeler
Chief Executive Officer

Toronto, Canada
January 21, 2008

(signed)

John Bell
Chief Financial Officer

Auditors' Report

To the Shareholders of Patheon Inc.

We have audited the consolidated balance sheets of Patheon Inc. as at October 31, 2007 and 2006 and the consolidated statements of loss, changes in shareholders' equity, comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed)

Ernst & Young LLP
Chartered Accountants
Licensed Public Accountants

Toronto, Canada
January 21, 2008

Consolidated Balance Sheets

(in thousands of U.S. dollars) As at October 31	2007 \$	2006 \$
ASSETS		
Current		
Cash and cash equivalents (note 5)	30,557	50,723
Accounts receivable	130,801	117,705
Inventories (note 6)	88,729	72,057
Prepaid expenses and other	12,347	6,615
Assets held for sale (note 3)	9,843	8,341
Total current assets	272,277	255,441
Capital assets (note 7)	487,423	467,365
Intangible assets (note 8)	8,718	41,447
Deferred costs (note 9)	8,878	9,717
Future tax assets (note 18)	31,055	21,827
Goodwill (note 10)	3,658	3,077
Investments	946	586
Assets held for sale (note 3)	16,662	26,723
	829,617	826,183
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (note 11)	8,224	3,829
Accounts payable and accrued liabilities	163,721	140,254
Income taxes payable	4,684	879
Current portion of long-term debt (note 12)	11,902	283,717
Liabilities related to assets held for sale (note 3)	3,174	2,527
Total current liabilities	191,705	431,206
Long-term debt (note 12)	203,647	62,071
Deferred revenues	25,994	23,366
Future tax liabilities (note 18)	47,578	33,128
Convertible preferred shares – debt component (note 13)	139,916	—
Other long-term liabilities (note 14)	22,069	24,265
Liabilities related to assets held for sale (note 3)	1,523	1,416
Total liabilities	632,432	575,452
Shareholders' equity		
Convertible preferred shares – equity component (note 16)	15,925	—
Restricted voting shares (note 16)	391,967	400,721
Contributed surplus	4,049	3,829
Deficit	(286,250)	(189,900)
Accumulated other comprehensive income	71,494	36,081
Total shareholders' equity	197,185	250,731
	829,617	826,183

See accompanying notes.

On behalf of the Board:

(signed)

Peter A.W. Green
Director

(signed)

Gregory C. Wilkins
Director

Consolidated Statements of Loss

(in thousands of U.S. dollars, except earnings (loss) per share) Years ended October 31	2007 \$	2006 \$
Revenues (note 19)	677,074	674,659
Operating expenses	599,087	603,783
Foreign exchange gain on debt (note 17)	(12,331)	—
Repositioning expenses (note 22)	15,800	12,998
Asset impairment charge (note 4)	48,580	254,661
Depreciation and amortization	40,979	38,766
Amortization of intangible assets	6,687	11,871
Foreign exchange loss on foreign operations (note 17)	858	—
Interest	29,167	21,333
Refinancing expenses (note 23)	13,471	1,643
Amortization of deferred financing costs	—	944
Write-off of deferred financing costs (note 23)	—	6,332
Loss from continuing operations before income taxes	(65,224)	(277,672)
Provision for (recovery of) income taxes (note 18)		
Current	14,617	17,725
Future	4,617	(6,678)
	19,234	11,047
Loss from continuing operations	(84,458)	(288,719)
Earnings (loss) from discontinued operations (note 3)	(10,143)	569
Net loss for the year	(94,601)	(288,150)
Basic and diluted earnings (loss) per share		
From continuing operations	(\$0.91)	(\$3.11)
From discontinued operations	(\$0.11)	\$0.01
	(\$1.02)	(\$3.10)
Average number of shares outstanding during the year – basic and diluted (in thousands)	92,834	92,868

See accompanying notes.

Consolidated Statements of Changes in Shareholders' Equity

(in thousands of U.S. dollars) Years ended October 31	2007 \$	2006 \$
Convertible preferred shares – equity component (note 16)		
Shares issued during the year, net of issue costs	15,925	—
Balance at end of year	15,925	—
Restricted voting shares (note 16)		
Balance at beginning of year	400,721	400,594
Issued during the year, net of issue costs	24	127
Repurchased during the year, net of transaction costs	(8,778)	—
Balance at end of year	391,967	400,721
Contributed surplus		
Balance at beginning of year	3,829	2,901
Stock options	220	928
Balance at end of year	4,049	3,829
Retained earnings (deficit)		
Balance at beginning of year	(189,900)	98,250
Adjustment related to change in accounting policy (note 2)	(1,749)	—
Net loss for the year	(94,601)	(288,150)
Balance at end of year	(286,250)	(189,900)
Accumulated other comprehensive income		
Balance at beginning of year	36,081	38,106
Transition adjustment (note 2)	(762)	—
Other comprehensive income (loss) for the year	36,175	(2,025)
Balance at end of year	71,494	36,081
Total shareholders' equity	197,185	250,731

See accompanying notes.

Consolidated Statements of Comprehensive Loss

(in thousands of U.S. dollars) Years ended October 31	2007 \$	2006 \$
Net loss for the year	(94,601)	(288,150)
Other comprehensive income (loss), net of income taxes		
Change in foreign currency gains on investments in subsidiaries, net of hedging activities ⁽¹⁾	30,787	(2,025)
Foreign currency losses on investments in subsidiaries, net of hedging activities reclassified to consolidated statement of loss ⁽²⁾	2,793	—
Change in value of derivatives designated as foreign currency and interest rate cash flow hedges ⁽³⁾	3,723	—
Gains on foreign currency and interest rate cash flow hedges reclassified to consolidated statement of loss ⁽⁴⁾	(1,128)	—
Other comprehensive income (loss) for the year	36,175	(2,025)
Comprehensive loss for the year	(58,426)	(290,175)

See accompanying notes.

The amounts disclosed in other comprehensive income have been recorded net of income taxes as follows:

- (1) Net of an income tax expense of nil (2006 – \$nil).
- (2) Net of an income tax recovery of \$1,935,000.
- (3) Net of an income tax recovery of \$373,000.
- (4) Net of an income tax recovery of \$343,000.

Consolidated Statements of Cash Flows

(in thousands of U.S. dollars) Years ended October 31	2007 \$	2006 \$
OPERATING ACTIVITIES		
Net loss from continuing operations	(84,458)	(288,719)
Add (deduct) charges to operations not requiring a current cash payment		
Asset impairment charge (note 4)	48,580	254,661
Depreciation and amortization	47,666	50,637
Foreign exchange loss on foreign operations (note 17)	858	—
Foreign exchange gain on debt	(12,331)	—
Accreted interest on convertible preferred shares (note 13)	7,054	—
Write-off of deferred financing costs (note 23)	—	6,332
Other non-cash interest	1,657	944
Employee future benefits, net of contributions	(4,846)	1,112
Future income taxes	4,617	(6,678)
Amortization of deferred revenues	(2,021)	(1,978)
Other	2,087	1,587
	8,863	17,898
Net change in non-cash working capital balances related to continuing operations (note 17)	(2,442)	20,506
Increase in deferred revenues	2,065	9,614
Cash provided by operating activities of continuing operations	8,486	48,018
Cash provided by operating activities of discontinued operations	3,105	4,212
Cash provided by operating activities	11,591	52,230
INVESTING ACTIVITIES		
Additions to capital assets	(35,802)	(66,592)
Net increase in investments	(202)	(49)
Increase in deferred pre-operating costs	(3,659)	(2,204)
Cash used in investing activities of continuing operations	(39,663)	(68,845)
Cash used in investing activities of discontinued operations	(275)	(907)
Cash used in investing activities	(39,938)	(69,752)
FINANCING ACTIVITIES		
Increase (decrease) in bank indebtedness	3,532	(11,096)
Increase in long-term debt	198,108	416,389
Repayment of long-term debt	(337,452)	(364,800)
Issue of convertible preferred shares (note 13 and note 16)	150,000	—
Convertible preferred share issue costs – equity component (note 16)	(1,213)	—
Issue of restricted voting shares (note 16)	24	127
Repurchase of restricted voting shares (note 16)	(8,778)	—
Decrease in restricted cash	—	7,805
Increase in deferred financing costs	—	(3,965)
Cash provided by financing activities	4,221	44,460
Effect of exchange rate changes on cash and cash equivalents	3,960	1,278
Net increase (decrease) in cash and cash equivalents during the year	(20,166)	28,216
Cash and cash equivalents, beginning of year	50,723	22,507
Cash and cash equivalents, end of year	30,557	50,723
Supplemental cash flow information		
Interest paid	22,183	22,573
Income taxes paid	9,600	11,460

See accompanying notes.

Notes to Consolidated Financial Statements

Note 1 Nature of Business

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

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

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

Note 2 Summary of Significant Accounting Policies

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

Principles of Consolidation

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

Use of Estimates in the Preparation of the Consolidated Financial Statements

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect: the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amounts of revenue and expenses in the reporting period. Management believes that the estimates and assumptions used in preparing its consolidated financial statements are reasonable and prudent; however, actual results could differ from those estimates.

Changes in Accounting Policy

The Company adopted the CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; Section 3865, Hedges; Section 1530, Comprehensive Income; and Section 3251, Equity on November 1, 2006. The adoption of the new standards resulted in changes in accounting for financial instruments and hedges as well as the recognition of certain transition adjustments that have been recorded in the deficit account and in accumulated other comprehensive income. The comparative consolidated financial statements have not been restated as a result of the adoption of the standards, except as noted below. The principal changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described below.

(a) Financial Assets and Financial Liabilities

Under the new standards, all financial instruments are classified into one of the following five categories: held-for-trading, held to maturity investments, loans and receivables, available-for-sale financial assets and other financial liabilities. All financial instruments, including derivatives, are included in the consolidated balance sheet and are measured at fair value except for held to maturity investments, loans and receivables and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are recorded at cost as they are initiated and are subsequently measured at fair value and all revaluation gains and losses are included in net earnings (loss) in the period in which they arise. Available-for-sale financial instruments are also recorded at cost and are subsequently measured at fair value with all revaluation gains and losses included in other comprehensive income.

On transition to the new standards, gains from the cancellation of interest rate swaps that had previously been deferred, were recognized in accumulated other comprehensive income. In addition, an investment in shares of a publicly traded company was designated as held-for-trading. Prior to the adoption of the new standards, this investment had been accounted for on a cost basis, as adjusted for an other than temporary decline in value. All other financial assets are accounted for on an amortized cost basis and financial liabilities are accounted for on an accruals basis, consistent with prior accounting policies.

In connection with the adoption of the new standards, the Company changed its accounting policy relating to costs of obtaining bank and other debt financing. Under the new policy all transaction costs, including fees paid to advisors and other related costs, are expensed as incurred. Financing costs, including underwriting and arrangement fees paid to lenders are deferred and netted against the carrying value of the related debt and amortized into interest expense using the effective interest rate method. The Company previously deferred all transaction and financing costs associated with obtaining bank and other debt financing. The Company believes that the new policy is reliable and more relevant as it results in a more transparent treatment of transaction costs that the Company has incurred in its recent refinancing activities and in the carrying value of debt.

The costs of obtaining bank and other debt financing that were previously reported in deferred costs are now netted against the carrying value of the related debt and amortized into interest expense using the effective interest rate method. Prior to the adoption of the new standards, the amortization of deferred financing costs was reported as a separate line in the consolidated statement of earnings (loss) and the amortized balance disclosed in deferred costs on the consolidated balance sheet.

(b) Derivatives and Hedge Accounting

The Company enters into foreign currency forward contracts to reduce its exposure to foreign currency denominated cash flows and the change in the fair value of foreign denominated assets and liabilities. The Company also enters into interest rate swap contracts to reduce its exposure to variable interest rates.

All derivative instruments are recorded on the consolidated balance sheet at fair value unless exempted from derivative treatment as a normal purchase and sale. All changes in their fair value are recorded in earnings (loss) unless cash flow hedge accounting is used, in which case the changes in the fair value associated with the effective portions of the hedge are recorded in other comprehensive income. Prior to the adoption of the new standards, the Company accounted for derivatives that met the requirements of hedge accounting on an accrual basis.

The Company also holds foreign currency denominated debt as a hedge against the carrying value of its equity investment in certain foreign currency denominated operations. The change in the fair value of foreign denominated debt that is designated as an effective hedge of the net investments in foreign operations is recognized in other comprehensive income. The change in the fair value of foreign denominated debt that is not considered to be an effective hedge is recorded in earnings (loss).

(c) Comprehensive Loss and Accumulated Other Comprehensive Income

Comprehensive loss is comprised of the Company's net loss and other comprehensive income (loss). Other comprehensive income includes foreign currency translation gains and losses on net investments in self-sustaining operations net of hedging activities and changes in the fair value of derivative instruments designated as cash flow hedges, all net of income taxes.

Amounts accumulated in other comprehensive income are reclassified to the consolidated statement of loss in the period in which the hedged item affects earnings (loss). Foreign currency gains and losses on net investments in self-sustaining foreign operations, net of hedging activities, accumulated in other comprehensive income are reclassified to the consolidated statement of loss upon the repatriation, reduction or disposal of the investment in the foreign operation.

(d) Impact of Changes in Accounting Policy

On transition to the new accounting standards, deferred after tax gains from interest rate swaps of \$656,000 and after tax losses on the fair value of cash flow hedges of \$1,418,000 were recorded in accumulated other comprehensive income. Accumulated other comprehensive income also includes gains on net investments in self-sustaining foreign operations, net of hedging activities of \$36,081,000 previously recorded in the cumulative translation adjustment account. As a result, the previously recorded cumulative translation adjustment account has been eliminated and the balances have been included in accumulated other comprehensive income. On transition to the new standards, the comparative amounts of other comprehensive income for the year only reflect the amounts previously recorded in the cumulative translation adjustment account.

The change in policy relating to the costs of obtaining bank and other debt financing had the effect of increasing the retained deficit at November 1, 2006 by \$1,749,000. Refinancing expenses for the year ended October 31, 2007 include transaction costs incurred in connection with the completion of the Company's senior secured credit facilities and the debt component of the convertible preferred shares of \$1,889,000 (note 23).

Foreign Exchange Translation

The assets and liabilities of the Company's operations having a functional currency other than the U.S. dollar are translated into the Company's U.S. dollar reporting currency using the exchange rate in effect at the year end and revenues and expenses are translated at the average rate during each month. Translation gains and losses related to the carrying value of the Company's foreign operations and certain foreign currency denominated debt held by the Company and designated as a hedge against the carrying value of certain foreign subsidiaries, are included in accumulated other comprehensive income in shareholders' equity. Foreign exchange gains and losses on transactions occurring in a currency different than an operation's functional currency are reflected in earnings.

Notes to Audited Consolidated Financial Statements

October 31, 2007 and 2006

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

Revenue Recognition

The Company recognizes revenue for its commercial manufacturing and pharmaceutical development services when services are completed in accordance with specific agreements with its clients and when all costs connected with providing these services have been incurred, the price is fixed or determinable and collectability is reasonably assured. Client deposits on pharmaceutical development services in progress are included in accounts payable and accrued liabilities.

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

Deferred Revenues

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

Cash and Cash Equivalents

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

Inventories

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

Capital Assets

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

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

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

Repairs and maintenance costs are charged to operations as incurred.

Intangible Assets

Intangible assets represent the values assigned to acquired client contracts and relationships. They are amortized on a straight-line basis over their estimated economic lives.

Impairment of Long-Lived Depreciable Assets

The Company reviews whether there are any indicators of impairment of its capital assets and identifiable intangible assets ("long-lived depreciable assets"). If such indicators are present, the Company assesses the recoverability of the assets or group of assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to earnings.

Deferred Costs

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

Prior to the adoption of CICA Handbook Section 3855 "Financial Instrument – Recognition and Measurement" (please refer to the 'Changes in Accounting Policy' section), the costs of obtaining bank and other debt financing were deferred and amortized on a straight-line basis over the term of the debt to which they related.

Goodwill

Goodwill represents the excess of the purchase price of the Company's interest in subsidiary companies over the fair value of the underlying net identifiable assets arising on acquisitions. Goodwill is not subject to amortization but is subject to an annual review for impairment, or more frequently if events or changes in circumstances indicate that goodwill is impaired. Goodwill impairment is assessed based on a comparison of the fair value of an individual reporting unit to the underlying carrying value of the reporting unit's net assets including goodwill. When the carrying amount of the reporting unit exceeds its fair value, the fair value of the reporting unit's goodwill, determined in the same manner as in a business combination, is compared with its carrying amount to measure the amount of the impairment loss, if any.

Employee Benefit Plans

The Company provides a number of benefit plans to its employees including:

(a) defined benefit pension plans; (b) post-employment benefit plans; (c) defined contribution pension plans; and (d) unfunded termination indemnities.

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

The valuation of defined benefit pension plan assets is at current market value, based on actuarial valuation, for purposes of calculating the expected return on plan assets. Past service costs resulting from plan amendments are deferred and amortized on a straight-line basis over the remaining service life of employees active at the time of amendment.

Actuarial gains and losses arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plans and the other retirement benefit plans at the measurement date of October 31, 2007 is 19 years (2006 – 11.8 years).

The cost of defined contribution pension plans is charged to earnings as funds are contributed by the Company.

Unfunded termination indemnities for the employees of the Company's subsidiary in Italy are accrued based on Italian severance pay statutes. The liability recorded on the consolidated balance sheets is the amount to which the employees would be entitled if the employees' employment with the Company ceased.

Income Taxes

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

The Company evaluates, on a quarterly basis, the ability to realize its future tax assets. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets.

Convertible Preferred Shares

The Company's convertible preferred shares are considered to be a compound financial instrument that contains both a debt component and an equity component.

On issuance of the convertible preferred shares, the fair value of the debt component is determined by discounting the expected future cash flows over the expected life using a market interest rate for a non-convertible debt instrument with similar terms. The value is carried as debt on an amortized cost basis until extinguished on conversion or redemption. The remainder of the proceeds are allocated as a separate component of shareholders' equity, net of transaction costs. Transaction costs are apportioned between the debt and equity components based on their respective carrying amounts when the instrument was issued.

On conversion, the carrying amount of the debt component and the equity component are transferred to share capital and no gain or loss is recognized.

The interest cost recognized in respect of the debt component represents the accretion of the liability, over its expected life using the effective interest method, to the amount that would be payable if redeemed.

Notes to Audited Consolidated Financial Statements

October 31, 2007 and 2006

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

Stock Options

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

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

Earnings (Loss) Per Share

The calculation of earnings (loss) per share – from continuing and discontinued operations is based on the reported net earnings (loss) – from continuing and discontinued operations divided by the weighted average number of restricted voting shares outstanding during the year. Diluted earnings per share reflect the assumed conversion of all dilutive securities using the treasury stock method.

Under the treasury stock method:

- ▶ the exercise of options is assumed to be at the beginning of the period (or at the time of issuance, if later);
- ▶ options for which the closing fair market value exceeds the option price are the only ones that are assumed to be dilutive;
- ▶ the proceeds from the exercise of options, plus future period compensation expense on options granted on or after November 1, 2003, are assumed to be used to purchase restricted voting shares at the average price during the period;
- ▶ the number of restricted voting shares assumed to be dilutive, plus the weighted average number of restricted voting shares outstanding during the year, is used in the denominator of the diluted earnings per share computation;
- ▶ the convertible preferred shares are assumed to have been converted at the beginning of the period (or at time of issuance, if later), and the resulting restricted voting shares are included in the denominator; and
- ▶ any expenses applicable to convertible preferred shares are added back to the numerator, net of income taxes.

Since the Company was in a loss position for the years ended October 31, 2007 and 2006, there is no dilutive effect.

Government Financing

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

Recently Issued Accounting Pronouncements

Capital Disclosures

The CICA issued a new accounting standard, Section 1535, Capital Disclosures, which requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. The Company will adopt this standard beginning November 1, 2007 and is currently evaluating the effect of adopting this standard.

Financial Instruments

The CICA issued two new accounting standards, Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation, which apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. These new standards revise and enhance the disclosure requirements, and carry forward, substantially unchanged, the presentation requirements. These new standards emphasize the significance of financial instruments to the entity's financial position and performance, the nature and extent of risks arising from financial instruments, and how these risks are managed. The Company will adopt this standard beginning November 1, 2007 and is currently evaluating the effect of adopting this standard.

Inventories

The CICA issued a new accounting standard, Section 3031, "Inventories," which requires inventory to be measured at the lower of cost and net realizable value. The standard provides guidance on the types of costs that can be capitalized and requires the reversal of previous inventory write-downs if economic circumstances have changed to support higher inventory values. The Company will adopt this standard beginning November 1, 2008 and is currently evaluating the effect of adopting this standard.

International Financial Reporting Standards

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards ("IFRS") over a transition period expected to end in 2011. Management is reviewing the transition to IFRS on the Company's consolidated financial statements and has not yet determined the impact.

Note 3 Discontinued Operations and Assets Held for Sale

On April 17, 2007, the Company announced that as part of its strategy to focus on developing and manufacturing prescription pharmaceutical products and to improve the Company's profitability, it plans to restructure its current network of six pharmaceutical manufacturing facilities in Canada.

In connection with this initiative, on December 6, 2007 the Company announced that it had entered into a definitive agreement to sell its Niagara-Burlington operations focused on the manufacturing of OTC products to Pharmetics Inc. Please refer to note 25 – "Subsequent Events" for additional information regarding this transaction.

The Company also plans to close its York Mills, Toronto facility and transfer substantially all commercial production and development services to its site in Whitby and sell the land and buildings. The process of transferring production to other facilities is expected to be completed by the first half of fiscal 2009.

The results of the Niagara-Burlington operations have been reported as discontinued operations and prior period amounts have been reclassified to conform to the current period presentation. During 2007 the Company recorded an impairment charge of \$12,465,000 to write down the carrying value of Niagara-Burlington operation's long-lived assets to their fair value less estimated disposition costs.

The results of discontinued operations for the year ended October 31, 2007 and 2006 are as follows:

	2007 \$	2006 \$
Revenues	35,244	37,493
Operating expenses	32,475	34,580
Repositioning expenses (recovery)	(397)	789
Asset impairment charge	12,465	—
Depreciation and amortization	844	1,112
Earnings (loss) before income taxes	(10,143)	1,012
Provision for income taxes	—	443
Net earnings (loss) for the year	(10,143)	569

Assets held for sale and the related liabilities include the Niagara-Burlington Operations and the land and buildings at York Mills. In accordance with Section 3475 of the CICA Handbook, long-lived assets held for sale are measured at the lower of their carrying amount or fair value less cost to sell. Assets held for sale and the related liabilities, as at October 31, 2007 and 2006, are as follows:

	2007 \$	2006 \$
Current assets		
Accounts receivable	4,376	4,251
Inventories	5,307	3,905
Prepaid expenses and other	160	185
Total current assets	9,843	8,341
Capital assets	16,662	26,723
Current liabilities		
Accounts payable and accrued liabilities	3,174	2,527
Other long-term liabilities	1,523	1,416

October 31, 2007 and 2006

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

Note 4 Asset Impairment Charge

During 2007, it was determined that the carrying value of the intangible assets and depreciable tangible capital assets (collectively the "long-lived depreciable assets") at the Company's operations in Carolina, Puerto Rico were impaired as a result of volume declines arising from the genericization of Omnicef[®], this being the largest single product that is manufactured at the facility. The Company tested the recoverability of the long-lived depreciable assets at the Carolina operations and determined that the expected future cash flows over the economic life of the principal assets were less than the carrying value of the long-lived depreciable assets. As a result, the Company recorded an impairment charge of \$48,580,000; \$26,042,000 for intangible assets and \$22,538,000 for tangible capital assets. The fair value of the intangible assets was determined using a discounted cash flow methodology and the fair value of the tangible capital assets was based on a weighted average continued use and liquidation value.

During 2006, the Company determined that the carrying value of long-lived depreciable assets at the Company's operations in Caguas and Manati, Puerto Rico and the goodwill associated with all the Puerto Rico operations were impaired as a result of certain events which occurred during 2006. These events included: continued deterioration in revenues culminating in a significant increase in losses reported by the Puerto Rico operations in the third quarter; suspension of production of a major product due to concerns over product shelf life; the risk of a decline in revenue of another major product as a result of the approval by the U.S. Food and Drug Administration of a generic version of the product; and the completion of a long-range plan that showed a significant reduction in earnings relative to prior forecasts.

The Company tested the recoverability of the long-lived depreciable assets for all of the Puerto Rico operations and determined that, in Caguas and Manati, the expected future cash flows over the economic life of the principal assets were less than the carrying value of the long-lived depreciable assets. As a result the Company recorded an impairment charge of \$81,428,000; \$51,921,000 for intangible assets and \$29,507,000 for tangible capital assets. The fair value of the intangible assets was determined using a discounted cash flow methodology and the fair value of tangible capital assets was based on a value in continued use, taking into account utilization levels.

The Company tested the recoverability of the goodwill associated with the Puerto Rico operations using a discounted cash flow methodology, and recorded an impairment charge of \$172,477,000 representing the full value of the Puerto Rico goodwill.

During 2006, the Company, as part of its ongoing review of long-term investments, concluded that its investment in the shares of a drug technology company which was accounted for on the cost basis had an other than temporary decline and wrote down its value by \$756,000 to its market value.

A summary of the asset impairment charges for the years ended October 31, 2007 and 2006 is as follows:

	2007 \$	2006 \$
Intangible asset impairment	26,042	51,921
Tangible capital asset impairment	22,538	29,507
Goodwill impairment	—	172,477
Other investment impairment	—	756
	48,580	254,661

Note 5 Cash and Cash Equivalents

	2007 \$	2006 \$
Interest-bearing balances with banks, with interest rates between 1% to 5%	30,557	18,899
Term deposits	—	31,824
Balance, end of the year	30,557	50,723

Note 6 Inventories

	2007 \$	2006 \$
Raw materials and packaging components	63,154	44,771
Work-in-process	25,575	27,286
Balance, end of the year	88,729	72,057

Note 7 Capital Assets

	Cost \$	Accumulated Depreciation \$	2007 Net Book Value \$	Cost \$	Accumulated Depreciation \$	2006 Net Book Value \$
Land	42,578	—	42,578	40,662	—	40,662
Buildings	230,939	46,193	184,746	232,050	62,207	169,843
Machinery and equipment	401,880	176,725	225,155	337,938	144,854	193,084
Office equipment	43,412	41,093	2,319	31,089	24,438	6,651
Furniture and fixtures	16,400	8,320	8,080	18,100	11,602	6,498
Construction in progress	24,545	—	24,545	50,627	—	50,627
Balance, end of the year	759,754	272,331	487,423	710,466	243,101	467,365

The amount required to complete authorized capital projects at October 31, 2007 is approximately \$15,804,000 (2006 – \$17,664,000). The expenditures are expected to be incurred during the year ending October 31, 2008.

Included in capital assets are assets under capital leases with a cost of \$16,642,000 at October 31, 2007 (2006 – \$17,758,000). The depreciation of assets under capital leases of \$5,411,000 (2006 – \$5,765,000) is included in accumulated depreciation at October 31, 2007.

Note 8 Intangible Assets

	2007 \$	2006 \$
Balance, beginning of the year	41,447	110,095
Amortization	(6,687)	(11,871)
Impairment (note 4)	(26,042)	(51,921)
Foreign currency impact on intangible assets	—	(4,856)
Balance, end of the year	8,718	41,447

Note 9 Deferred Costs

	2007 \$	2006 \$
Pre-operating costs	8,878	6,512
Financing costs	—	3,205
Balance, end of the year	8,878	9,717

As a result of changes in the Company's accounting policies, all deferred financing costs are now netted against the carrying value of the related debt. Please refer to note 2 – "Summary of Significant Accounting Policies".

Note 10 Goodwill

	2007 \$	2006 \$
Balance, beginning of the year	3,077	180,665
Acquisition	—	2,316
Impairment (note 4)	—	(172,477)
Foreign currency impact on goodwill	581	(7,427)
Balance, end of the year	3,658	3,077

Notes to Audited Consolidated Financial Statements

October 31, 2007 and 2006

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

Note 11 Bank Indebtedness

	2007 \$	2006 \$
Italian short-term operating credit facilities totaling €19,200,000 (2006 – €19,200,000), bearing interest at 3-month Euribor plus spreads between 0.5% and 1.25%. Certain of the short-term credit facilities are collateralized by accounts receivable. Amounts utilized at October 31, 2007 were €4,000,000; (2006 – €3,000,000).	5,794	3,829
Short-term insurance premium financing	2,430	—
Balance, end of the year	8,224	3,829

Note 12 Long-Term Debt

	2007 \$	2006 \$
Senior secured term loan maturing April 26, 2014, bearing interest at 7.8% based upon floating LIBOR, US or CAD prime, or federal funds effective rates, plus applicable margins.	149,250	—
\$75 million senior secured revolving loan facility maturing April 26, 2012, bearing interest at 6.4% based upon floating LIBOR, US, or CAD prime, or federal funds effective rates, plus applicable margins.	2,500	—
U.S. obligations under capital leases bearing interest at fixed rates between 4.4% and 7.8%, maturing over various dates from 2008 to 2011.	2,528	3,972
Italian mortgage (2007 – €18,244,638; 2006 – €20,706,000), bearing interest at 5.9% based upon floating 3-month Euribor, maturing in 2014.	26,244	26,427
Italian mortgage (2007 – €23,872,001; 2006 – €26,917,000), bearing interest at 6.1% based upon floating 3-month Euribor maturing in 2014.	34,402	34,354
Italian unsecured government loan (2007 – €3,098,000; 2006 – €3,098,000), bearing interest at 0.9% per annum, maturing in 2012.	4,487	3,954
Various long-term debt obligations refinanced during 2007	—	277,081
Total long-term debt outstanding	219,411	345,788
Less unamortized transaction costs	3,862	—
Less current portion	11,902	283,717
Balance, end of the year	203,647	62,071

The Company is required to make quarterly installment payments of \$375,000 on the senior secured term loan facility, along with additional mandatory repayments based on certain excess cash flow measures. The Company's ability to draw on the senior secured revolving loan facility is dependent upon the Company's inventory and trade accounts receivable levels. The senior secured term loan and the senior secured revolving loan facility contain restrictive covenants typical to such debt agreements, including restrictions on capital expenditures and the maintenance of certain financial ratios, all of which were met as at October 31, 2007. The senior secured term loan and the senior secured revolving facility are collateralized by substantially all of the assets of the Company's operations in Canada, U.S.A., Puerto Rico and the U.K. and the Company's investments in the shares of all other operating subsidiaries.

The Company has entered into interest rate swap contracts to convert interest on the senior secured term loan from a floating rate to a fixed rate of 7.7% until March 2010.

Estimated minimum annual repayments of long-term debt based on current exchange rates for the next five years are:

	\$
2008	11,902
2009	10,765
2010	10,756
2011	10,802
2012	12,705
Thereafter	162,481
Total payments	219,411

Included within the above future repayments of long-term debt are obligations under capital leases. Future minimum capital lease payments under capital leases in effect at October 31, 2007 are as follows:

	\$
2008	990
2009	690
2010	663
2011	654
Total payments	2,997
Less capital lease minimum payments representing interest	469
	2,528

Interest on long-term debt amounted to \$22,559,000 (2006 – \$22,265,000).

Note 13 : Convertible Preferred Shares – Debt Component

	2007 \$
Fair value of the debt component of the convertible preferred shares upon issuance	132,862
Accreted interest	7,054
Balance, end of the year	139,916

On April 27, 2007 JLL Partners, through its investment vehicle, JLL Patheon Holdings, LLC, purchased 150,000 units of Class I convertible preferred shares of Patheon for \$150 million.

The convertible preferred shares are a compound financial instrument with both a debt and equity component. On issuance, the fair value of the debt component of the preferred shares was \$132,862,000. The remainder of the proceeds attributable to shareholders' equity was \$15,925,000, net of apportioned transaction costs of \$1,213,000. Please refer to note 16 – "Shareholders' Equity".

Note 14 : Other Long-Term Liabilities

	2007 \$	2006 \$
Unfunded termination indemnities (2007 – €6,210,000; 2006 – €6,450,000)	8,995	8,228
Employee future benefits (note 15)	13,074	16,037
	22,069	24,265

The unfunded termination indemnities relate to the employees of the Company's Italian subsidiary. In accordance with Italian severance pay statutes, an employee benefit is accrued for service to date and is payable when the employees' employment with the Company ceases. The termination indemnity liability is calculated in accordance with local civil and labour laws based on each employee's length of service, employment category and remuneration. The termination liability is adjusted annually by a cost-of-living index provided by the Italian Government. There is no vesting period or funding requirement associated with the liability. The liability recorded in the consolidated balance sheets is the amount to which the employees would be entitled if their employment with the Company ceased. The related expense for the year amounted to \$2,312,000 (2006 – \$1,971,000).

October 31, 2007 and 2006

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

Note 15 Employee Future Benefits

The Company has a number of defined benefit pension plans. In addition, it has other benefit plans that provide post-retirement healthcare and dental benefits. The Company measured the accrued benefit obligation and the fair value of plan assets for accounting purposes as at October 31, 2007 for the defined benefit pension and other benefit plans.

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

	Defined Benefit Pension Plans 2007 \$	Other Benefit Plans 2007 \$	Defined Benefit Pension Plans 2006 \$	Other Benefit Plans 2006 \$
Change in benefit obligation				
Benefit obligation, beginning of the year	65,920	11,196	58,365	9,030
Current service cost	4,241	910	4,999	1,202
Interest cost	3,677	543	3,221	490
Plan amendments	—	—	(146)	—
Member contributions during the year	991	—	—	—
Benefits paid	(2,223)	(94)	(1,984)	(79)
Actuarial loss	203	(1,782)	(2,669)	63
Curtailment gain	—	(5,156)	—	—
Currency translation	8,432	1,192	4,134	490
Benefit obligation, end of the year	81,241	6,809	65,920	11,196
Change in plan assets				
Market value of plan assets, beginning of the year	50,149	—	38,916	—
Actual return on plan assets	5,885	—	4,569	—
Member contributions during the year	991	—	—	—
Employer contributions	5,775	94	4,852	79
Benefits paid	(2,206)	(94)	(1,984)	(79)
Currency translation	6,717	—	3,796	—
Market value of plan assets, end of the year	67,311	—	50,149	—
Reconciliation of funded status				
Funded status, deficit	(13,930)	(6,809)	(15,771)	(11,196)
Unamortized net actuarial loss	7,206	400	7,436	3,636
Unamortized past service costs	59	—	(142)	—
Accrued benefit liability	(6,665)	(6,409)	(8,477)	(7,560)

The accrued benefit liability of \$13,074,000 (2006 – \$16,037,000) is included in other long-term liabilities (note 14). For all of the Company's plans, the accrued benefit obligations are in excess of plan assets as at October 31, 2007 and 2006.

Defined benefit pension plan assets consist of:

	2007 %	2006 %
Equity securities	86	88
Debt securities	9	10
Other	5	2
Total	100	100

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligation and benefit plan expense in connection with its defined benefit pension and other benefit plans is as follows (weighted average assumptions as at October 31, 2007 and 2006):

October 31, 2007 and 2006

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

	Defined Benefit Pension Plans 2007 %	Other Benefit Plans 2007 %	Defined Benefit Pension Plans 2006 %	Other Benefit Plans 2006 %
Accrued benefit obligation				
Discount rate	5.6	5.8	5.0	5.3
Rate of compensation increase	4.1	—	3.5	—
Benefit costs recognized				
Discount rate	5.5	5.5	5.0	5.5
Expected long-term rate of return on plan assets	7.3	—	7.0	—
Rate of compensation increase	3.8	—	3.5	—

In connection with the other benefit plans, a 4% to 12% annual rate of increase in the per capita cost of covered health care and dental benefits was assumed for 2007 (2006 – 4% to 10%). The rate was assumed to decrease gradually over the next five years to 6% and remain at that level thereafter (2006 – 6% and thereafter). The following table outlines the effects of a one-percentage-point increase and decrease in the assumed health care and dental benefit trend rates:

	Benefit Obligation \$	Benefit Expense \$
Impact of:		
1% increase	941	116
1% decrease	(815)	(98)

The cost components of the Company's defined benefit pension plan and other benefit plans in aggregate are as follows:

	Defined Benefit Pension Plans 2007 \$	Other Benefit Plans 2007 \$	Defined Benefit Pension Plans 2006 \$	Other Benefit Plans 2006 \$
Current service cost	4,241	910	4,999	1,202
Interest cost	3,677	543	3,221	490
Actual return on plan assets	(5,885)	—	(4,569)	—
Actuarial (gain) loss	203	(1,782)	(2,668)	63
Elements of employee future benefit costs before adjustments to recognize the long-term nature of employee future benefits	2,236	(329)	983	1,755
Adjustments to recognize the long-term nature of employee future benefit costs:				
Curtailment gains/Settlement	—	(4,292)	(1,447)	—
Difference between expected return and actual return on plan assets for the year	1,728	—	1,462	—
Difference between amortization of the net actuarial loss for the year and the actual actuarial loss on accrued benefit obligation for the year	120	2,498	3,166	274
Difference between amortization of past service costs for the year and actual plan amendments for the year	(209)	—	20	—
Net benefit cost recognized	3,875	(2,123)	4,184	2,029

The net benefit cost recognized for the year ended October 31, 2007, includes a curtailment gain of \$4,292,000 arising from a decision to phase out certain post-employment benefits in the Company's Canadian operations.

The Company also provides retirement benefits for the majority of its employees at its Canadian, U.S. and Puerto Rican sites under defined contribution pension plans. The total expense for the plans amounted to \$7,147,000 (2006 – \$7,592,000).

Total cash payments for employee future benefits for 2007 totaled \$13,016,000 (2006 – \$12,523,000), consisting of cash contributed by the Company to its defined benefit pension plans of \$5,775,000 (2006 – \$4,852,000), cash payments directly to beneficiaries for its other benefit plans of \$94,000 (2006 – \$79,000) and cash contributed to its defined contribution pension plans of \$7,147,000 (2006 – \$7,592,000).

Note 16 Shareholders' Equity

Share Capital

Share capital consists of the following:

	2007 \$	2006 \$
Authorized		
Unlimited Class I preferred shares – Issuable 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 the Company's board of directors.		
Unlimited restricted voting shares.		
Issued and outstanding		
150,000 Class I preferred shares consisting of 150,000 Series C ("convertible preferred shares") and 150,000 Series D ("special voting preferred shares")	15,925	–
Restricted voting shares of 90,624,388 (previously referred to as common shares); 2006 – 92,950,688	391,967	400,721

Convertible Preferred Shares

On April 27, 2007 JLL Partners, through its investment vehicle, JLL Patheon Holdings, LLC, purchased 150,000 units of Class I convertible preferred shares of Patheon for \$150 million. Each unit consists of a Class I Series C convertible preferred share and a Series D special voting preferred share. On issuance, the fair value of the debt component of the preferred shares was \$132,862,000 (please refer to note 13 – "Convertible Preferred Shares – Debt Component"). The remainder of the proceeds, attributable to shareholders' equity was \$15,925,000, net of apportioned transaction costs of \$1,213,000.

Until October 27, 2009, no cash dividends will be paid on the preferred shares, but the liquidation preference and conversion rate will increase on a quarterly basis by 2.125%. After October 27, 2009, these increases in the liquidation preference and conversion rate will continue until the maturity or prior conversion, unless the Company elects to pay a cash dividend for any applicable quarter, in which case the Company will pay a cash dividend for such quarter based on an annual dividend rate of 8.5% on the aggregate liquidation preference of the convertible preferred shares.

At October 31, 2007, each convertible preferred share is convertible into 218.7154 restricted voting shares, as adjusted for any non-cash dividends noted above, at any time at the holder's option. The Company will be entitled to require the holder to convert 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.

If not previously converted, the Company is required to redeem the convertible preferred shares for cash on April 27, 2017 at a price equal to the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon. The Company is also required to redeem the convertible preferred shares upon the occurrence of a change of control of Patheon at a price equal to the greater of the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon, or the price per share paid to holders of restricted voting shares in the change of control transaction, multiplied by the number of restricted voting shares into which the convertible preferred shares are then convertible.

The convertible preferred shares have the right to vote, together with the holders of the restricted voting shares, on an as-if converted basis, in respect of all matters other than the election of directors. As at October 31, 2007, these voting rights represent approximately 27% of the voting rights of Patheon. The special voting preferred shares have the right to appoint up to three directors.

Restricted Voting Shares

The Company's articles were amended on April 26, 2007 to re-designate the common shares as restricted voting shares. This occurred in connection with the issuance of the convertible preferred shares. The holders of the convertible preferred shares have the right to appoint three of nine members of the Board of Directors. The holders of Patheon's restricted voting shares have the right to elect the remaining members of the Board of Directors. Under the rules of the Toronto Stock Exchange, voting equity securities are not to be designated, or called, common shares unless they have a right to vote in all circumstances that is not less, on a per share basis, than the voting rights of each other class of voting securities. Accordingly, the Company amended its articles to re-designate the common shares as restricted voting shares. This re-designation involves only a change in the name of the securities; the number of shares outstanding and the terms and conditions of the outstanding shares are not affected by the change.

During 2007, the Company repurchased, through a normal course issuer bid, 2,334,300 restricted voting shares at a cost of \$8,778,000. During the year, the Company issued 8,000 (2006 – 105,000) restricted voting shares under the stock option plan for proceeds of \$24,000 (2006 – \$127,000).

Shareholder Rights Plans

On March 31, 2005, the shareholders approved the renewal of an amended and restated shareholder rights plan (the "Renewal Plan") which continued the rights granted under a shareholder rights plan approved by shareholders on March 23, 1999. The Renewal Plan applies to all restricted voting shares (formerly common shares) and all future issues of restricted voting shares. The Renewal Plan is designed to encourage fair treatment of all the Company's shareholders in the event of a take-over bid, to provide shareholders and the Board of Directors with more time to fully consider any unsolicited take-over bid for the Company, to allow the Board of Directors to pursue, if appropriate, other alternatives to enhance shareholder value, and to allow additional time for competing bids to emerge. The Renewal Plan will be in effect until the close of the 2008 annual shareholders' meeting of the Company.

Under the terms of the Renewal Plan, one right has been granted for each restricted voting share. The rights granted under the Renewal Plan become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the Company's outstanding restricted voting shares without complying with the "Permitted Bid" provisions or without approval of the Board of Directors. Should the rights become exercisable, each right would entitle a holder, other than the acquiring person and persons related to it, to purchase C\$100 (US\$106) worth of common shares of the Company for C\$50 (US\$53).

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

Incentive Stock Option Plan

The Company has an incentive stock option plan. Persons eligible to participate in the plan are directors, officers, and key employees of the Company and its subsidiaries or any other person engaged to provide ongoing management or consulting services to Patheon. The plan provides that the maximum number of shares that may be issued under the plan is 7.5% of the issued and outstanding restricted voting shares of the Company at any point in time. As of October 31, 2007, the total number of restricted voting shares issuable under the plan was 6,796,829 shares (2006 – 6,971,302), of which there are stock options outstanding to purchase 3,857,916 shares (2006 – 3,949,815) under the plan. The exercise price of restricted voting shares subject to an option is determined at the time of grant and the price cannot be less than the weighted average market price of the restricted voting shares of Patheon on the Toronto Stock Exchange during the two trading days immediately preceding the grant date. Options generally expire 10 years after the grant date and are also subject to early expiry in the event of death, resignation, dismissal or retirement of an optionee. Options vest over one to three years, with one-third vesting on each of the first, second and third anniversaries of the grant date for those vesting over three years. Please also refer to note 21 – "Stock-Based Compensation Expense".

A summary of the plan and changes during each of 2007 and 2006 are as follows:

	Shares Number	2007 Weighted Average Exercise Price \$	Shares Number	2006 Weighted Average Exercise Price \$
(Dollar amounts in Canadian dollars)				
Outstanding, beginning of the year	3,949,815	10.53	3,886,840	10.66
Granted	100,000	4.83	547,500	6.66
Exercised	(8,000)	3.53	(105,000)	1.36
Forfeited	(183,899)	10.98	(379,525)	8.75
Outstanding, end of the year	3,857,916	10.38	3,949,815	10.53
Exercisable, end of the year	3,706,249	10.57	3,617,304	10.73

Notes to Audited Consolidated Financial Statements

October 31, 2007 and 2006

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

The following table summarizes information about options outstanding at October 31, 2007:

(Dollar amounts in Canadian dollars)	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of Exercise Prices					
\$2.55 – 4.83	372,000	3.1 years	\$3.85	272,000	\$3.49
\$6.17 – 7.57	347,500	3.8 years	\$6.67	315,833	\$6.65
\$8.15 – 9.91	973,666	2.4 years	\$8.46	953,666	\$8.46
\$10.91 – 13.95	1,617,750	4.0 years	\$12.17	1,617,750	\$12.17
\$14.12 – 15.96	547,000	2.6 years	\$15.30	547,000	\$15.30
	3,857,916		\$10.38	3,706,249	\$10.57

Note 17 : Other Information

Foreign Exchange

During 2007, the foreign exchange loss on operating exposures (including benefits from cash flow hedges and the revaluation of all foreign currency denominated working capital recorded in operating expenses was \$3,410,000 (2006 – gain of \$817,000).

During 2007, the Company recorded a foreign exchange gain of \$12,331,000 on the revaluation of certain U.S. dollar denominated debt, net of hedging activities, in its Canadian legal entity. During 2007, the Company also recorded a foreign exchange loss of \$858,000 in connection with a change in the Company's internal capital structure, which resulted in the recognition of foreign exchange translation losses previously recorded in accumulated other comprehensive income.

Net Change in Non-Cash Working Capital Balances Related to Continuing Operations

The net changes in non-cash working capital balances related to continuing operations are as follows:

	2007 \$	2006 \$
Accounts receivable	(813)	9,803
Inventories	(9,351)	(1,225)
Prepaid expenses and other	(955)	(2,207)
Accounts payable and accrued liabilities	3,961	6,560
Income taxes payable	4,716	7,575
	(2,442)	20,506

Related Party Transactions

Revenues from companies controlled by a director and significant shareholder of the Company were in the amount of \$473,000 (2006 – \$3,145,000). These transactions were conducted in the normal course of business and are recorded at the exchanged amount. Accounts receivable at October 31, 2007 includes a balance of \$392,000 (2006 – \$446,000) with respect to these related party transactions.

At October 31, 2007 the Company has an investment of \$739,000 (2006 – \$173,000) representing an 18% interest in two Italian companies (collectively referred to as "BSP Pharmaceuticals") whose largest investor is an officer of the Company. These companies will specialize in the manufacturing of cytotoxic pharmaceutical products.

The Company has accrued management fees owing to it under a management services agreement with BSP Pharmaceuticals of \$1,593,000 for the year ended October 31, 2007 (2006 – nil). These fees will be invoiced to BSP Pharmaceuticals once it has finalized all of its bank financing. These services were conducted in the normal course of business and are recorded at the exchanged amounts.

In connection with certain of BSP Pharmaceuticals' bank financing, the Company has made commitments that it will not dispose of its interest in BSP Pharmaceuticals prior to January 1, 2011.

Note 18 Income Taxes

The following is a reconciliation of the expected income tax expense (recovery) obtained by applying the combined corporate tax rates to the loss from continuing operations before income taxes:

	2007 \$	2006 \$
Expected income tax expense (recovery) using statutory tax rates	(22,477)	(95,686)
Change in valuation allowance	4,797	6,381
Permanent differences and other:		
Foreign	6,899	4,067
Domestic	(1,076)	1,389
Goodwill impairment	—	59,436
Foreign rate differentials	28,989	35,412
Withholding tax on intercompany dividend	2,102	—
Large Corporations Tax – Domestic	—	48
Provision for income taxes	19,234	11,047
Effective tax rate	(29.5%)	(4.0%)

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

	2007 \$	2006 \$
Canada		
Future income tax assets – long-term		
Share issue costs	1,812	1,946
Deferred financing costs	3,188	2,509
Accounting provisions not currently deductible for tax purposes	5,924	3,096
Net operating loss carryforward	1,086	—
Unclaimed R&D expenditures	4,748	4,667
Book depreciation in excess of tax depreciation (federal)	3,518	—
Valuation allowance	(16,072)	(6,311)
	4,204	5,907
Foreign		
Future income tax assets – long-term		
Accounting provisions not currently deductible for tax purposes	7,957	7,537
Net operating loss carryforward	19,204	7,386
Other	1,781	997
Valuation allowance	(2,091)	—
	26,851	15,920
Future tax assets	31,055	21,827
Canada		
Future income tax liabilities – long-term		
Tax depreciation in excess of book depreciation (provincial)	4,146	5,200
Investment tax credits	410	—
Other	—	1,025
	4,556	6,225
Foreign		
Future income tax liabilities – long-term		
Tax depreciation in excess of book depreciation	41,228	26,549
Other	1,794	354
	43,022	26,903
Future tax liabilities	47,578	33,128

The Company has tax-effected net operating losses carried forward of \$20,290,000; \$17,063,000 of the losses have an indefinite life and \$3,227,000 have expiry dates ranging from October 31, 2008 to October 31, 2026.

Notes to Audited Consolidated Financial Statements

October 31, 2007 and 2006

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

Note 19 | Segmented Information

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

Canadian and foreign operations consist of the following:

	Manufacturing Location			
	Canada	USA	Europe	Total
Year ended October 31, 2007	\$	\$	\$	\$
Revenues by client's billing location:				
Canada	14,270	1,069	1,128	16,467
USA	137,389	196,690	17,757	351,836
Europe	39,235	3,127	254,547	296,909
Other geographic areas	4,197	2,146	5,519	11,862
Total revenues	195,091	203,032	278,951	677,074
Capital assets	120,808	119,483	247,132	487,423
Goodwill	3,658	–	–	3,658

	Manufacturing Location			
	Canada	USA	Europe	Total
Year ended October 31, 2006	\$	\$	\$	\$
Revenues by client's billing location:				
Canada	21,323	856	1,930	24,109
USA	138,587	231,184	13,751	383,522
Europe	53,010	846	202,842	256,698
Other geographic areas	4,696	190	5,444	10,330
Total revenues	217,616	233,076	223,967	674,659
Capital assets	103,002	142,491	221,872	467,365
Goodwill	3,077	–	–	3,077

Revenues are attributed to countries based on the location of the client's billing address, capital assets are attributed to the country in which they are located, and goodwill is attributed to the country in which the entity to which the goodwill pertains is located.

During the year ended October 31, 2007, one client (2006 – two clients) accounted for more than 10% of the Company's total revenues. As a percentage of total revenues, this client amounted to 13% (2006 – 13% and 12%).

Revenue information by service activity is as follows:

Years ended October 31,	2007		2006	
	\$	%	\$	%
Commercial manufacturing – prescription	514,069	76%	506,732	75%
Commercial manufacturing – over-the-counter	46,549	7%	69,973	10%
Development services	116,456	17%	97,954	15%
	677,074	100%	674,659	100%

Note 20 | Commitments and Contingencies

Long-Term Operating Leases

The Company has entered into long-term rental agreements expiring at various dates until 2014. The future rental payments for the next five years and thereafter are estimated as follows: 2008 – \$3,113,000, 2009 – \$2,807,000, 2010 – \$2,065,000, 2011 – \$1,658,000, 2012 – \$1,148,000, and thereafter – \$563,000.

Other

In the normal course of operations, the Company is subject to litigation and claims from time to time. The Company may also be subject to lawsuits, investigations and other claims, including environmental, labour, product, customer disputes and other matters. The Company believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, the Company believes that the ultimate resolution of such contingencies will not have a material adverse impact on the results of operations, financial position or liquidity.

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

Note 21 Stock-Based Compensation

For the purposes of calculating the stock-based compensation expense in connection with the Company's incentive stock option plan, the fair value of stock options is estimated at the date of the grant using the Black-Scholes option pricing model and the cost is amortized over the vesting period.

The fair value of stock options is estimated at the date of the grant. The weighted average fair value of stock options granted for the year ended October 31, 2007 was \$1.92 (2006 – \$1.73). The fair value of stock options for purposes of determining stock-based compensation is estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2007	2006
Risk free interest rate	4.2%	4.2%
Expected volatility	42%	42%
Expected weighted average life of the options	6 years	4 years
Expected dividend yield	0%	0%

The Company recorded stock-based compensation expense in the year of \$220,000 (2006 – \$928,000) for options granted on or after November 1, 2003.

Note 22 Repositioning Expenses

The Company has incurred a number of expenses associated with its performance enhancement program, which is intended to identify operational improvements and cost reduction initiatives. The related expenses include costs associated with a reduction in the workforce, project management costs and consulting fees from external specialists who are assisting in identifying operational improvements.

During 2007, the Company also incurred professional fees and other costs in connection with its review of strategic and financial alternatives.

The following is a summary of expenses associated with these initiatives (collectively "repositioning expenses") for the years ended October 31, 2007 and 2006:

	2007 \$	2006 \$
Performance enhancement program:		
Employee-related expenses	8,938	8,821
Consulting, professional and project management costs	3,507	1,193
Strategic alternatives review	3,355	2,984
Total repositioning expenses	15,800	12,998

As at October 31, 2007, \$6,048,000 (2006 – \$8,699,000) of the repositioning expenses were unpaid and are recorded in accounts payable and accrued liabilities. Repositioning expenses paid during the year amounted to \$18,998,000 (2006 – \$4,215,000).

Note 23 Refinancing Expenses

During 2007 the Company incurred expenses of \$13,471,000 in connection with its refinancing activities. The expenses consist of transaction costs for the new senior secured term loan and senior secured revolving loan facility, costs allocated to the debt portion of the convertible preferred shares and prepayment charges in connection with cancellation of certain of the Company's U.K. debt facilities.

During 2006, the Company incurred charges of \$1,643,000 in connection with the cancellation and prepayment of certain of its North American credit facilities. The Company also wrote off \$6,332,000 in related deferred financing costs.

Note 24 Financial Instruments

(a) Foreign Exchange

The Company utilizes financial instruments to manage the risk associated with fluctuations in foreign exchange and interest rates. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions.

As at October 31, 2007, the Company's Canadian operations had entered into foreign exchange forward contracts to sell an aggregate amount of US\$34,172,000 (2006 – US\$60,000,000). These contracts hedge the Canadian operations expected exposure to U.S. dollar denominated cash flows and mature at the latest on April 21, 2008, at an exchange rate of \$1.0535 Canadian. The mark-to-market value on these financial instruments as at October 31, 2007 was an unrealized gain of \$4,052,000 (2006 – unrealized loss of \$1,418,000) which has been recorded in accumulated other comprehensive income in shareholders' equity.

As at October 31, 2007 the Company has designated \$141.6 million of U.S. dollar denominated debt as a hedge against its net investment in its subsidiaries in the U.S.A. and Puerto Rico. The exchange gains and losses arising from this debt, from the date so designated, are recorded in accumulated other comprehensive income in shareholders' equity.

As at October 31, 2007, the Company's Canadian operations had entered into a foreign exchange contract to purchase US\$45,000,000. The contract matures on January 28, 2010, at an exchange rate of 1.0015. The contract hedges the Canadian operations net US dollar balance sheet exposure. For accounting purposes, the contract has not been designated as a hedge. The mark-to-market value of this contract was a loss of \$2,699,000, which has been recorded in the loss from continuing operations.

(b) Interest Rate Risk

The Company has exposure to movements in interest rates. The Company has entered into interest rate swaps to convert the interest expense on the senior secured term loan, until March 2010, from a floating interest rate to a fixed interest rate.

The mark-to-market value of these financial instruments at October 31, 2007 was an unrealized loss of \$2,593,000 which has been recorded in accumulated other comprehensive income in shareholders' equity.

(c) Fair Value

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

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

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

Long-term debt and debt component of convertible preferred shares

With the exception of the senior secured term loan, the fair value of the Company's remaining long-term debt and the debt component of the convertible preferred shares, based on current rates for debt with similar terms and maturities, is not materially different from its carrying value.

As at October 31, 2007, the fair value of the senior secured term loan was estimated to be \$142,582,000, based on current rates for debt with similar terms and maturities.

Foreign exchange forward contracts and interest rate swaps

These financial instruments are measured at their fair value on the balance sheet.

(d) Credit Risk

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

As at October 31, 2007, the Company's cash and cash equivalents were held in interest-bearing balances with banks. It is the Company's policy to invest its cash and cash equivalents (including any short-term investments) in entities with an investment grade credit rating. Credit risk is further reduced by limiting the amount which is invested in any one government or corporation.

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

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

Note 25 Subsequent Events

On December 6, 2007, the Company announced that it had entered into a definitive agreement to sell its Niagara-Burlington commercial manufacturing business to Pharmetics Inc. Under the terms of the agreement Pharmetics will acquire the assets, including equipment facilities and land at the Company's facilities in Fort Erie and Burlington Gateway. Pharmetics will provide employment to all of the commercial manufacturing employees at the two sites and, subject to assignment of third party contracts, will continue to manufacture and supply all of the products currently manufactured at these sites.

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 purchase price for the business is CAD\$5.75 million plus working capital, subject to adjustments.

On December 14, 2007, the Company announced that as a result of its review of the Puerto Rico operations, with a focus on restructuring the operations, eliminating operating losses and developing a long-term plan for the business, it has decided to retain and continue to streamline its facilities in Caguas and Manati and divest of its facility in Carolina.

Revenues for the year ended October 31, 2007 for the Carolina operations were \$42.9 million. The Carolina operations reported a profit before repositioning expenses, asset impairment charge, depreciation and amortization, foreign exchange losses reclassified from other comprehensive income, interest, refinancing charges, write-off of deferred financing costs and income taxes for the year ended October 31, 2007 of \$6.1 million.

Note 26 Comparative Amounts

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