

Management's Discussion and Analysis

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This management's discussion and analysis of financial condition and results of operations ("MD&A") should be read in conjunction with the Company's consolidated financial statements and related notes and Auditors' Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are in U.S. dollars unless otherwise indicated. This information is current to January 22, 2008.

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

Note to the Reader

Cautionary Note Regarding Forward-Looking Statements

This MD&A contains forward-looking statements which reflect management's expectations regarding the Company's future growth, results of operations, performance (both operational and financial) and business prospects and opportunities. Wherever possible, words such as "plans", "expects" or "does not expect", "forecasts", "anticipates" or "does not anticipate", "believes", "intends" and similar expressions or statements that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved have been used to identify these forward-looking statements.

Although the forward-looking statements contained in this MD&A reflect management's current assumptions based upon information currently available to management and based upon what management believes to be reasonable assumptions, the Company cannot be certain that actual results will be consistent with these forward-looking statements.

Forward-looking statements necessarily involve significant known and unknown risks, assumptions and uncertainties that may cause the Company's actual results, performance, prospects and opportunities in future periods to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things: the market demand for client products; credit and client concentration; the ability to identify and secure new contracts; regulatory matters, including compliance with pharmaceutical regulations; international operations risks; exposure to foreign currency risks; competition; product liability claims; intellectual property; environmental, health and safety risks; substantial financial leverage; interest rates; conditions of MOVA's tax exemptions; divestiture of the Carolina site; significant shareholders; risks associated with information systems; and supply arrangements.

Although the Company has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be as anticipated, estimated

or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

Accordingly, readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date of this MD&A and, except as required by law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Use of Non-GAAP Financial Measures

Except as otherwise indicated, references in this MD&A to "EBITDA before repositioning expenses" are to earnings from continuing operations before repositioning expenses, asset impairment charges, depreciation and amortization, foreign exchange losses reclassified from other comprehensive income, interest, refinancing expenses, write-off of deferred financing costs and income taxes. "EBITDA margin before repositioning expenses" is EBITDA before repositioning expenses as a percentage of revenues. EBITDA before repositioning expenses and EBITDA margin before repositioning expenses are measures of earnings and earnings margin not recognized by GAAP. Since each of these measures is a non-GAAP measure that does not have a standardized meaning, it may not be comparable to similar measures presented by other issuers.

Readers are cautioned that these non-GAAP measures should not be construed as alternatives to net earnings (loss) determined in accordance with GAAP as indicators of performance. The Company has included these measures because it believes that this information is used by certain investors to assess financial performance of the Company, in particular the operating earnings before non-cash charges and large non-recurring costs.

Company Profile and Strategy

About Patheon

Patheon Inc. ("Patheon" or the "Company") is a public company, amalgamated under the Canada Business Corporations Act, which trades under the symbol PTI on the Toronto Stock Exchange. The Company, organized and managed as a single business segment, is an independent provider of commercial manufacturing and pharmaceutical development services ("PDS") of prescription ("Rx") and over-the-counter ("OTC") drugs to the international pharmaceutical industry.

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

Commercial Manufacturing

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

Patheon provides manufacturing services in accordance with client specifications. Depending on the particular client, Patheon may be responsible for some or all aspects of the manufacturing

and packaging process, from sourcing excipient raw materials and packaging components to delivering the finished product in consumer-ready form to the client. Typically, Patheon's clients supply the active pharmaceutical ingredients used in the production process.

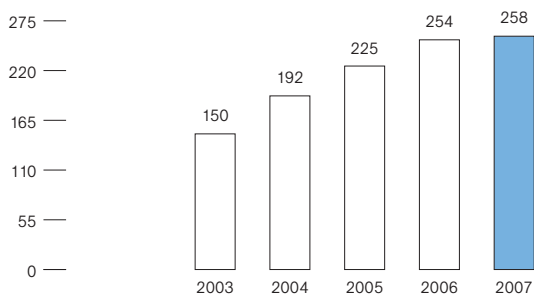
In 2007, Patheon's facilities were audited by 201 separate client audit teams, representing both prospective and existing clients. Audits by prospective clients permit them to gain confidence that Patheon's operations are conducted in accordance with applicable regulatory requirements. Audits by existing clients permit these clients to reaffirm that Patheon's operations, as they relate to their products, are conducted in accordance with these requirements. These audits contribute to Patheon's ongoing improvement of manufacturing and development practices. In addition, there were 18 regulatory audits conducted at the Company's sites in North America and Europe.

Pharmaceutical Development

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

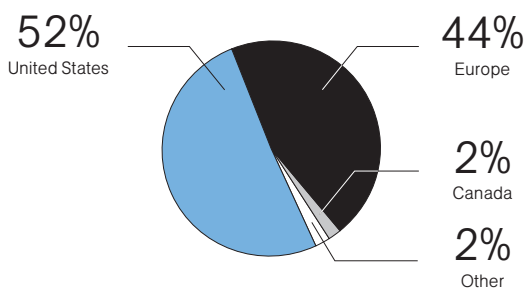
Client Base

(number of clients)



Revenues by Geographic Region

(based on clients' billing addresses)



United States Europe Canada Other

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, lyophilization, controlled release and liquid filled hard capsules). At October 31, 2007, the company was working on a total of 197 of its clients' projects in the development pipeline, including nine drug candidates at the New Drug Application ("NDA") stage. Since the beginning of fiscal 2001, 19 new pharmaceutical products developed by Patheon's PDS units have progressed to commercial manufacturing, including two in fiscal 2007. A third new product developed by PDS received regulatory approval in the third quarter of 2007 and, based on advice from the Company's client, is expected to be commercialized in 2008.

Vision and Strategy

Patheon's vision is to become the world leader in providing pharmaceutical development and manufacturing services. Patheon strives to be the preferred manufacturing and pharmaceutical development 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.

Patheon expects, based on its internal analysis and experience, that stronger manufacturing and development relationships will continue to emerge between pharmaceutical companies and service companies as the pharmaceutical industry continues to re-evaluate its internal manufacturing capabilities and streamlines its external service-provider network. The Company is using its position as a comprehensive provider of commercial manufacturing services to establish and maintain long-term and strategic relationships with clients on a global basis.

Prior to 2006, a key aspect of Patheon's strategy was a plan to expand capacity, expertise and capabilities through acquisitions, positioning the Company to be the preferred manufacturing services partner to the pharmaceutical industry. This led to the acquisition of several pharmaceutical manufacturing facilities and the entry into long-term manufacturing relationships in conjunction with certain of these acquisitions. More recently, Patheon has focused on growing its R_x commercial manufacturing and PDS business internally by broadening its service offering to include differentiated and specialized technologies and capabilities and expanding the level of business from existing clients, attracting new clients, and entering into commercial manufacturing agreements for newly approved products for which the Company has provided development services.

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

Overview of Pharmaceutical Industry Outsourcing

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

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

In addition, more products are being developed by biotechnology companies, focused on new drug discoveries. Many of these companies have focused their financial resources on the development and marketing of their products, rather than investing in their own manufacturing capacity. As a result, the demand for third-party dosage form manufacturing services continues to increase as these smaller companies grow in number and relative representation within the industry.

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

Company Profile and Strategy (continued)

Patheon's target markets include the global market for the manufacture of finished dosage forms and for dosage form research and development. The size of the market for outsourced dosage form manufacturing, based on publicly available industry sources, is estimated to be approximately \$10 billion – the majority of which comprises solid and semi-solid dosage forms, such as tablets, capsules and creams, a third of which consists of outsourced manufacturing of injectable products, with the balance comprising specialty dosage forms. In 2006, the top 400 pharmaceutical and biotechnology companies spent an estimated \$100 billion worldwide on research and development. Patheon's management estimates that this amount includes approximately \$3 billion spent on dosage form development, of which approximately \$1 billion is outsourced. The number of new clinical trials started by pharmaceutical companies continues to increase. A total of 707 commercial Investigational New Drug Applications were filed with the FDA's Center for Drug Evaluation and Research in 2006, up from 608 in 2005. Pharmaceutical and biotechnology companies are relying increasingly on contract drug development suppliers to help move high-potential chemical entities through the various stages of evaluation more quickly.

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

- ▶ growth of the global pharmaceutical industry. According to leading market research firm IMS Health, global pharmaceutical industry revenues have grown from \$354 billion in 2000 to approximately \$643 billion in 2006;
- ▶ global research and development expenditures are increasing;
- ▶ the number of product candidates in development continues to expand;
- ▶ consolidation of the pharmaceutical industry, and supply chain restructuring, are providing new opportunities as companies seek to reduce excess capacity in their manufacturing networks;
- ▶ increased demand for specialized manufacturing capabilities in key technical niches (for example, lyophilization); and
- ▶ increased demand for back-up sources of supply.

Competitors

Commercial Manufacturing

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

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

Pharmaceutical Development

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

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

In recent years a number of companies in Asia, particularly India, have been entering the pharmaceutical contract manufacturing and PDS sectors and have been proceeding with obtaining FDA approval for some of their plants as well as acquiring additional plants in Europe and North America.

Recent Developments

Financing Arrangements and Strategic Alternatives

On September 11, 2006, the Company announced that its Board of Directors had established a special committee to evaluate a range of strategic and financial alternatives for the Company. As a result of this review, on April 27, 2007 JLL Partners, through its investment vehicle, JLL Patheon Holdings, LLC ("JLL Partners") purchased \$150 million of convertible preferred shares and special voting preferred shares of the Company through a private placement. On April 27, 2007 the Company also completed new credit facilities in the aggregate amount of \$225 million, comprising a seven-year \$150 million term loan and a five-year \$75 million revolving facility.

The net proceeds from the JLL Partners investment and the seven-year term loan were used to repay the Company's obligations under its existing North American and U.K. credit facilities.

Restructuring the Canadian Site Network

On April 17, 2007 the Company announced that as part of its strategy to focus on developing and manufacturing R_x 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 OTC 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 Drive). Pharmetics will provide employment to the entire active workforce of about 250 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 Company is retaining its leased Burlington Century facility where its central quality control laboratory is based.

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.

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.

A smaller portion of the York Mills operations will be transferred to the Toronto Region Operations and Cincinnati facilities. Based on current internal projections, the process of transferring production to other facilities 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 CAD\$12.5 million, including a non-refundable deposit of CAD\$1.0 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.

The assets and the related liabilities of the Niagara-Burlington Operations, along with the York Mills real estate, have been classified as held for sale on the balance sheet in the consolidated financial statements.

Restructuring the Puerto Rico Operations

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.

On December 14, 2007, the Company announced that, as a result of this review, it had decided to retain and continue to streamline its facilities in Caguas and Manati and to divest its facility in Carolina, Puerto Rico. The decision follows the genericization of Omnicef® in May 2007 and the resulting significant drop in revenues at the facility.⁽¹⁾

The Carolina site is a 230,000-square-foot facility, with approximately 200 employees, that specializes in the manufacture of oral cephalosporin solid dosage forms, including tablets, capsules and powders for suspension. It currently manufactures four products on behalf of six clients.

The Company has concluded that Carolina, a high-quality site with specialized capabilities and expertise, would be of greater strategic value to another company with a focus on manufacturing oral cephalosporins. The divestiture will allow the Company to focus on improving operating performance and growing the business at the Caguas and Manati facilities.

Based on current divestiture plans and subject to future negotiation, the Company expects to provide that any purchaser will assume responsibility for the staff at the Carolina facility and contracts with third parties, subject to their approval. Patheon has retained an advisor to manage the sale of the Carolina site.

(1) Omnicef® is a registered trademark of Astellas Pharma, Inc.

Company Profile and Strategy (continued)

Normal Course Issuer Bid

In October 2007, the Company 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 October 31, 2007, the Company had repurchased and cancelled 2,334,300 restricted voting shares at a cost of \$8.8 million. The normal course issuer bid will expire in October 2008.

Selected Annual Financial Information

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

Years ended October 31 (in thousands of U.S. dollars, except per share amounts)	2007 \$	2006 \$	2005 \$
Revenues	677,074	674,659	658,856
Earnings (loss) from continuing operations before repositioning expenses and asset impairment charge	(21,791)	(25,185)	19,693
Basic and diluted earnings (loss) per share from continuing operations before repositioning expenses and asset impairment charge	(\$0.24)	(\$0.28)	\$0.23
Net earnings (loss)	(94,601)	(288,150)	21,621
Basic and diluted earnings (loss) per share	(\$1.02)	(\$3.10)	\$0.25
Total assets	829,617	826,183	1,051,568
Total long-term liabilities	440,727	144,246	351,283
Cash dividends	—	—	—

A reconciliation of net earnings (loss) and earnings (loss) per share from continuing operations, before repositioning expenses and asset impairment charge, with net earnings (loss) and earnings (loss) per share from continuing operations is as follows:

Years ended October 31 (in thousands of U.S. dollars, except per share amounts)	2007 (Loss) \$	EPS	2006 (Loss) \$	EPS	2005 Earnings \$	EPS
Net earnings (loss) from continuing operations	(84,458)	(\$0.91)	(288,719)	(\$3.11)	19,693	\$0.23
Repositioning expenses	15,800	\$0.17	12,998	\$0.14	—	—
Income taxes related to repositioning expenses	(932)	(\$0.01)	(1,564)	(\$0.02)	—	—
Asset impairment charge	48,580	\$0.52	254,661	\$2.74	—	—
Income taxes related to asset impairment charge	(781)	(\$0.01)	(2,561)	(\$0.03)	—	—
Net earnings (loss) from continuing operations before repositioning expenses and asset impairment charge	(21,791)	(\$0.24)	(25,185)	(\$0.28)	19,693	\$0.23

Changes in revenues, net earnings (loss) before repositioning expenses and asset impairment charge, net earnings (loss) and related basic and diluted earnings (loss) per share between 2007 and 2006 are explained in the "Results of Operations" section in this MD&A. The decline in earnings from continuing operations before repositioning expenses and asset impairment charge in 2006 relative to 2005 principally reflected a reduction in the profitability of the Caguas and Carolina operations in Puerto Rico. In Caguas, profitability was impacted by declines in base business volumes and the suspension of production during the third quarter of 2006 of a major product due to concerns over product shelf life. In Carolina, profitability was impacted during the first half of 2006 by an FDA warning letter, which resulted in additional costs and operating inefficiencies.

The increase in long-term liabilities in 2007 compared with 2006 is due to the completion of a \$150 million long-term senior secured debt facility and the issue of \$150 million of convertible preferred shares to JLL Partners. The proceeds from these financing activities were used to repay existing debt facilities in North America and the U.K. In 2006, these debt facilities were classified within current liabilities.

The reduction in long-term liabilities in 2006 compared with 2005 was due to the reclassification of long-term debt to short-term indebtedness as a result of the likelihood of potential future covenant defaults under the Company's prior North American credit facilities. The reduction in total assets in 2006 compared with 2005 was principally due to an asset impairment charge which wrote down the carrying value of long-lived depreciable assets and goodwill in the Puerto Rico operations, as explained in note 4 to the Company's 2007 audited consolidated financial statements.

Key Performance Drivers

The Company has identified several performance drivers that are key to its operating performance: (i) generating higher-quality revenues by increasing the percentage of more profitable R_x and PDS business at its facilities; (ii) improving capacity utilization and operating efficiencies at its sites; and (iii) managing the impact of changes in the foreign exchange trading relationship between the Canadian and U.S. dollar.

(i) Generating higher-quality revenues

Patheon continues to pursue its strategy of focusing resources and capital on increasing the percentage of revenues generated from providing higher-margin R_x manufacturing and pharmaceutical development services. As part of this strategy,

on December 6, 2007 the Company announced that it had entered into a definitive agreement to sell its Niagara-Burlington operations that are focused on the commercial manufacturing of OTC products. In 2007, prescription manufacturing services and pharmaceutical development services comprised 93% of revenues from continuing operations, excluding the Niagara-Burlington OTC operations, compared with 90% in 2006.

Patheon's ability to provide its clients with integrated drug development, scale-up and commercial manufacturing services across a broad range of capabilities is a unique offering and a key competitive advantage. It reduces the need for its clients to incur costly and time-consuming transfers between facilities of products in development, thereby providing strategic benefits to clients who are seeking to bring new drugs to market more quickly. From the Company's perspective, pharmaceutical development services are provided on a fee-for-service basis at relatively attractive margins, and the products being developed, if approved, can be an important source of new business for the Company's commercial manufacturing operations.

(ii) Improving capacity utilization and operating efficiency

The Company's operating sites' cost structure is largely fixed in the short term. Therefore, unanticipated fluctuations in manufacturing activity can have a significant impact on profit margins. The Company continues to focus on improving capacity utilization at all of its sites by entering into new commercial manufacturing agreements with new and existing clients. The Company also continues to evaluate how to best utilize the amount of available capacity in its network.

On April 17, 2007, the Company announced that it intends to close its York Mills site in Toronto and transfer substantially all commercial production and development services at the facility to its Whitby, Mississauga and Cincinnati sites. This closure is expected to improve profitability by reducing excess manufacturing capacity and reducing ongoing anticipated capital expenditure requirements. The transfers are expected to be completed by the end of the first half of fiscal 2009.

On December 14, 2007, the Company also announced that it intended to divest its facility in Carolina, Puerto Rico that manufactures oral cephalosporin solid dosage form products. This decision was made following a significant reduction in capacity utilization at the facility during the fourth quarter of 2007, as a result of the emergence of generic competition for Omnicef[®], the single largest volume product manufactured at the site.

Company Profile and Strategy (continued)

In 2007, the Company continued with its performance enhancement program that was initiated in 2006, with an aim of improving operating results. The program consists of three main initiatives:

- ▶ a global procurement program;
- ▶ a workforce reduction program; and
- ▶ a manufacturing efficiency review by external advisors.

The objective of the global procurement program is to leverage the Company's global purchasing power to reduce costs, reducing the number of vendors and reducing the Company's investment in working capital through better payment terms and vendor managed inventory. The Company successfully negotiated contracts which resulted in cost savings in fiscal 2007 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.

Patheon continued to reduce the size of its global workforce during 2007 by approximately 520 positions, or 9%, to approximately 5,100 full-time equivalent positions as at October 31, 2007, (approximately 4,900 at December 31, 2007). These reductions were undertaken principally in the Caguas and Carolina operations in Puerto Rico to address production volume declines.

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. In 2007, the Company extended its manufacturing efficiency review process to other sites in the Company's network, including the Toronto Region Operations, Cincinnati and Swindon sites and PDS in Canada. In 2007, follow-up audits were conducted in Whitby, Toronto Region Operations, and Cincinnati which verified improvements in production throughput and labour efficiency. A similar audit is planned for Swindon and PDS Canada in 2008. As well, by late 2007, planning had begun to identify future improvement initiatives in 2008.

(iii) Managing the impact of foreign exchange fluctuations

Because the Company's client service contracts in North America are primarily in U.S. dollars, the profitability of the Company's Canadian operations can be impacted by significant changes in the foreign exchange trading relationship between the Canadian and U.S. dollar. Approximately 70% of revenues and approximately 20% of operating expenses of the Canadian operations are transacted in U.S. dollars. The Company has to convert a portion of its net U.S. dollar inflow to Canadian dollars to finance the Canadian dollar expenses of its Canadian sites. A one-cent change in the U.S./Canadian dollar exchange rate is estimated to impact pre tax earnings by approximately \$0.9 million on an annual basis, before the impact of the hedging program. As discussed in the "Risk Management" section of this MD&A, the Company employs a hedging program to mitigate the impact of this risk.

At October 31, 2007, the balance sheet of the Company's Canadian operations included \$229.5 million of U.S. dollar denominated debt (including the debt component of the Company's convertible preferred shares). The Canadian operations are required to revalue the Canadian dollar equivalent of the U.S. dollar denominated debt at each period end. At October 31, 2007, \$141.6 million of this debt was designated as an effective hedge against the Company's investments in subsidiaries in the U.S.A. and Puerto Rico. All foreign exchange gains and losses associated with the debt that is considered to be an effective hedge are recorded in other comprehensive income. Foreign exchange gains and losses from the remaining debt are recorded in earnings. In October 2007, the Company entered into a forward foreign exchange contract to reduce the related impact on earnings. In 2007, the Company recorded foreign exchange gains, net of hedging activities, in the loss from continuing operations, in connection with this exposure of \$12.3 million.

Performance Analysis

Results of Operations

The results of operations for Niagara-Burlington have been segregated and presented separately as discontinued operations. All comparative amounts have been reclassified to conform to the current period presentation.

Results of Consolidated Operations

Years ended October 31 (in thousands of U.S. dollars, except percentages and per-share amounts)	2007 \$	2006 \$	% Change
Revenues	677,074	674,659	0%
Operating expenses	599,087	603,783	-1%
Foreign exchange gain on debt	(12,331)	—	
Earnings before the following:	90,318	70,876	27%
(as a % of revenues)	13.3%	10.5%	
Repositioning expenses	15,800	12,998	22%
Asset impairment charge	48,580	254,661	-81%
Depreciation and amortization	40,979	38,766	6%
Amortization of intangible assets	6,687	11,871	-44%
Foreign exchange loss on foreign operations	858	—	
Interest	29,167	21,333	37%
Refinancing expenses	13,471	1,643	720%
Amortization of deferred financing costs	—	944	
Write-off of deferred financing costs	—	6,332	
Loss before income taxes	(65,224)	(277,672)	77%
Provision for (recovery of) income taxes			
Current	14,617	17,725	-18%
Future	4,617	(6,678)	-169%
Provision for income taxes	19,234	11,047	74%
Loss from continuing operations	(84,458)	(288,719)	71%
(as a % of revenues)	-12.5%	-42.8%	
Earnings (loss) from discontinued operations	(10,143)	569	-1883%
Net loss for the year	(94,601)	(288,150)	67%
Basic and diluted earnings (loss) per share			
From continuing operations	(\$0.91)	(\$3.11)	71%
From discontinued operations	(\$0.11)	\$0.01	-1200%
	(\$1.02)	(\$3.10)	67%

Performance Analysis (continued)

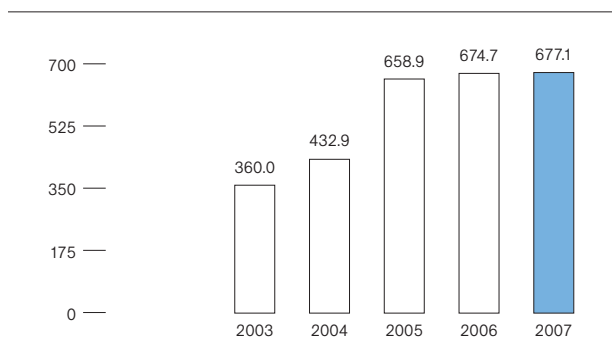
Revenues

Revenues by Geographic Region and Service Activity

Years ended October 31 (in thousands of U.S. dollars, except percentages)	2007 \$	2006 \$	% Change
NORTH AMERICA			
Commercial Manufacturing			
Prescription	270,515	309,379	-13%
Over-the-counter	43,076	66,327	-35%
	313,591	375,706	-17%
Development Services	84,532	74,986	13%
	398,123	450,692	-12%
EUROPE			
Commercial Manufacturing			
Prescription	243,554	197,353	23%
Over-the-counter	3,473	3,646	-5%
	247,027	200,999	23%
Development Services	31,924	22,968	39%
	278,951	223,967	25%
TOTAL			
Commercial Manufacturing			
Prescription	514,069	506,732	1%
Over-the-counter	46,549	69,973	-33%
	560,618	576,705	-3%
Development Services	116,456	97,954	19%
CONSOLIDATED REVENUES	677,074	674,659	0%

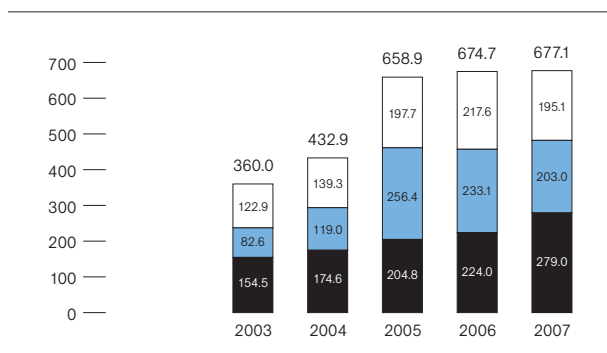
Revenues

(in millions of U.S. dollars)



Revenues by Geographic Region*

(in millions of U.S. dollars)



Canada U.S. Europe

* Based on site location

Consolidated revenues from continuing operations for the year ended October 31, 2007 increased \$2.4 million to \$677.1 million from \$674.7 million in 2006. R_x manufacturing and PDS revenues grew by 1% and 19%, respectively, while OTC manufacturing revenues declined by 33%.

For the year ended October 31, 2007, revenues excluding the Puerto Rico operations were \$577.3 million, compared with \$544.9 million in 2006.

Prescription manufacturing and development services represented 93% of revenues in 2007, compared with 90% in 2006. This improvement is consistent with one of the Company's key performance drivers of increasing the percentage of higher-margin R_x and PDS business.

Geographically, in North America, revenues for the year ended October 31, 2007 declined by \$52.6 million or 12% relative to the prior year. The decline reflected a significant reduction in OTC volumes in the Whitby and Cincinnati operations as certain clients have repatriated products back to their own manufacturing networks. R_x volumes declined in Caguas and Carolina, Puerto Rico as a result of lower production of Zocor[®] and Omnicef[®], both of which were impacted by the introduction of competitive generic products, and from lower volumes of Levothyroxine sodium, where the Company's client suffered a significant decline in market share⁽²⁾. R_x revenues were also lower in Canada principally as a result of lower volumes for a product where in 2006 the Company's client was building trade inventory levels for a newly launched product. The declines in commercial manufacturing revenues were offset in part by an increase in PDS revenues in Canada and Cincinnati.

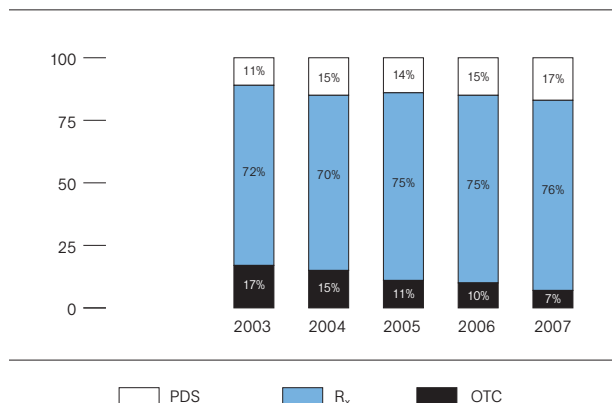
In Europe, revenues for the year ended October 31, 2007 were \$55.0 million or 25% higher than 2006. The increase in revenues reflected higher R_x manufacturing revenues from operations in Italy and France, arising from the continued benefits from two carve out initiatives, where the Company is manufacturing a range of products for two clients that have closed down facilities within their own manufacturing networks. In Swindon, U.K. the PDS operations also continued to show further increases in volumes, but these gains were offset in part by lower pre-launch commercial revenues for cephalosporin lyophilization services and production delays during the fourth quarter. In 2007, the Euro and U.K. sterling strengthened approximately 9% and 10%, respectively, against the U.S. dollar compared with the prior year, increasing reported revenues by approximately \$22.9 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 14% higher than in 2006.

Operating Expenses

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support, administrative expenses and foreign exchange gains and losses relating to operating activities. For the year ended October 31, 2007 operating expenses were \$599.1 million, compared with \$603.8 million in the same period a year ago, a decline of 1%. The decline reflects savings from the performance enhancement program, offset in part by the strengthening European and Canadian currencies relative to the U.S. dollar. Operating expenses in 2007 are net of an actuarial gain of \$4.3 million arising from a decision to phase out certain post retirement benefits in the Canadian operations.

Operating expenses as a percentage of revenues were 88.5%, compared with 89.5% in the prior year.

Revenues by Service Activity



(2) Zocor[®] is a registered trademark of Merck & Co., Inc.

Performance Analysis (continued)

Foreign Exchange Gain on Debt

The foreign exchange gain of \$12.3 million recorded in the year ended October 31, 2007 related to the revaluation of U.S. dollar denominated debt in the Canadian legal entity that is not designated as an effective hedge against its investments in subsidiaries in the U.S.A and Puerto Rico. In October 2007, the Company entered into a forward foreign exchange contract to reduce the future related impact on earnings.

EBITDA Before Repositioning Expenses and EBITDA Margin Before Repositioning Expenses

In 2007, EBITDA before repositioning expenses, representing earnings from continuing operations before repositioning expenses, asset impairment charges, depreciation and amortization, foreign exchange losses reclassified from other comprehensive income, interest, refinancing expenses, write-off of deferred financing costs, and income taxes was \$90.3 million, an increase of \$19.4 million, or 27%, from 2006. EBITDA margin before repositioning expenses was 13.3% in 2007, compared with 10.5% in 2006.

For the year ended October 31, 2007, EBITDA before repositioning expenses excluding the Puerto Rico operations was \$108.6 million, compared with \$69.5 million in the same period last year. This represented an EBITDA margin before repositioning expenses of 18.8% in 2007, compared with 12.7% in 2006.

The Canadian commercial operations reported EBITDA before repositioning expenses of \$29.5 million in 2007, or \$6.9 million higher than in 2006. This improvement was achieved despite lower R_x and OTC volumes and reflected savings from the

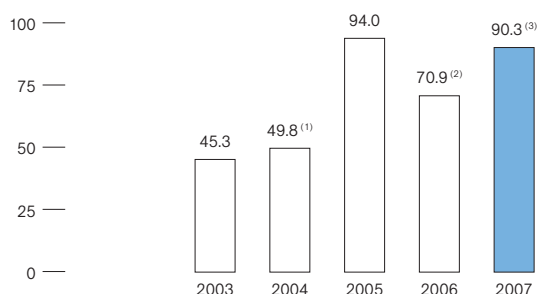
performance enhancement program, in particular at the Whitby operations. The improvement also included a significant portion of the actuarial gains arising from a change in the Company's post retirement benefit plans. EBITDA before repositioning expenses was not significantly impacted by foreign exchange, as the negative earnings impact of the 3% increase in the average Canadian dollar exchange rate relative to the U.S. dollar was offset by foreign exchange gains from the Company's cash flow hedging program.

EBITDA before repositioning expenses from the U.S.A. commercial operations (including Puerto Rico) in 2007 was a loss of \$7.2 million, compared with a profit of \$14.0 million in 2006. The decline principally reflects a reduction in R_x manufacturing volumes in the Caguas facility in Puerto Rico. In Carolina, volume declines were offset by benefits from the performance enhancement program. In Cincinnati, volume declines were offset by savings from the performance enhancement program and a change in the revenue mix to higher margin R_x business.

In Europe, EBITDA before repositioning expenses from commercial operations in 2007 was \$36.9 million, being \$10.1 million higher than in 2006. The improvement reflects increased volumes in the operations in Italy and France, offset in part in Swindon by lower pre-launch revenues for the cephalosporin lyophilization services, fourth quarter production delays and foreign exchange losses. The stronger European currencies relative to the U.S. dollar compared with the same period last year also had the impact of increasing EBITDA before repositioning expenses by approximately \$2.9 million.

EBITDA Before Repositioning Expenses

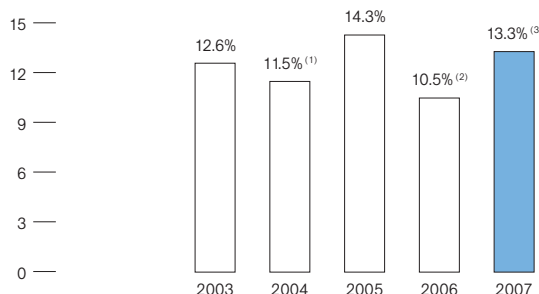
(in millions of U.S. dollars)



- (1) Before Swindon, U.K. repositioning expenses of \$4.4 million
- (2) Before global repositioning expenses of \$13.0 million
- (3) Before global repositioning expenses of \$15.8 million

EBITDA Margin Before Repositioning Expenses

(% of revenues)



- (1) Before Swindon, U.K. repositioning expenses of \$4.4 million
- (2) Before global repositioning expenses of \$13.0 million
- (3) Before global repositioning expenses of \$15.8 million

EBITDA before repositioning expenses from the global PDS operations in 2007 was \$30.7 million, being \$10.7 million higher than in 2006. The improved profitability was a result of growing volumes across all operations.

Corporate costs in 2007 reflected a net recovery of \$0.4 million, compared with costs of \$12.4 million in 2006. The 2007 recovery included foreign exchange gains of \$12.3 million arising from the revaluation of U.S. dollar denominated debt, net of hedging activities, held in the Canadian legal entity. In October 2007, the Company hedged its net U.S. dollar balance sheet exposure, which is expected to reduce future volatility.

Repositioning Expenses

In 2007, the Company incurred repositioning expenses of \$15.8 million in connection with its performance enhancement program, the site rationalization program in Puerto Rico and Canada and its review of strategic and financial alternatives. The expenses included consulting fees associated with the manufacturing efficiency review, costs associated with reductions in the workforce and professional and other costs in connection with the strategic alternatives review.

In 2006, the Company incurred \$13.8 million of expenses in connection with its performance enhancement program, amendments to its North American bank financing facilities and its review of strategic and financial alternatives. The expenses included costs associated with a reduction in the workforce and consulting and professional fees.

Asset Impairment Charge

In 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[®], 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 \$48.6 million; \$26.1 million for intangible assets and \$22.5 million 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.

In 2006, the Company determined that the carrying value of the long-lived depreciable assets at the Company's operations in Caguas and Manati, Puerto Rico and the goodwill associated with all of the Puerto Rico operations were impaired as a result of certain events which occurred during the third quarter of 2006. These events included: continued deterioration in revenues culminating in a significant increase in losses reported in the third quarter of 2006; 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 at 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 \$81.4 million; \$51.9 million for intangible assets and \$29.5 million 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.

In 2006, the Company also tested the recoverability of the goodwill associated with Puerto Rico operations using a discounted cash flow methodology, and recorded an impairment charge of \$172.5 million representing the full value of the Puerto Rico goodwill.

In 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 \$0.8 million to its market value as of July 31, 2006.

Performance Analysis (continued)

Depreciation and Amortization Expense

Depreciation and amortization expense, excluding amortization of intangible assets, was \$41.0 million in 2007, compared with \$38.8 million in 2006, an increase of \$2.2 million, or 6%. The increase principally reflected the effect of the strengthening European and Canadian currencies relative to the U.S. dollar, offset in part by lower depreciation charges from the Puerto Rico operations as a result of the impairment charges recorded in 2007 and 2006. Depreciation and amortization expense includes the amortization of deferred pre-operating costs.

Amortization of Intangible Assets

The amortization of intangible assets was \$6.7 million in 2007, compared with \$11.9 million in 2006. The amortization of intangible assets relates to the Puerto Rico operations. The charge was lower than for the same period last year due to the impact of the impairment charges recorded during the third quarters of 2007 and 2006.

Foreign Exchange Loss on Foreign Operations

In 2007, the Company recorded a net foreign exchange loss of \$0.9 million. This reflected the recognition of net foreign exchange translation losses previously recorded in accumulated other comprehensive income, arising from a change in the Company's internal capital structure.

Interest Expense and Amortization of Deferred Financing Costs

The interest expense in 2007 was \$29.2 million, compared with \$21.3 million in 2006. The increase in interest costs in the first half of the year reflected higher debt levels, along with increased borrowing costs as a result of the amendments to the Company's North American loan facilities. The interest expense in the second half of 2007 reflected the impact of the Company's refinancing that was completed on April 27, 2007 and included a non-cash accretive interest charge of \$7.1 million in respect of the debt component of the convertible preferred shares.

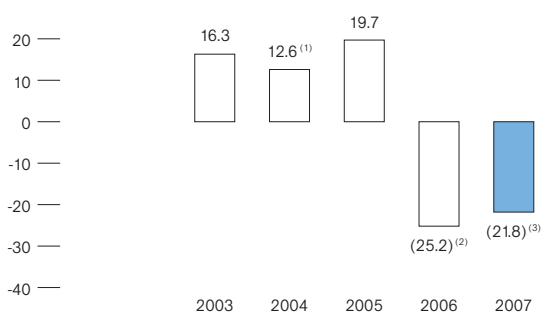
In 2007, the Company adopted CICA Accounting Standard Section 3855 for the accounting of financial instruments, including its policy on deferring costs of obtaining bank and other debt financing (see "Critical Accounting Policies and Estimates"). As a result, amounts that in prior periods were recorded as amortization of deferred financing costs are now recorded in interest expense.

Refinancing Expenses and Write-off of Deferred Financing Costs

In 2007, refinancing expenses of \$13.5 million were incurred in connection with the Company's refinancing that took place on April 27, 2007 (see "Recent Developments"). The expenses were made up of transaction costs for the new credit facilities, transaction costs allocated to the debt portion of the convertible preferred shares and repayment charges in connection with the cancellation of certain of the Company's U.K. debt facilities.

Net Earnings (Loss) From Continuing Operations Before Repositioning Expenses and Asset Impairment Charge

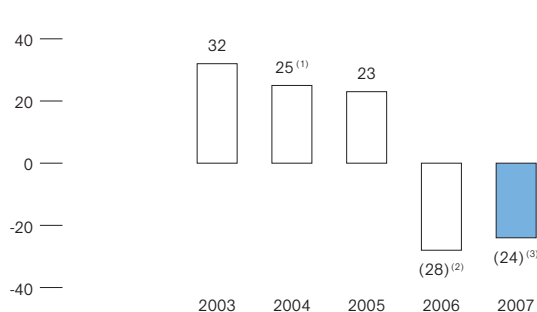
(in millions of U.S. dollars)



- (1) Before Swindon U.K. repositioning expenses of \$3.1 million after tax
- (2) Before global repositioning expenses of \$11.4 million after tax and an asset impairment charge of \$252.1 million after tax
- (3) Before global repositioning expenses of \$14.9 million after tax and an asset impairment charge of \$47.8 million after tax

EPS – Basic (Before Repositioning Expenses and Asset Impairment Charge)

(in U.S. cents)



- (1) Before Swindon, U.K. repositioning expenses of 6 cents per share after tax
- (2) Before global repositioning expenses of 12 cents per share after tax and an asset impairment charge of \$2.71 after tax
- (3) Before global repositioning expenses of 16 cents per share after tax and an asset impairment charge of 51 cents per share after tax

In 2006, the Company incurred charges of \$1.6 million in connection with the cancellation and prepayment of certain of its North American credit facilities. The Company also wrote off \$6.3 million in related deferred financing costs.

Loss Before Income Taxes from Continuing Operations

The Company reported a loss before income taxes of \$65.2 million for the year ended October 31, 2007, compared with a loss before income taxes of \$277.7 million in 2006.

Income Taxes

The income tax expense for the year ended October 31, 2007 was \$19.2 million, compared with \$11.0 million in 2006. The income tax charge in 2007 principally reflected high tax rates in Italy where the Company reported increased taxable income, compounded by tax losses in certain entities in Puerto Rico and Canada, where the tax benefit after valuation reserves was not recognized. The 2007 expense included a charge of \$2.1 million in connection with an inter-company dividend payment and a charge of \$1.9 million in connection with the transfer of net foreign exchange losses from accumulated other comprehensive income. The 2006 charge included a valuation reserve charge of \$6.4 million against future tax asset balances in the Canadian operations.

Loss and Loss Per Share from Continuing Operations

The Company recorded a loss from continuing operations for the year ended October 31, 2007 of \$84.5 million, compared with a loss of \$288.7 million in the same period a year ago. The loss per share was 91¢ compared with \$3.11 a year earlier. The loss in 2007 included an after tax asset impairment charge of \$47.8 million, or 51¢ per share, after tax repositioning expenses of \$14.9 million, or 16¢ per share and after tax refinancing expenses of \$12.6 million, or 14¢ per share. The loss in 2006 included an after tax asset impairment charge of \$252.1 million, or \$2.71 per share, after tax repositioning expenses of \$11.4 million or 12¢ per share and after tax refinancing expenses and charges for the write-off of deferred financing costs of \$6.2 million, or 7¢ per share.

Earnings (Loss) and Earnings (Loss) Per Share from Discontinued Operations

Discontinued operations include the results of the Niagara-Burlington Operations. The results from discontinued operations for the years ended October 31, 2007 and 2006 were as follows:

Years ended October 31 (in thousands of U.S. dollars)	2007 \$	2006 \$
Revenues	35,244	37,493
Operating expenses	32,475	34,580
Earnings before the following:	2,769	2,913
(as a % of revenues)	7.9%	7.8%
Asset impairment charge	12,465	–
Repositioning expenses (recovery of)	(397)	789
Depreciation and amortization	844	1,112
Earnings (loss) before income taxes	(10,143)	1,012
Provision for income taxes	–	443
Earnings (loss) from discontinued operations for the year	(10,143)	569

The net loss from discontinued operations for the year ended October 31, 2007 was \$10.1 million, or 10.9¢ per share compared with net earnings of \$0.6 million or 1¢ per share in 2006. The net loss in 2007 included an asset impairment charge of \$12.5 million, or 13¢ per share to write down the capital assets to their fair market value less the estimated cost to sell.

Net Loss and Loss Per Share

The Company recorded a net loss for the year ended October 31, 2007 of \$94.6 million or \$1.02 per share, compared with a loss of \$288.2 million or \$3.10 per share in 2006.

Because the Company reported a loss in the years ended October 31, 2007 and 2006 there is no impact of dilution.

Performance Analysis (continued)

Selected Quarterly Financial Information

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

Quarter ended (in thousands of U.S. dollars, except per share amounts)	Revenues \$	EBITDA Before Repositioning Expenses \$	Net Earnings (Loss) From Continuing Operations \$	Basic and Diluted Earnings (Loss) Per Share From Continuing Operations \$	Net Earnings (Loss) \$	Basic and Diluted Earnings (Loss) Per Share \$
2007						
January 31	162,808	22,793	(2,188)	(\$0.02)	(2,024)	(\$0.02)
April 30	171,966	23,153	(22,552)	(\$0.24)	(21,986)	(\$0.24)
July 31	175,508	23,138	(50,668)	(\$0.55)	(63,069)	(\$0.68)
October 31	166,792	21,234	(9,050)	(\$0.10)	(7,522)	(\$0.08)
	677,074	90,318	(84,458)	(\$0.91)	(94,601)	(\$1.02)
2006						
January 31	150,013	13,880	(11,408)	(\$0.12)	(11,510)	(\$0.12)
April 30	180,157	23,244	2,549	\$0.03	2,989	\$0.03
July 31	178,739	14,990	(257,698)	(\$2.78)	(257,213)	(\$2.77)
October 31	165,750	18,762	(22,162)	(\$0.24)	(22,416)	(\$0.24)
	674,659	70,876	(288,719)	(\$3.11)	(288,150)	(\$3.10)

The loss from continuing operations in the quarter ended April 30, 2007 included after tax asset refinancing expenses of \$14.9 million or 16¢ per share. The loss from continuing operations in the quarter ended July 31, 2007 included an after tax asset impairment charge of \$47.8 million or 51¢ per share. The loss from continuing operations for the quarter ended January 31, 2006 included refinancing expenses and charges for the write-off of deferred financing costs of \$6.2 million, or 7¢ per share. The loss from continuing operations for the quarter ending July 31, 2006 included an after tax asset impairment charge of \$252.1 million, or \$2.71 per share. The loss from continuing operations for the quarter ending October 31, 2006 included an after tax charge for repositioning expenses of \$11.4 million, or 12¢ per share.

Seasonal Variability of Results

Historically, the Company's manufacturing and PDS revenues typically have been lower in the first fiscal quarter. The Company 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 shut-down during a portion of the traditional holiday period in December and January. Revenues in the fourth fiscal quarter are also typically impacted by summer shut downs during August in the European operations.

Outlook for 2008

Due to normal shut downs during December and other seasonal factors, revenues from continuing operations in the first quarter of 2008 are anticipated to be lower than the fourth quarter of 2007. Revenues from continuing operations for fiscal 2008 are expected to be comparable to 2007. This expectation is based on internal management forecasts, which in turn are based on client purchase orders and forecasts of anticipated demand and other factors. These internal management forecasts were prepared for internal planning purposes and may not be appropriate for forecasting future financial results or for other purposes.

Liquidity and Capital Resources

Summary of Cash Flows

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

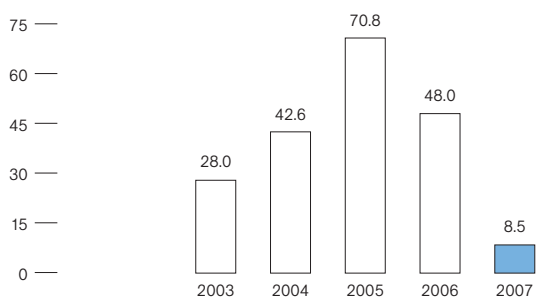
(in thousands of U.S. dollars)	2007 \$	2006 \$
Loss from continuing operations	(84,458)	(288,719)
Asset impairment charge	48,580	254,661
Depreciation and amortization	47,666	50,637
Foreign exchange loss on foreign operations	858	—
Foreign exchange gain on debt	(12,331)	—
Accreted interest on convertible preferred shares	7,054	—
Write-off of deferred financing costs	—	6,332
Amortization of deferred financing costs	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
Working capital	(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
Cash used in investing activities	(39,938)	(69,752)
Cash provided by financing activities	4,221	44,460
Other	3,960	1,278
Net increase (decrease) in cash and cash equivalents	(20,166)	28,216

Cash Provided by Operating Activities

Cash provided by operating activities from continuing operations was \$8.5 million in 2007, compared with \$48.0 million in 2006. The deterioration reflects lower earnings before non-cash charges. Cash flows in 2006 also benefitted from a net reduction in the investment in working capital of \$20.5 million, compared with an increase in working capital of \$2.4 million in 2007. In 2007, the Company received \$2.1 million from clients to assist in the funding of capital expenditure projects that are tied to specific manufacturing and supply

Cash Provided by Operating Activities of Continuing Operations

(in millions of U.S. dollars)



Performance Analysis (continued)

agreements. This compares with \$9.6 million that was received in 2006. These amounts are recorded as an increase in deferred revenues and will be recognized as income over the life of the commercial manufacturing contract.

Cash provided by operating activities of discontinued operations in 2007 was \$3.1 million, compared with \$4.2 million in 2006. The reduction principally reflected an additional benefit from reduced working capital in 2006 relative to 2007.

Cash Used in Investing Activities

The following table summarizes the cash used in investing activities for the periods indicated:

(in thousands of U.S. dollars)	2007 \$	2006 \$
Additions to capital assets		
Sustaining	(18,034)	(16,975)
Project-related	(17,768)	(49,617)
Total 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)

Cash used in investing activities from continuing operations in 2007 was \$39.7 million, compared with \$68.8 million in 2006. The decrease principally reflected lower project-related capital expenditures on the cephalosporin lyophilization capacity in the Swindon, U.K. facility. The major expenditures for this expansion were incurred in 2006. The increase in deferred pre-operating costs of \$3.7 million in 2007 related to the lyophilized cephalosporin facility in Swindon, U.K. Deferred pre-operating costs are amortized over a period of five years from the date of start-up.

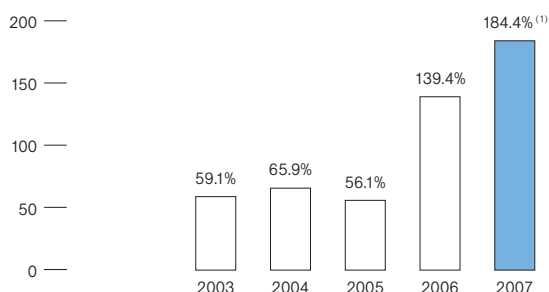
The Company's principal ongoing investment activities are sustaining and project-related capital programs at its network of sites. The majority of the Company's capital allocation is normally invested in project-related programs, which are defined as outlays that will generate growth in capacity and revenues, while sustaining expenditures relate to the preservation of existing assets and capacity. The Company invested \$35.8 million in capital expenditures in 2007 compared with \$66.6 million in 2006, of which project-related expenditures were \$17.8 million in 2007 and \$49.6 million in 2006.

During 2007, the Company's major project-related programs (in millions) were:

- ▶ Swindon facility in U.K., in connection with the construction of a facility for the manufacture of sterile lyophilized cephalosporin products \$5.3
- ▶ Cincinnati facility in U.S.A., installation of an intermediate-scale process train \$1.3

Capital commitments to complete authorized capital projects were \$15.8 million at October 31, 2007. Based on current internal projections, these expenditures are expected to be incurred during the fiscal year ending October 31, 2008. These

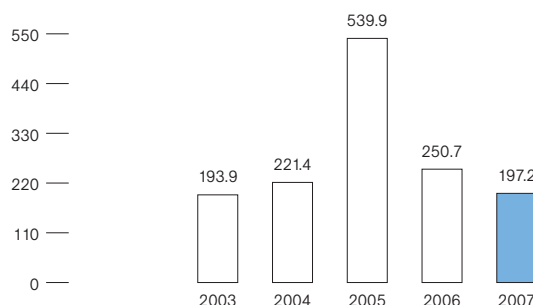
Interest-Bearing Debt to Shareholders' Equity



(1) Interest-bearing debt includes the debt component of convertible preferred shares of \$139.9 million

Shareholders' Equity

(in millions of U.S. dollars)



expenditures will be financed from cash flows from operations, existing cash reserves and credit facilities and from a new capital lease that has been negotiated.

Project-related capital expenditures in fiscal 2008 are expected to be higher than in 2007. The major project-related capital programs currently anticipated for 2008 consist of:

- ▶ Plant expansion in Whitby, Ontario to support the consolidation of the York Mills operations;
- ▶ Plant expansion at the Toronto Region Operations, Ontario to support additional capacity for oral contraceptive products;
- ▶ Swindon, U.K. facility, completion of the lyophilized cephalosporin project; and
- ▶ Cincinnati facility in U.S.A., continuing costs for installation of the intermediate-scale process train.

Cash Provided by Financing Activities

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

(in thousands of U.S. dollars)	2007 \$	2006 \$
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	150,000	–
Convertible preferred share issue costs – equity component	(1,213)	–
Issue of restricted voting shares	24	127
Repurchase of restricted voting shares	(8,778)	–
Decrease in restricted cash	–	7,805
Increase in deferred financing costs	–	(3,965)
Cash provided by financing activities	4,221	44,460

The principal financing activity for the year ended October 31, 2007 was the issue, through a private placement, of \$150 million of convertible preferred shares of the Company to JLL Partners and the completion of new credit facilities in the aggregate amount of \$225 million, comprising of a seven-year \$150 million term loan and a five-year \$75 million revolving facility. The net proceeds from the JLL Partners investment and the seven-year term loan were used to repay the Company's obligations under its existing North American and U.K. credit facilities.

In 2007, the Company also used \$8.8 million of cash to repurchase 2,334,300 of its restricted voting shares under a normal course issuer bid.

The principal financing activity for the year ended October 31, 2006 was the completion of new credit facilities in North America in the aggregate amount of \$290.0 million (\$275.0 million as amended) to refinance existing debt of the Company and its U.S. subsidiaries (including those in Puerto Rico). These facilities were subsequently replaced in 2007. During 2006, the Company's Italian subsidiary also entered into a new long-term debt facility in the amount of 28.5 million euros (\$33.9 million) to replace existing loans.

Financing Arrangements

Convertible Preferred Shares

The \$150 million 8.5% convertible preferred shares purchased by JLL Partners on April 27, 2007 represent 150,000 units, each consisting of one Class I Preferred Share, Series C (a convertible preferred share) and one Class I Preferred Share, Series D (a special voting preferred share) at a purchase price of \$1,000 per unit.

Until October 27, 2009, no cash dividends will be paid, 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 of the convertible preferred shares, 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 was convertible into 218.7154 Patheon 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 convertible preferred shares were convertible into approximately 32.8 million

Performance Analysis (continued)

restricted voting shares of the Company, which would represent approximately 27% of the restricted voting shares outstanding as at that date, after giving effect to such conversion. The special voting preferred shares have the right to appoint up to three directors.

The convertible preferred shares are considered to be a compound financial instrument with both a debt and equity component. On issuance, the fair value of the debt component was \$132.9 million. The remainder of the proceeds, attributable to shareholders' equity was \$15.9 million, net of apportioned transaction costs of \$1.2 million. (See Convertible Preferred Shares in "Critical Accounting Policies and Estimates"). At October 31, 2007 the carrying value of the debt component of the convertible preferred shares was \$139.9 million.

\$225 Million Credit Facilities

On April 27, 2007 the Company completed new credit facilities in the aggregate amount of \$225 million, comprising a seven-year \$150 million senior secured term loan and a five-year \$75 million asset based revolving credit facility. The Company is required to make quarterly installment payments of \$375,000 on the term loan facility, along with additional mandatory repayments based on certain excess cash flow measures. Interest on the facilities is at floating rates based on LIBOR, US or CAD prime, or the federal funds effective rate, plus applicable margins. 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. The facilities are secured 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. At October 31, 2007 the balance on the senior secured term loan was \$149.3 million and \$6.7 million was drawn on the revolving credit facility, including letters of credit of \$4.2 million.

Financing Ratios

Total interest-bearing debt at October 31, 2007 was \$363.7 million, being \$14.1 million higher than at October 31, 2006. Total interest-bearing debt in 2007 includes the debt component of the convertible preferred shares of \$139.9 million, as the consolidated financial statements include an accretive interest expense in relation to this liability. The Company has no obligation to pay cash dividends on the convertible preference shares until after October 27, 2009, at which time the Company can elect to increase the liquidation preference and conversion rate of the convertible preferred shares rather than paying a cash dividend. At October 31, 2007, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 184.4%, compared with 139.4% at October 31, 2006. The increase principally reflects the reduction in shareholders' equity arising from the losses that the Company has incurred in the twelve months ended October 31, 2007.

The following table summarizes the fixed and variable percentages of debt outstanding at October 31, 2007, including the debt component of the convertible preferred shares, and the applicable interest rates at the end of each quarter in 2007. The 2007 numbers reflect the impact of interest rate swap contracts that the Company has entered into:

	% of Debt Outstanding		Interest Rates at End of Each Quarter in 2007			
	2007	2006	Q4	Q3	Q2	Q1
Fixed rate	81%	7%				
Variable rate based on:						
Prime - Canada	0%	7%	6.25%	6.25%	6.00%	6.00%
U.S. base rate	0%	2%	8.25%	8.75%	8.75%	8.75%
U.S. LIBOR (1 month)	1%	61%	4.71%	5.32%	5.32%	5.32%
Euribor (3 months)	18%	19%	4.60%	4.26%	4.02%	3.78%
U.K. LIBOR	0%	3%	6.28%	6.04%	5.73%	5.59%
U.K. base rate	0%	1%	5.75%	5.75%	5.25%	5.25%

Contractual Obligations

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

(in thousands of U.S. dollars)	Total	Payments Due by Period			
		Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt	219,411	11,902	21,521	23,507	162,481
Operating leases	11,354	3,113	4,872	2,806	563
Purchase obligations	15,804	15,804	-	-	-
Total contractual obligations	246,569	30,819	26,393	26,313	163,044

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

Obligations with Respect to Employee Future Benefit Plans

The Company's obligations as at October 31, 2007 with respect to employee future benefit plans were:

(in thousands of U.S. dollars)	Defined Benefit Pension Plans	Other Benefit Plans	Total
Projected benefit obligations	81,241	6,809	88,050
Less plan assets	(67,311)	–	(67,311)
Unfunded amount	13,930	6,809	20,739
Unrecognized past service costs and net actuarial losses	7,265	400	7,665
Amount included in other long-term liabilities	6,665	6,409	13,074

The Company also provides retirement benefits for the majority of its employees at its Canadian, U.S. and Puerto Rican sites under a defined contribution plan. The total expense for the plan amounted to \$7.1 million in 2007 (2006 – \$7.6 million). Please refer to note 15 to the consolidated financial statements for further information with respect to the Company's employee future benefit plans.

Off-balance Sheet Arrangements

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

Adequacy of Financial Resources

With the completion of the new financing arrangements on April 27, 2007, including the issuance of the convertible preferred shares, the Company believes that, subject to usual business risks as further described in the Risk Management section, its financial resources are sufficient to fund projected capital expenditures, debt service requirements and employee future benefit obligations in the normal course of business. As at October 31, 2007, the Company had cash balances of \$30.6 million and \$85.7 million in undrawn credit facilities available to it. At October 31, 2007, the Company was in compliance with all covenant requirements under its financing arrangements. The risks associated with going concern uncertainty reported in the Company's 2006 Annual Report have been eliminated.

Additional Information

Share Capital

As of December 31, 2007, the Company had outstanding 90,624,388 restricted voting shares and 150,000 Class I preferred shares consisting of 150,000 Class I Series C convertible preferred shares and 150,000 Class I Series D special voting shares. At December 31, 2007 the Company had 5,675,916 stock options outstanding of which 4,192,582 were exercisable. Please refer to note 16 to the consolidated financial statements for further information.

Related Party Transactions

Revenues from companies controlled by a director and significant shareholder of the Company were in the amount of \$0.5 million in 2007 (2006 – \$3.1 million). 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 \$0.4 million (2006 – \$0.5) with respect to these related party transactions.

At October 31, 2007, the Company has an investment of \$0.7 million (2006 – \$0.2) 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 \$1.6 million 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.

Risk Management and Accounting Policies

Risk Management

A comprehensive list of risk factors that may affect the Company are set out in the Company's most recent Annual Information Form.

Patheon applies rigorous assessment, mitigation and management practices to seek to reduce the extent of the operational, financial, regulatory and legal risks affecting its business.

Contractual Arrangements

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

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

Foreign Currency

The Company's business activities are conducted in several currencies – Canadian dollars and U.S. dollars for the Canadian operations, U.S. dollars for the U.S. operations and euros and U.K. sterling for the European operations.

Since the European and U.S. operations conduct business principally in their respective local currencies, the exposure to foreign currency gains and losses is not significant. However, the Company's Canadian operations negotiate sales contracts for

payment in both U.S. and Canadian dollars, and materials and equipment are purchased in both U.S. and Canadian dollars. The majority of its non-material costs (including payroll, facilities costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars. Approximately 70% of revenues of the Canadian operations and approximately 20% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience trading and translation gains or losses because of volatility in the exchange rate between the Canadian and U.S. dollar. Based on the Company's current U.S. denominated net inflows, for each one-cent change in the Canadian-U.S. rate, the impact on annual pre-tax earnings is approximately \$0.9 million.

The Company mitigates this foreign exchange risk by engaging in foreign currency hedging activities using derivative financial instruments. At October 31, 2007, the Company had outstanding foreign exchange forward contracts to sell U.S.\$34.2 million at an exchange rate of \$1.0535 Canadian. The contracts mature at the latest on April 21, 2008 and cover approximately 75% of the Company's expected foreign exchange exposure for the first half of the 2008 fiscal year.

At October 31, 2007, the balance sheet of the Company's Canadian operations included \$229.5 million of U.S. dollar denominated debt (including the debt component of the Company's convertible preferred shares). The Canadian operations are required to revalue the Canadian dollar equivalent of the U.S. dollar denominated debt at each period end. At October 31, 2007, \$141.6 million of this debt was designated as an effective hedge against the Company's investments in subsidiaries in the U.S.A. and Puerto Rico. All foreign exchange gains and losses associated with the debt that is considered to be an effective hedge are recorded in other comprehensive income. Foreign exchange gains and losses from the remaining debt are recorded in earnings and are offset in part by gains and losses on the revaluation of U.S. dollar denominated cash and receivables. In order to mitigate future earnings volatility, the Company has entered into a foreign exchange forward contract to buy U.S.\$45.0 million at an exchange rate of \$1.0015 Canadian. The mark-to-market value at October 31, 2007 that was recorded in earnings is an unrealized loss of \$2.7 million.

Translation gains and losses related to the carrying value of the Company's non U.S. dollar denominated foreign operations are deferred and included in accumulated other comprehensive income in shareholders' equity.

The Company does not purchase any derivative instruments for speculative purposes.

Product Liability Claims

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

Interest Rate Exposure

The Company has exposure to movements in interest rates. The Company has entered into interest rate swaps to convert the interest expense on its senior secured term loan from a floating interest rate to a fixed interest rate until March 2010. Taking this interest rate swap into account, 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, a 1% change in floating interest rates would have an impact on annual pre-tax earnings of approximately \$0.7 million.

Credit and Client Concentration

The Company, in the normal course of business, monitors the financial condition of its clients and reviews the credit history of each new client. The Company establishes an allowance for doubtful accounts that corresponds to the specific credit risk of its clients, historical trends and economic circumstances. During the year ended October 31, 2007, one client (2006 – two) accounted for more than 10% of the Company's total revenues. As a percentage of revenues from continuing operations this client amounted to 13% (2006 – 13% and 12%).

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

- (a) the negotiation of long-term manufacturing agreements with these clients;
- (b) the diversity of products and projects undertaken by Patheon; and
- (c) the expansion of PDS units in both Europe and North America; by increasing the variety of service activities, the Company is increasing its client base, thereby lowering the risk of depending on a small number of clients for a significant portion of its revenues.

Environmental and Health and Safety Risks

The Company has a commitment to safeguard the health of employees and the quality of the environment. Highly qualified environmental, health and safety professionals at all Company locations are dedicated to the maintenance and improvement of programs and procedures to ensure continued employee and environmental protection. To the best of the Company's knowledge, all of its facilities are in compliance with environmental and occupational health and safety regulations.

Regulatory Matters Affecting Manufacturing and Pharmaceutical Development Services

The Company is required to comply with the regulatory requirements of the national and international regulatory bodies having jurisdiction in the countries where it manufactures products or where its clients' products are distributed. As a result, most of the Company's facilities are subject to regulation by the FDA, and certain facilities are subject to regulation by the Health Products and Food Branch (Canada), the Medicines and Healthcare Products Regulatory Agency (United Kingdom), the European Medicines Evaluation Agency (Europe) and other regulatory bodies. These regulatory requirements impact many aspects of the Company's operations, including manufacturing, labeling, packaging, adverse event reporting, storage and record keeping related to clients' products. In addition, if new legislation or regulations are enacted or existing legislation or regulations are amended or are interpreted or enforced differently, the Company may be required to obtain additional approvals or operate according to different manufacturing standards. This may require the Company to change its manufacturing techniques or make capital improvements to its facilities. There can be no assurance that the Company will be able to meet all of the applicable regulatory requirements in the future. If the company fails to comply with applicable regulatory requirements, it may be subject to fines, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, debarment, exclusion, disgorgement of profits, operating restrictions and criminal prosecutions, as well as the loss of contracts and resulting revenue losses. In addition, such failure to comply could expose the Company to contractual and product liability claims, including claims for reimbursement by clients for lost or damaged active pharmaceutical ingredients, the cost of which could be significant.

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

Risk Management and Accounting Policies (continued)

Critical Accounting Policies and Estimates

General

The Accounting Policies have been reviewed and discussed with the Company's Audit Committee and are described in note 2 to the audited consolidated financial statements. The most critical of these policies are those related to revenue recognition, deferred revenues, impairment of long-lived depreciable assets, convertible preferred shares, employee future benefits and income taxes (notes 2, 4, 13, 15, 16 and 18 of the audited consolidated financial statements).

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

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 accrual 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.

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 cash flow 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. Changes in the fair value of the foreign denominated debt that is designated as an effective hedge of the net investments in foreign operations are recognized in other comprehensive income. Changes in the fair value of the foreign denominated debt that is not considered to be an effective hedge are recorded in earnings (loss).

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 earnings (loss) in the period in which the hedged item affects the 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 earnings (loss) upon the repatriation, reduction or disposal of the investment in the foreign operation.

Impact of Changes in Accounting Policy

On transition to the new accounting standards, deferred after tax gains from interest rate swaps of \$0.7 million and after tax losses on the fair value of foreign exchange cash flow hedges of \$1.4 million 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 \$36.1 million 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 period 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 \$1.7 million. 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 \$11.9 million.

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. Customer deposits on pharmaceutical development services in progress are included in accounts payable and accrued liabilities.

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

Risk Management and Accounting Policies (continued)

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. During 2007, \$2.0 million was recognized as earnings and \$2.1 million was received as a capital expenditure reimbursement.

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. In 2007 the Company recorded an impairment charge of \$48.6 million.

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. In 2007, the interest cost recognized in respect of the debt component of the preferred shares was \$7.1 million.

Employee Future Benefits

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 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 determination of the obligation and expense for defined benefit pensions and other post-employment benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are disclosed in note 15 to the Company's 2007 audited consolidated financial statements. In 2007, the Company recorded a net expense of \$1.8 million in connection with its defined benefit pension and other post-employment benefit pension plans. This included a curtailment gain of \$4.3 million in connection with a decision made to phase out benefits under one of the Company's post-employment benefit plans.

The cost of defined contribution pension plans is charged to earnings as funds are contributed by the Company. In 2007, the Company recorded an expense of \$7.2 million in connection with these plans.

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.

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

Future tax assets of \$31.1 million have been recorded at October 31, 2007. This consists primarily of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, the tax benefit of net operating loss carryforwards related to the U.K. operations, unclaimed R&D expenditures and deferred financing and share issue costs. The Company evaluates quarterly the ability to realize its future tax assets. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets.

Future tax liabilities of \$47.6 million have been recorded at October 31, 2007. This liability has arisen primarily on tax depreciation in excess of book depreciation.

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

Effectiveness of Disclosure Controls and Internal Controls

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), on a timely basis so that appropriate decisions can be made regarding public disclosure. An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of October 31, 2007 by and under the supervision of the Company's management, including the CEO and the CFO. Based on this evaluation, the CEO and the CFO have concluded that the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings of the Canadian Securities Administrators) are effective to ensure that the information required to be disclosed in reports that the Company files or submits under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in such legislation.

Under the supervision of the CEO and CFO, the Company has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. This design evaluation included documentation activities, management inquiries and other reviews as deemed appropriate by management in consideration of the size and nature of the Company's business. There were no changes in the Company's internal controls over financial reporting during the most recent interim period that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

Five-Year Financial Summary

Years ended October 31 (in thousands of U.S. dollars, except share information, per-share amounts and percentages)	2007 \$	2006 \$	2005 \$	2004 \$	2003 \$
REVENUES AND NET EARNINGS (LOSS)					
Revenues	677,074	674,659	658,856	432,937	360,025
EBITDA before repositioning expenses ⁽¹⁾	90,318	70,876	94,008	49,807	45,276
(% of revenues)	13.3%	10.5%	14.3%	11.5%	12.6%
Repositioning expenses	15,800	12,998	–	4,407	–
Asset impairment charge	48,580	254,661	–	–	–
Depreciation, amortization, and write off of deferred financing costs	47,666	57,913	50,385	21,813	15,451
Gain on sale of land	–	–	(4,587)	–	–
Interest, debt prepayment charges, refinancing expenses and foreign exchange loss on foreign operations	43,496	22,976	16,449	5,609	4,508
Provision for income taxes	19,234	11,047	12,068	8,440	8,993
Earnings (loss) from continuing operations	(84,458)	(288,719)	19,693	9,538	16,324
(% of revenues)	–12.5%	–42.8%	3.0%	2.2%	4.5%
Earnings (loss) from discontinued operations	(10,143)	569	1,928	1,140	2,254
Net earnings (loss) for the year	(94,601)	(288,150)	21,621	10,678	18,578
Earnings (loss) per share – diluted	(\$1.02)	(\$ 3.10)	\$0.25	\$0.21	\$0.36
From continuing operations	(\$0.91)	(\$ 3.11)	\$0.23	\$0.19	\$0.32
From discontinued operations	(\$0.11)	\$0.01	\$0.02	\$0.02	\$0.04
Number of shares (000s)					
Outstanding at October 31	90,625	92,951	92,846	51,556	51,506
Weighted average for the year – basic	92,834	92,868	86,828	51,521	51,384
FINANCIAL POSITION					
Current assets	272,277	255,441	251,034	165,491	149,258
Current liabilities	191,705	431,206	160,434	138,167	110,913
Working capital	80,572	(175,765)	90,600	27,324	38,345
Total assets	829,617	826,183	1,051,568	522,583	436,860
Book value per share at year end ⁽²⁾	\$2.00	\$2.70	\$5.81	\$4.29	\$3.77
Interest-bearing debt ⁽³⁾	363,689	349,617	302,898	145,792	114,626
Shareholders' equity	197,185	250,731	539,851	221,398	193,923
Return on shareholders' equity ⁽⁴⁾	–42.2%	–72.9%	5.4%	5.2%	11.4%
Interest-bearing debt to shareholders' equity	184.4%	139.4%	56.1%	65.9%	59.1%
Total capitalization ⁽⁵⁾	560,874	600,348	842,749	367,190	308,549
Interest-bearing debt to total capitalization	64.8%	58.2%	35.9%	39.7%	37.2%
CASH FLOW					
Cash provided by operating activities of continuing operations	8,486	48,018	70,832	42,587	27,982
Cash provided by operating activities Additions to capital assets from continuing operations	11,591	52,230	77,166	40,419	35,307
– sustaining	18,034	16,975	15,135	10,457	13,554
– project-related	17,768	49,617	39,511	50,709	38,987
Total additions to capital assets from continuing operations	35,802	66,592	54,646	61,166	52,541
Total additions to capital assets	36,077	67,499	56,792	62,604	53,669
Acquisitions	–	–	211,823	–	28,220
Net proceeds from equity issues	–	–	190,261	–	–

(1) EBITDA before repositioning expenses represents earnings from continuing operations before repositioning expenses, asset impairment charges, depreciation and amortization, foreign exchange loss on foreign operations reclassified from other comprehensive income, interest, refinancing expenses, write-off of deferred financing costs and income taxes.

(2) Book value per share is defined as shareholders' equity, excluding the equity component of the convertible preferred shares, divided by the number of restricted voting shares outstanding at year end.

(3) Interest-bearing debt includes the debt component of the convertible preferred shares.

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

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

Five-Year Summary of Quarterly Results

		Q1	Q2	Q3	Q4	Year
(in thousands of U.S. dollars except per-share amounts)		\$	\$	\$	\$	\$
Revenues	FY03	66,140	91,010	100,271	102,604	360,025
	FY04	99,946	113,061	108,134	111,796	432,937
	FY05	143,119	171,934	168,289	175,514	658,856
	FY06	150,013	180,157	178,739	165,750	674,659
	FY07	162,808	171,966	175,508	166,792	677,074
EBITDA before repositioning expenses	FY03	6,357	9,795	14,721	14,403	45,276
	FY04	10,744	11,700	13,240	14,123	49,807
	FY05	20,323	22,543	25,394	25,748	94,008
	FY06	13,880	23,244	14,990	18,762	70,876
	FY07	22,793	23,153	23,138	21,234	90,318
Earnings (loss) from continuing operations	FY03	2,136	3,415	5,767	5,006	16,324
	FY04	2,622	2,687	2,206	2,023	9,538
	FY05	5,352	2,799	3,341	8,201	19,693
	FY06	(11,408)	2,549	(257,698)	(22,162)	(288,719)
	FY07	(2,188)	(22,552)	(50,668)	(9,050)	(84,458)
Net earnings (loss)	FY03	3,080	4,791	6,097	4,610	18,578
	FY04	2,589	3,102	1,990	2,997	10,678
	FY05	6,004	3,783	3,455	8,379	21,621
	FY06	(11,510)	2,989	(257,213)	(22,416)	(288,150)
	FY07	(2,024)	(21,986)	(63,069)	(7,522)	(94,601)
Diluted EPS – continuing operations (USc)	FY03	4.1	6.5	11.1	9.6	31.3
	FY04	5.1	5.1	4.3	3.9	18.4
	FY05	7.8	2.4	3.3	9.1	22.6
	FY06	(12.3)	2.7	(277.5)	(23.8)	(310.9)
	FY07	(2.4)	(24.3)	(54.4)	(9.9)	(91.0)
Diluted EPS (USc)	FY03	5.9	9.2	11.7	8.8	35.6
	FY04	5.0	5.9	3.9	5.8	20.6
	FY05	8.7	3.4	3.4	9.3	24.8
	FY06	(12.4)	3.2	(277.0)	(24.1)	(310.3)
	FY07	(2.2)	(23.6)	(67.9)	(8.2)	(101.9)