



## FIRST QUARTER 2007 REPORT TO SHAREHOLDERS

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### PATHEON ANNOUNCES FIRST QUARTER RESULTS

**Toronto, Canada (March 9, 2007)** – Patheon (TSX:PTI), a global provider of drug development and manufacturing services to the international pharmaceutical industry, today announced its results for the first quarter ended January 31, 2007. (All amounts are in U.S. dollars unless otherwise indicated.)

#### **Financial Results**

*First Quarter Ended January 31, 2007*

*Compared With First Quarter Ended January 31, 2006*

- Revenues increased 9% to \$171.7 million;
- EBITDA before repositioning expenses in the first quarter was \$23.2 million (13.5% of revenues) compared with \$14.0 million (8.9% of revenues);
- Repositioning expenses, relating primarily to workforce reduction and the expansion of the Company's manufacturing efficiency review process, were \$3.7 million (\$2.9 million after tax);
- The net loss for the quarter was \$2.6 million (2.8 cents per share), compared with a net loss of \$11.5 million (12.4 cents per share) a year ago.

“Our revenues and EBITDA before repositioning expenses improved significantly during the first quarter,” said Riccardo Trecroce, Chief Executive Officer, Patheon Inc. “We achieved strong revenue growth in prescription manufacturing and pharmaceutical development services, which have grown to represent almost 90% of our total revenue base. Our earnings also improved, due mainly to efficiency gains at several Canadian sites, particularly Whitby, higher volumes at our Carolina, Puerto Rico site relative to last year, and solid growth at our PDS operations in Canada, Cincinnati and Swindon.”

Patheon hosted a live audio webcast of its analysts' conference call. See page 30 for details.
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The Company's net income was impacted by repositioning expenses of \$3.7 million in the first quarter, comprising \$1.1 million in severance costs, \$1.6 million in professional fees relating to the expansion of its manufacturing efficiency review process, and \$1.0 million in costs relating to work on the Board's strategic alternatives review. Net income in the first quarter of 2007 was also impacted by interest expense of \$7.7 million compared with \$5.1 million in the same period a year ago, and an income tax charge of \$1.8 million compared with a recovery of \$1.1 million in the first quarter of last year.

### **Strategic and Operating Performance Initiatives**

"With last week's announcement of the proposed US\$150 million investment by JLL Partners, we took a significant step towards improving our capital structure," said Mr. Trecroce. "This investment will allow us to move forward with renewed momentum and greater financial flexibility.

"We remain highly focused on improving our operating performance," Mr. Trecroce continued. "Initiatives under our Performance Enhancement Program are well underway throughout our global organization and are already having a positive impact on profitability, as demonstrated by our first quarter results."

During the quarter, the Company further reduced the size of its global workforce by approximately 300 positions, or about 5%, to about 5,300 full-time equivalent positions as at January 31, 2007. Virtually all of the reductions took place at the Company's North American sites, and were achieved through retirements, attrition and terminations with severance packages.

The Company also made significant progress on its manufacturing efficiency review initiative during the quarter. The initiative is nearing completion at the Company's Toronto Region, Cincinnati, Carolina and Swindon sites, where it is expected to result in sustained process improvements and higher productivity.

Patheon has continued to implement its global procurement program, leveraging the Company's global purchasing power to negotiate contracts that will continue to reduce operating and raw material costs.

### **First quarter operating results**

First-quarter revenues increased by \$13.8 million, or 9%, over the same period a year ago. Revenues from Rx manufacturing services grew by \$14.2 million, or 13%, reflecting higher volumes at the Canadian, European and Puerto Rico operations. Revenues from pharmaceutical development services (PDS) revenues increased by \$5.0 million, or 23%, due to strong growth at the Toronto Region, Cincinnati and Swindon PDS operations. These gains were partially offset by a decline of \$5.4 million, or 23%, in revenues from over-the-counter (OTC) manufacturing services, primarily due to a decision by clients in Whitby and Cincinnati to repatriate products back to their own manufacturing networks.

Consolidated EBITDA before repositioning expenses of \$23.2 million in the first quarter represented an increase of \$9.2 million, or 66%, compared with the same period a year ago. The EBITDA margin before repositioning was 13.5% in the first quarter, compared with 8.9% in the first quarter of 2006.

In Canada, EBITDA before repositioning expenses from commercial manufacturing operations was \$8.5 million, or \$6.0 million higher than the same period a year ago. The improvement reflects efficiency gains at Whitby Operations, combined with higher capacity utilization at the other operations. In addition, the profitability of the Canadian operations during the first quarter of 2007 was not significantly impacted by foreign exchange, as the Canadian dollar strengthened relative to the U.S. dollar by only 1% compared with the first quarter of 2006.

EBITDA before repositioning expenses from U.S. operations was \$4.8 million – a \$2.1 million improvement over the same period a year ago. The improvement was primarily due to higher capacity utilization at the Carolina site, which in the first quarter of 2006 had been impacted by a voluntary shut down in production following receipt of an FDA warning letter. These gains at Carolina were partially offset by lower volumes at Caguas during the first quarter of 2007.

In Europe, EBITDA before repositioning expenses from the commercial manufacturing operations was \$5.4 million, or \$1.5 million lower than the same period a year ago. The decline reflects a change in the mix of products during the quarter, lower technical transfer service revenues, and lower pre-launch revenues for the cephalosporin lyophilisation product in Swindon compared with a year ago.

EBITDA before repositioning expenses from global pharmaceutical development services was \$7.4 million, or \$2.8 million higher than the same period a year ago. The increase reflects improved revenue growth across all operations.

## **Outlook**

Revenues for the second quarter of 2007 are expected to be approximately the same as in the first quarter of 2007. Revenues are expected to be slightly higher across the network with the exception of the U.S. operations, where we are experiencing lower client demand for products currently being manufactured at those operations.

On behalf of the Board,



Riccardo Trecroce  
Chief Executive Officer



Peter A.W. Green  
Chairman of the Board

March 9, 2007

## **FORWARD-LOOKING STATEMENTS**

### **Cautionary Note**

This report contains forward-looking statements which reflect management's expectations regarding the Company's future growth of operations, performance (both operational and financial) and business prospects and opportunities.

PLEASE REFER TO THE CAUTIONARY NOTE AT THE END OF THE MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MD&A") ATTACHED TO AND FORMING PART OF THIS REPORT.

## Consolidated Statements of Loss

(unaudited)

	Three months ended January 31,		
	2007	2006	% change
<i>(in thousands of U.S. dollars, except per share amounts)</i>	\$	\$	
<b>Revenues</b>	<b>171,695</b>	157,944	8.7%
Operating expenses	<b>148,461</b>	143,932	3.1%
Earnings before the following:	<b>23,234</b>	14,012	65.8%
<i>(as a % of revenues)</i>	<b>13.5%</b>	8.9%	
Repositioning expenses (note 5)	<b>3,701</b>	-	
Depreciation and amortization	<b>10,470</b>	9,811	6.7%
Amortization of intangible assets	<b>2,181</b>	3,423	-36.3%
Interest	<b>7,723</b>	5,103	51.3%
Debt prepayment charges (note 9)	-	1,643	
Amortization of deferred financing costs	-	325	
Write-off of deferred financing costs (note 9)	-	6,332	
Loss before income taxes	<b>(841)</b>	(12,625)	93.3%
Provision for (recovery of) income taxes	<b>1,795</b>	(1,115)	261.0%
<b>Net loss for the period</b>	<b>(2,636)</b>	(11,510)	77.1%
<i>(as a % of revenues)</i>	<b>-1.5%</b>	-7.3%	
<b>Loss per share</b>			
Basic	<b>(2.8¢)</b>	(12.4¢)	77.4%
Diluted	<b>(2.8¢)</b>	(12.4¢)	77.4%
Average number of shares outstanding during period:			
Basic (in thousands)	<b>92,951</b>	92,846	0.1%
Diluted (in thousands)	<b>92,951</b>	92,846	0.1%

see accompanying notes

# Consolidated Balance Sheets

(unaudited)

(See note 1 - Going Concern Uncertainty)

As at January 31,      As at October 31,  
2007                      2006

(in thousands of U.S. dollars)                      \$                      \$

## Assets

### Current

Cash and cash equivalents	36,826	50,723
Accounts receivable	110,853	121,956
Inventories	79,605	75,962
Prepaid expenses and other	5,258	6,800
<b>Total current assets</b>	<b>232,542</b>	<b>255,441</b>

Capital assets	491,504	494,088
Intangible assets	39,266	41,447
Deferred costs	7,189	9,717
Future tax assets	24,307	21,827
Goodwill	2,936	3,077
Investment	630	586
<b>Total capital assets</b>	<b>798,374</b>	<b>826,183</b>

## Liabilities and Shareholders' equity

### Current

Bank indebtedness	10,909	3,829
Accounts payable and accrued liabilities	129,115	142,781
Income taxes payable	3,947	879
Current portion of long-term debt (note 8)	268,966	283,717
<b>Total current liabilities</b>	<b>412,937</b>	<b>431,206</b>

Long-term debt (note 8)	60,574	62,071
Other long-term liabilities	26,083	25,681
Deferred revenues	23,286	23,366
Future tax liabilities	34,857	33,128
<b>Total liabilities</b>	<b>557,737</b>	<b>575,452</b>

### Shareholders' equity

Share capital	400,721	400,721
Contributed surplus	3,874	3,829
Retained deficit	(192,536)	(189,900)
Accumulated other comprehensive income	28,578	36,081
<b>Total shareholders' equity</b>	<b>240,637</b>	<b>250,731</b>
<b>Total liabilities and shareholders' equity</b>	<b>798,374</b>	<b>826,183</b>

see accompanying notes

## Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

	Three months ended January 31,	
	2007	2006
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Share capital</b>		
Balance at beginning and end of period	400,721	400,594
<b>Contributed surplus</b>		
Balance at beginning of period	3,829	2,901
Stock options	45	340
Balance at end of period	3,874	3,241
<b>Retained earnings (deficit)</b>		
Balance at beginning of period	(189,900)	98,250
Net loss for the period	(2,636)	(11,510)
Balance at end of period	(192,536)	86,740
<b>Accumulated other comprehensive income</b>		
Balance at beginning of period	36,081	38,106
Transition adjustment (note 1)	(762)	-
Other comprehensive income (loss) for the period	(6,741)	17,683
Balance at end of period	28,578	55,789
<b>Total shareholders' equity at end of period</b>	<b>240,637</b>	<b>546,364</b>

see accompanying notes

## Consolidated Statement of Comprehensive Loss

(unaudited)

	Three months ended January 31,	
	2007	
<i>(in thousands of U.S. dollars)</i>	\$	
<b>Net loss for the period</b>	<b>(2,636)</b>	
<b>Other comprehensive loss, net of income taxes (note 10)</b>		
Change in foreign currency losses on investments in subsidiaries, net of hedging activities (2006 - gain of \$17,683)	(4,505)	
Change in losses on derivatives designated as cash flow hedges	(2,509)	
Losses on cash flow hedges reclassified to statement of loss	310	
Gains on interest rate hedges reclassified to statement of loss	(37)	
Other comprehensive loss for the period	(6,741)	
<b>Comprehensive loss for the period</b>	<b>(9,377)</b>	

see accompanying notes



**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
**(Dollar information in tabular form is expressed in thousands of U.S. dollars)**

**1. Accounting policies**

**Going Concern Uncertainty**

The accompanying unaudited consolidated financial statements of Patheon Inc. (the “Company”) have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. As at January 31, 2007, the Company had a working capital deficiency of \$180,395,000. The deficiency includes the reclassification of \$250,801,000 of debt from long term to short term (see note 8). The Company’s ability to continue as a going concern is uncertain and is dependent upon the successful completion of the review, of strategic and financial alternatives (see note 12). If the Company is not able to implement a long term improvement in its capital structure, it anticipates that it will be in default of the covenants under the North American loan facilities as at April 30, 2007.

These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

**Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the most recent audited consolidated financial statements except for the adoption of Canadian Institute of Chartered Accountants (“CICA”) accounting standards Section 3855 “Financial Instruments – Recognition and Measurements”, Section 3861 “Financial Instruments – Disclosure and Presentation”, Section 3865 “Hedges” and Section 1530 “Comprehensive Income” as noted in Changes in Accounting Policy below.

These consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and notes for the year ended October 31, 2006.

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

**Changes in Accounting Policy**

Effective November 1, 2006 the Company adopted the CICA Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, Section 3861 “Financial Instruments – Disclosure and Presentation”, Section 3865 “Hedges” and Section 1530 “Comprehensive Income”. 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 accumulated other comprehensive income. The comparative interim consolidated financial statements have not been restated 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:

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
**(Dollar information in tabular form is expressed in thousands of U.S. dollars)**

Financial Assets and Financial Liabilities

An investment in shares of a publicly traded company have been designated as held for trading and are accounted for at fair value, with changes in the fair value being recorded in the consolidated statement of loss. Prior to the adoption of the new standards, this investment was accounted for on a cost basis, as adjusted for an other than temporary decline in value.

All other financial assets are accounted for on an amortized cost basis and financial liabilities are accounted for on an accruals basis, consistent with prior accounting policies, except deferred financing costs of \$3,178,000 at October 31, 2006, 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).

In 2006, the Company cancelled its interest rate swaps that were used as a hedge against changes in interest payments on floating rate debt. Deferred gains from the cancellation of these interest rate swaps that were previously recorded in accounts payable and accrued liabilities are now recorded in accumulated other comprehensive income.

Derivatives and Hedge Accounting

The Company enters into forward foreign exchange contracts to hedge its exposure in foreign denominated cash flows and holds foreign currency denominated debt as a hedge against the carrying value of its equity investment in certain foreign currency denominated operations.

Prior to the adoption of the new standards, the Company accounted for derivatives that met the requirements of hedge accounting on an accruals basis. Under the new standards all derivatives, other than those contracts that are entered into for the Company's own expected requirements, are recorded at their fair value.

The effective portion of changes in the fair value of cash flow hedges and hedges of net investments in foreign operations are recognized in other comprehensive income. Amounts accumulated in other comprehensive income are reclassified to the statement of earnings (loss) in the period in which the hedged item affects the earnings (loss). Any gain or loss in the fair value relating to the ineffective portion of the hedge is recognized immediately in the consolidated statement of earnings (loss). For the three month period ending January 31, 2007, \$113,000 of losses were recorded in the consolidated statement of loss.

Comprehensive Income (Loss) and Accumulated Other Comprehensive Income

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

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
**(Dollar information in tabular form is expressed in thousands of U.S. dollars)**

On transition to the new accounting standards, deferred after tax gains from interest rate swaps of \$656,000 and after tax losses on the fair value of cash flow hedges of \$1,418,000 were recorded in accumulated other comprehensive income. Accumulated other comprehensive income also includes gains on net investments in self sustaining foreign operations, net of hedging activities previously recorded in cumulative translation adjustment. 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 loss for the period only reflect the amounts previously recorded in the cumulative translation adjustment account.

**2. Share capital**

The following table summarizes information on share capital and related matters at January 31, 2007:

	<b>Outstanding</b>	<b>Exercisable</b>
Common shares	92,950,688	
Common share stock options	3,894,481	3,827,814

**3. Segmented information**

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

Canadian and foreign operations consist of:

	<b>Three months ended January 31, 2007</b>			
	<b>Manufacturing Location</b>			
	<b>Canada</b>	<b>USA</b>	<b>Europe</b>	<b>Total</b>
	\$	\$	\$	\$
<b>Revenues:</b>				
Canada	7,441	238	372	8,051
USA	38,978	59,207	3,823	102,008
Europe	8,143	432	50,996	59,571
Other geographic areas	679	56	1,330	2,065
<b>Total revenues</b>	<b>55,241</b>	<b>59,933</b>	<b>56,521</b>	<b>171,695</b>
<b>Capital assets</b>	<b>122,029</b>	<b>140,966</b>	<b>228,509</b>	<b>491,504</b>
<b>Goodwill</b>	<b>2,936</b>	-	-	<b>2,936</b>

	<b>Three months ended January 31, 2006</b>			
	<b>Manufacturing Location</b>			
	<b>Canada</b>	<b>USA</b>	<b>Europe</b>	<b>Total</b>
	\$	\$	\$	\$
<b>Revenues:</b>				
Canada	10,036	253	289	10,578
USA	33,377	55,313	2,026	90,716
Europe	10,005	261	44,316	54,582
Other geographic areas	1,214	81	773	2,068
<b>Total revenues</b>	<b>54,632</b>	<b>55,908</b>	<b>47,404</b>	<b>157,944</b>
<b>Capital assets</b>	<b>126,887</b>	<b>170,884</b>	<b>188,644</b>	<b>486,415</b>
<b>Goodwill</b>	<b>3,034</b>	<b>184,325</b>	-	<b>187,359</b>

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
**(Dollar information in tabular form is expressed in thousands of U.S. dollars)**

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

Revenue information by service activity is as follows:

	<b>Three months ended January 31,</b>			
	<b>2007</b>		<b>2006</b>	
	<b>\$</b>		<b>\$</b>	
Commercial manufacturing - prescription	126,227	73%	112,039	71%
Commercial manufacturing - over-the-counter	18,477	11%	23,895	15%
Development services	26,991	16%	22,010	14%
	<b>171,695</b>	<b>100%</b>	<b>157,944</b>	<b>100%</b>

**4. Stock-based compensation**

The Company has an incentive stock option plan. Persons eligible to participate in the plan are directors, officers, and key employees of the Company and its subsidiaries or any other person engaged to provide ongoing management or consulting services to Patheon. The plan provides that the maximum number of shares that may be issued under the plan is 7.5% of the issued and outstanding common shares of the Company at any point in time. As of January 31, 2007, the total number of common shares listed and reserved at the TSX for issuance under the plan was 6,858,427, of which there are stock options outstanding to purchase 3,894,481 shares under the plan. The exercise price of common shares subject to an option is determined at the time of grant and the price cannot be less than the weighted average market price of the common shares of Patheon on the Toronto Stock Exchange during the two trading days immediately preceding the grant date. Options generally expire 10 years after the grant date and are also subject to early expiry in the event of death, resignation, dismissal or retirement of an optionee. Options generally vest over three years, one-third on each of the first, second and third anniversary of the grant date.

The fair value of stock options is estimated at the date of the grant. There were no options granted during the three months ended January 31, 2007. The weighted average fair value for the stock options granted for the comparable three months ended January 31, 2006 was \$1.85. The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model.

Stock-based compensation expense recorded in the three months ended January 31, 2007 was \$45,000 (2006 - \$340,000) for options granted on or after November 1, 2003.

**5. Repositioning expenses**

During the first quarter of 2007, the Company incurred a number of expenses associated with its performance enhancement program, which is intended to identify operational improvements and cost reduction initiatives. The related expenses include costs associated with a reduction in the work force and consulting fees from external specialists who are assisting in identifying operational improvements.

During the first quarter of 2007, the Company also incurred professional fees and other costs, in connection with its review of strategic and financial alternatives (see note 12).

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
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The following is a summary of expenses associated with these initiatives (collectively “repositioning expenses”) for the three months ended January 31, 2007:

	\$
Performance enhancement program:	
-Employee-related expenses	1,144
-Consulting and professional fees	1,604
Strategic alternatives review	953
	<b>3,701</b>

As at January 31, 2007, \$5,512,000 of the repositioning expenses are unpaid and are recorded in accounts payable and accrued liabilities. This includes amounts accrued during the 2006 fiscal year. Repositioning expenses paid during the three months ended January 31, 2007 amounted to \$8,372,000.

**6. Other information**

**Foreign exchange**

During the three months ended January 31, 2007, the foreign exchange gain was \$ 1,754,000 (2006 loss - \$252,000).

**Employee future benefits**

The employee future benefit expense in connection with defined benefit pension plans and other post retirement benefit plans for the three months ended January 31, 2007 was \$1,679,000 (2006 – \$409,000).

**7. Financial instruments**

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

The Company’s Canadian operations have entered into foreign exchange forward contracts to sell an aggregate amount of US\$81,000,000 as at January 31, 2007. These contracts hedge the Company’s expected exposure to U.S. dollar denominated cash flows and mature at the latest on October 29, 2007 at exchange rates varying between \$1.0856 and \$1.1712 Canadian. The mark-to-market value on these financial instruments as at January 31, 2007 was an unrealized loss of US\$3,559,000 which has been recorded in accumulated other comprehensive income in shareholders’ equity.

As at January 31, 2007, the Company has designated \$204 million of US dollar denominated debt as a hedge against its equity investment in its operations in the U.S.A. and Puerto Rico. The exchange gains and losses arising from this debt are recorded in accumulated other comprehensive income in shareholders’ equity.

**8. Long-term debt**

During 2006, certain of the financial covenant tests included in the Company’s North American loan facilities were amended to ensure that the Company remained in compliance. The amended covenants cover a six-month period ending on March 31, 2007.

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
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If the Company is not able to implement a long term improvement in its capital structure as a result of its review of strategic and financial alternatives (see note 12), it anticipates that it will be in default of the covenants under the North American Loan Facilities as at April 30, 2007 and the lenders could demand repayment of all amounts outstanding under these credit facilities. Accordingly, in accordance with Emerging Issues Committee Abstract 59 the Company has re-classified \$228,728,000 of debt from long-term to short-term, representing the long-term portion of debt outstanding under the North American Loan Facilities. Any future default under the Company's North American Loan Facilities would cause a cross default under a lending facility in its UK subsidiary. Accordingly, the Company has also reclassified \$22,073,000 of related debt from long-term to short-term.

**9. Debt prepayment charges and write-off of deferred financing costs**

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

**10. Other comprehensive loss**

The amounts disclosed in other comprehensive loss for three months ended January 31, 2007 are net of income taxes. The change in foreign currency losses on investments in subsidiaries, net of hedging activities, is net of an income tax benefit of \$1,692,000. The change in losses on derivatives designated as cash flow hedges and the losses on cash flow hedges reclassified to the statement of loss are net of an income tax benefit of \$770,000. A full valuation allowance reserve has been set up against this benefit. The gains on interest rate hedges reclassified to the net statement of loss are net of an income tax benefit of \$20,000.

**11. Related party transactions**

Revenues from companies controlled by a director and significant shareholder of the Company were in the amount of \$59,000 for the three months ended January 31, 2007. These transactions were conducted in the normal course of business and are recorded at the exchanged amount which management believes to be at fair value. Accounts receivables at January 31, 2007 include a balance of \$222,000 resulting from these transactions.

At January 31, 2007, the Company has an investment of \$369,000 representing an 18% interest in two Italian companies whose largest investor is an Officer of the Company. These newly formed companies will specialize in the manufacturing of cytotoxic pharmaceutical products.

**12. Review of strategic and financial 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 March 2, 2007 the Company announced that it had entered into a definitive agreement with JLL Partners, under which JLL Partners Fund V, LP ("JLL Partners") will purchase US\$150 million of convertible preferred shares of the Company through a private placement. The Company intends to use the net proceeds of the offering, expected to be approximately US\$138 million, to pay down a portion of its outstanding debt under its existing North American credit facilities.

**Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2007**  
**(Dollar information in tabular form is expressed in thousands of U.S. dollars)**

JLL Partners' investment is conditional on the Company concurrently refinancing the remaining portion of its long-term debt under its North American loan agreement or entering into an amendment to the existing credit agreement with its North American lenders in light of the reduced level of debt. The purchase is also subject to approval by the Toronto Stock Exchange and approval by a majority of the Company's shareholders. The Company intends to seek shareholder approval at its Annual and Special Meeting of Shareholders on April 19, 2007. Subject to these approvals, the Company is targeting to close the transaction before April 30, 2007.

**13. Comparative amounts**

Certain other comparative amounts have been reclassified to conform to the current period presentation.

## **Patheon Inc.**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following management discussion and analysis of financial condition and results of operations ("MD&A") of Patheon Inc. ("Patheon" or "the Company") for the three-month periods ended January 31, 2007 and 2006 should be read in conjunction with the Company's consolidated financial statements and related notes contained in this interim report. This MD&A is dated as of March 9, 2007.

The purpose of this 2007 first quarter report is to provide an update to the information contained in the Company's Management's Discussion and Analysis for the Year Ended October 31, 2006, which contains a more comprehensive discussion of Company's strategy, capabilities to deliver results, risks and key performance indicators. Management assumes that the reader of this document has access to the MD&A for the Year Ended October 31, 2006. This document and other information can be downloaded in portable document format (PDF) from the Company's web site at [www.patheon.com](http://www.patheon.com) or from the SEDAR web site for Canadian regulatory filings at [www.sedar.com](http://www.sedar.com). To request a printed copy, the reader may also contact Patheon's transfer agent, Computershare Trust Company of Canada, at 1-800-564-6253 or via email at [service@computershare.com](mailto:service@computershare.com), or Patheon at [www.patheon.com](http://www.patheon.com).

### **Use of Non-GAAP Financial Measures**

Except as otherwise indicated, references in this MD&A to "EBITDA before repositioning expenses" are to earnings before repositioning expenses, depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs, and income taxes. "EBITDA margin before repositioning expenses" is EBITDA before repositioning expenses divided by revenues. EBITDA before repositioning expenses and EBITDA margin before repositioning expenses are measures of earnings or earnings margin not recognized by generally accepted accounting principles in Canada ("Canadian GAAP"). Since each of these measures is a non-GAAP measure that does not have a standardized meaning, it may not be comparable to similar measures presented by other issuers. Prospective investors are cautioned that these, and other non-GAAP measures should not be construed as alternatives to net earnings determined in accordance with Canadian 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.

### **Overview of Patheon**

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

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

The pharmaceutical development services provided by Patheon include most of the pharmaceutical development services typically required by companies conducting clinical trials and preparing for full-scale commercial production of a new drug.

At January 31, 2007, there were a total of 174 client products in the Patheon's pharmaceutical development services ("PDS") pipeline, including seven drug candidates at the New Drug Application ("NDA") stage. This compares with a total of 152 client products a year ago. No new products being developed on behalf of clients received regulatory approval during the first quarter of 2007.

### ***Vision and Strategy***

Patheon's vision is to be the leader in pharmaceutical manufacturing. Patheon strives to be the preferred manufacturing and pharmaceutical development services partner to the global pharmaceutical industry. Patheon's strategy is focused on providing "best-in-class" manufacturing and development services effectively balancing high product quality and reliability of supply with cost.

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

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 the business internally by expanding the level of business from existing clients, attracting new clients, and entering into commercial manufacturing agreements for newly approved products for which the Company has provided development services.

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

### ***Key Performance Drivers***

In Patheon's MD&A for the Year Ended October 31, 2006, several key performance drivers were identified for the Company: (i) generating higher quality revenues by increasing the percentage of higher margin Rx manufacturing and pharmaceutical development services; (ii) improving capacity utilization at the Company's sites which have a large fixed-cost base in the short term; (iii) improving operating efficiencies through a performance enhancement program with initiatives focused on a global procurement program, a workforce reduction program and a manufacturing efficiency review process; and (iv) mitigating the impact of changes in the foreign exchange trading relationship between the Canadian and U.S. dollar, since the Company's contracts in North America are primarily denominated in U.S. dollars, but the operating expenses of its six Canadian sites are primarily denominated in Canadian dollars. An update on our interim performance relating to these key issues is provided in the section below entitled "Results of Operations".

## **Recent Developments**

### ***Financing Arrangements and Strategic Alternatives***

During 2006, the Company entered into amending agreements with lenders under its North American loan facilities because of concern that the Company would not be in compliance with its debt-to-EBITDA ratio and fixed charge coverage financial covenants. The financial covenants were amended for a six-month period ending on March 31, 2007. The Company was in compliance with the amended terms and conditions of its North American loan agreement as at January 31, 2007.

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 March 2, 2007 the Company announced that it had entered into a definitive agreement with JLL Partners, under which JLL Partners Fund V, LP (“JLL Partners”) will purchase US\$150 million of convertible preferred shares of the Company through a private placement. The Company intends to use the net proceeds of the offering, expected to be approximately US\$138 million, to pay down a portion of its outstanding debt under its existing North American credit facilities.

JLL Partners’ investment is conditional on the Company concurrently refinancing the remaining portion of its long-term debt under its North American loan agreement or entering into an amendment to the existing credit agreement with its North American lenders in light of the reduced level of debt. The purchase is also subject to approval by the Toronto Stock Exchange and approval by a majority of the Company’s shareholders. The Company intends to seek shareholder approval at its Annual and Special Meeting of Shareholders on April 19, 2007. Subject to these approvals, the Company is targeting to close the transaction before April 30, 2007.

If the US\$150 million private placement transaction and refinancing of the remaining portion of the long term debt under its North American loan agreement is not completed, the Company anticipates that, in the absence of any further amendments, it will be in default under its North American loan agreement as at April 30, 2007 and the lenders could demand repayment of all amounts outstanding under these credit facilities. As at February 28, 2007, \$237.7 million was outstanding under these facilities (\$233.0 million as at January 31, 2007). In addition, any such default would constitute a default under certain lending facilities of the Company’s U.K. subsidiary, allowing the lender under these facilities to immediately demand repayment of all amounts outstanding under these facilities. As at February 28, 2007, \$29.2 million was outstanding under these facilities (\$29.8 million as at January 31, 2007).

The Company is still able to borrow under its amended \$60 million North American revolving loan facilities. As at February 28, 2007, \$32.2 million was borrowed under these facilities (\$27.3 million as at January 31, 2007). The maximum amount that may be borrowed under these facilities varies from time-to-time and is a function of borrowing base calculations prescribed in the credit agreement, and is typically less than \$60 million. The Company estimates that, based on these borrowing base calculations, as at February 28, 2007, an additional \$16.7 million was available to be drawn under these facilities. In addition the Company has cash reserves on hand, which at January 31, 2007 amounted to \$36.8 million. The Company is satisfied that it has sufficient liquidity to carry on its business in the ordinary course for the period covered by the amendment to the North American loan facilities.

### ***Going Concern Uncertainty Note***

As at January 31, 2007, the Company has reclassified the long-term debt outstanding under its North American loan facilities (\$228.7 million) and its U.K. subsidiary’s loan facility (\$22.1 million) as current indebtedness, in accordance with Emerging Issues Committee Abstract 59, which requires such reclassification unless a violation of the covenants under these credit facilities at a future compliance date within one year of the balance sheet date is not likely. See “Liquidity and Capital Resources – Adequacy of Financial Resources” and “Critical Accounting Policies and Estimates – Going Concern Uncertainty”, below. As a result of this reclassification, the Company had a working capital deficiency as at January 31, 2007 of \$180.4 million. Consequently, the Company’s consolidated financial statements for the first

quarter include a going concern uncertainty note, stating that the Company's ability to continue as a going concern is uncertain and is dependent upon the successful outcome of the review of strategic and financial alternatives. The Company's consolidated financial statements as at and for the first quarter ended January 31, 2007 do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern.

## Results of Operations

### Three Months Ended January 31, 2007 Compared with Three Months Ended January 31, 2006

#### Revenues by Geographic Region and Service Activity

U.S.\$ '000

	Three months ended January 31,		
	2007	2006	% Change
<b><u>North America</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	77,177	69,303	11%
Over-the-counter	17,203	23,519	-27%
	<b>94,380</b>	<b>92,822</b>	<b>2%</b>
<b>Development Services</b>			
	<b>20,794</b>	<b>17,718</b>	<b>17%</b>
	<b>115,174</b>	<b>110,540</b>	<b>4%</b>
<b><u>Europe</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	49,050	42,736	15%
Over-the-counter	1,274	376	239%
	<b>50,324</b>	<b>43,112</b>	<b>17%</b>
<b>Development Services</b>			
	<b>6,197</b>	<b>4,292</b>	<b>44%</b>
	<b>56,521</b>	<b>47,404</b>	<b>19%</b>
<b><u>TOTAL</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	126,227	112,039	13%
Over-the-counter	18,477	23,895	-23%
	<b>144,704</b>	<b>135,934</b>	<b>6%</b>
<b>Development Services</b>			
	<b>26,991</b>	<b>22,010</b>	<b>23%</b>
<b>CONSOLIDATED REVENUES</b>	<b>171,695</b>	<b>157,944</b>	<b>9%</b>

#### Revenues

Consolidated revenues for the three-month period ended January 31, 2007 increased 9%, or \$13.8 million, to \$171.7 million from \$157.9 million in the same period in 2006. In the first quarter, revenue increased in both Rx manufacturing and PDS, but declined in OTC manufacturing. On a consolidated basis, compared with the first quarter of 2006, Rx revenues increased by 13%, PDS revenues increased by 23% and OTC revenues declined by 23%.

Prescription manufacturing and development services represented 89% of revenues, compared with 85% for the comparable period in 2006.

Geographically, in North America, revenues increased in the first quarter by \$4.6 million or 4% over the same period a year ago. The increase reflects higher Rx revenues from the Canadian and Puerto Rico operations, higher PDS revenues in Canada and Cincinnati, offset by lower OTC manufacturing revenues in Canada and Cincinnati. In the same period last year Rx manufacturing revenues were constrained by the temporary shut down in production at Carolina, Puerto Rico to resolve issues with regard to a warning letter issued by the U.S. Food and Drug Administration (“FDA”) and by manufacturing inefficiencies in Whitby. Both of these issues were resolved during 2006. The improvements in Puerto Rico were offset in part by revenue declines arising from the loss of patent protection of Zocor® during the third quarter of 2006. The growth in PDS revenues reflects an increase in the number of development projects the Company is working on for its clients. OTC manufacturing revenues were impacted by certain clients repatriating products back to their own manufacturing network.

In Europe, revenues for the first quarter of 2007 were \$56.5 million or 19% higher than the same period of 2006. The year-over-year increase in revenues reflects higher volumes of sterile products in Italy, combined with the benefits of a carve-out initiative in Bourgoin Jallieu, France where, during the course of 2006, a client transferred production of a range of products from its own manufacturing network. The PDS operations in Swindon, U.K. also continued to benefit from revenue gains. European currencies strengthened against the U.S. dollar in the first quarter of fiscal 2007 compared with the prior year. The Euro strengthened approximately 9% and U.K. sterling strengthened approximately 11% against the U.S. dollar, increasing reported revenues by approximately \$5.0 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 9% higher than the same period in 2006.

#### ***Operating Expenses***

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support and administrative expenses. In the first quarter of 2007, operating expenses were \$148.5 million, being \$4.5 million higher than the same period a year ago. Operating expenses were principally impacted by higher volumes, and the impact of the strengthening European currencies relative to the U.S. dollar, offset in part by savings from the performance enhancement program. Operating expenses as a percentage of revenues were 86.5%, compared with 91.1% in the same period a year ago.

#### ***EBITDA before repositioning expenses and EBITDA margin before repositioning expenses***

On a consolidated basis in the first quarter of 2006, EBITDA before repositioning expenses, representing earnings before repositioning expenses, depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs, and income taxes was \$23.2 million, compared with \$14.0 million in the same period a year ago. EBITDA margin before repositioning expenses was 13.5% in the three-month period, compared with 8.9% in the same period a year ago.

In Canada, EBITDA before repositioning expenses from the commercial operations was \$8.5 million, being \$6.0 million higher than the same period last year. The improvement principally reflects operating efficiency gains at the Whitby operations, combined with higher capacity utilization levels in the other operations. EBITDA before repositioning expenses was not significantly impacted by foreign exchange in the first quarter of 2007, as the Canadian dollar was only approximately 1% stronger than the U.S. dollar, compared with the same period in 2006.

In the U.S.A. (including Puerto Rico) EBITDA before repositioning expenses for the commercial operations was \$4.8 million, being \$2.1 million higher than the same period last year. The increase principally reflects higher capacity utilization in Carolina, which in 2006 was impacted by a shut down in production of Omnicef® powder due to the FDA warning letter. This increase was offset in part by lower volumes in Caguas as a result of the loss in patent protection of Zocor®.

In Europe, EBITDA before repositioning expenses from the commercial manufacturing operations was \$5.4 million, being \$1.5 million lower than same period a year ago. The decline reflects a mix of lower margin products, fewer technical transfer service revenues and lower pre-launch revenues for the cephalosporin lyophilization services in Swindon than for the same period a year ago.

EBITDA before repositioning expenses from the global PDS operations was \$7.4 million, being \$2.8 million higher than the same period in 2006. The increase reflects revenue growth across all of the operations.

Corporate costs in the first quarter of 2007 were \$0.2 million higher than the same period last year.

### ***Repositioning Expenses***

During the first quarter of 2007 the Company incurred \$3.7 million of expenses in connection with its performance enhancement program and its review of strategic and financial alternatives. The expenses include consulting fees associated with the manufacturing efficiency review, further reductions in the work force and professional and other costs in connection with the strategic alternatives review. The Company expects to incur further repositioning expenses during the course of 2007 as it completes the performance enhancement program and review of strategic and financial alternatives.

### ***Depreciation and Amortization Expense***

Depreciation and amortization expense was \$10.5 million in the first quarter of 2007, compared with \$9.8 million in the first quarter of 2006, an increase of \$0.7 million, or 7%. The increase principally reflects the effect of the strengthening European currencies relative to the U.S. dollar.

### ***Amortization of Intangible Assets***

Amortization of intangible assets was \$2.2 million in the first quarter of 2007, compared with \$3.4 million for the first quarter of 2006. The charge is lower than for the same period last year due to the impact of the impairment charge of \$51.9 million that was made during the third quarter of 2006.

### ***Interest Expense and Amortization of Deferred Financing Costs***

Interest expense for the first quarter of 2007 was \$7.7 million, up from the \$5.1 million charge in the first quarter of 2006. During the first quarter of 2007 the Company has adopted CICA Accounting Standard Section 3855 for the accounting of financial instruments (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. The increase in interest costs also reflects higher debt levels, along with increased borrowing costs as a result of the amendments to the Company's North American loan facilities.

### ***Debt Prepayment Charges and Write-off of Deferred Financing Costs***

During the first quarter of 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***

The Company reported a loss before income taxes of \$0.8 million, compared with \$12.6 million in the same period a year ago.

### ***Income Taxes***

The Company recorded an income tax charge of \$1.8 million in the first quarter of 2007 compared with a recovery of \$1.1 million in the same period last year. The income tax charge in the first quarter of 2007 reflects the effect of the low tax rate in Puerto Rico, where the Company is currently incurring significant losses.

### *Net Loss and Loss Per Share*

The Company recorded a net loss in the first quarter of 2007 of \$2.6 million, compared with \$11.5 million in the same period last year. The loss per share was 2.8¢, compared with 12.4¢ a year earlier.

Because the Company reported a loss in the first quarter of 2007 and 2006 there is no impact of dilution.

### **Seasonal Variability of Results**

Typically, the Company's manufacturing and PDS revenues are 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.

### **Liquidity and Capital Resources**

#### *Summary of Cash Flows*

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

	<b>Three months ended January 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
Net loss	(2,636)	(11,510)
Depreciation and amortization	12,651	13,234
Write-off of deferred financing costs	-	6,332
Amortization of deferred financing costs	681	325
Employee future benefits	471	(786)
Future income taxes	(224)	2,315
Amortization of deferred revenues	(486)	(497)
Other	276	498
Working capital	(6,252)	(2,147)
Increase in deferred revenues	-	9,614
Cash provided by operating activities	<b>4,481</b>	17,378
Cash used in investing activities	<b>(9,013)</b>	(14,438)
Cash used in financing activities	<b>(8,158)</b>	(12,328)
Other	<b>(1,207)</b>	122
Net decrease in cash and cash equivalents	<b>(13,897)</b>	(9,266)

#### *Cash Provided by Operating Activities*

Cash provided by operating activities was \$4.5 million in the first quarter of 2007 compared with \$17.4 million for the comparable period in 2006. The reduction principally reflects the inclusion in 2006 of \$9.6 million of cash received from a client for the reimbursement of costs the Company incurred in connection with the sterile cephalosporin lyophilization capacity that is being installed in Swindon, U.K. This amount is recorded as an increase in deferred revenues and will be recognized as income over the life of the commercial manufacturing contract.

### ***Cash Used in Investing Activities***

Cash used in investing activities in the first quarter of 2007 was \$9.0 million, compared with \$14.4 million in the same period a year ago. The decrease principally reflects lower project-related capital expenditures on the cephalosporin lyophilization capacity that is being installed in the Swindon, U.K. facility.

A summary of cash used in investing activities is as follows:

	<b>Three months ended January 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
Additions to capital assets-sustaining	<b>(3,117)</b>	(2,740)
-project-related	<b>(4,947)</b>	(11,180)
Decrease in investments	<b>116</b>	-
Increase in deferred pre-operating costs	<b>(1,065)</b>	(518)
Cash used in investing activities	<b><u>(9,013)</u></b>	<b><u>(14,438)</u></b>

### ***Cash Used in Financing Activities***

There have been no significant financing activities during the first quarter of 2007.

The principal financing activity during the first quarter of 2006 was the completion of new credit facilities in North America in the aggregate amount of \$290.0 million to refinance existing debt of the Company and its U.S. subsidiaries. The Company was able to release \$7.8 million of restricted cash that had previously been held as security for certain of the cancelled facilities. The Company also incurred costs in connection with the refinancing of \$2.6 million. During the first quarter of 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.

A summary of cash used in financing activities is as follows:

	<b>Three months ended January 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
Increase (decrease) in bank indebtedness	<b>6,942</b>	(13,596)
Increase in long-term debt	<b>9,370</b>	283,580
Repayment of long-term debt	<b>(24,470)</b>	(287,352)
Decrease in restricted cash	-	7,805
Increase in deferred financing costs	-	(2,765)
Cash used in financing activities	<b><u>(8,158)</u></b>	<b><u>(12,328)</u></b>

### ***Financing Arrangements and Ratios***

Total interest bearing debt at January 31, 2007 was \$340.4 million, being \$9.2 million lower than at October 31, 2006. At January 31, 2007, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 141.5%, compared with 139.4% at October 31, 2006. The increase is due to a reduction in total shareholders' equity.

During 2006, the Company entered into agreements with lenders under its North American loan facilities because of concern that the Company would not be in compliance with its debt-to-EBITDA ratio and fixed charge coverage financial covenants. The financial covenants were amended to cover a six-month period ending on March 31, 2007. The Company was in compliance with the terms and conditions of its North American loan facilities as at January 31, 2007.

If the Company is not able to implement a long term improvement in its capital structure as a result of its review of strategic and financial alternatives, it anticipates that it will be in default of the covenants under the North American loan facilities as at April 30, 2007 and the lenders could demand repayment of all amounts outstanding under these credit facilities. As at February 28, 2007, \$237.7 million was outstanding under these facilities (\$233.0 million as at January 31, 2007). In addition, any such default would constitute a default under a lending facility of the company's U.K. subsidiary, allowing the lender under this facility to demand repayment of all amounts outstanding under that facility. As at February 28, 2007, \$29.2 million was outstanding under that facility (\$29.8 million as at January 31, 2007).

In accordance with Emerging Issues Committee Abstract 59, the Company has re-classified \$250.8 million of debt from long-term debt to current indebtedness. This amount represents the long-term portion of the Company's indebtedness under its North American loan facilities (\$228.7 million) and the indebtedness of the Company's U.K. subsidiary under its credit facility (\$22.1 million), which was previously classified as long-term debt. Emerging Issues Committee Abstract-59 requires this reclassification, in light of the North American loan facilities amendments to prevent a default, unless a violation of the covenants under these credit facilities at a determination date within one year of the balance sheet date is not likely.

#### ***Adequacy of Financial Resources***

As at January 31, 2007 the Company has a working capital deficiency of \$180.4 million due to the reclassification of long-term debt to short term debt as noted above. The Company is able to borrow under its \$60 million North American revolving loan facility, and as at January 31, 2007, \$27.3 million was borrowed under this facility. In addition the company has cash reserves which at January 31, 2007 amounted to \$36.8 million. The Company's ability to fund its normal operating activities and debt service requirements is dependent on it being able to improve its long-term capital structure as a result of its review of strategic and financial alternatives.

### **Critical Accounting Policies and Estimates**

#### ***Going Concern Uncertainty***

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. As at January 31, 2007, the Company had a working capital deficiency of \$180.4 million as a result of the reclassification of \$250.8 million of debt from long term to short term, as discussed under "Liquidity and Capital Resources – Financing Arrangements and Ratios" above. The Company's ability to continue as a going concern is uncertain and is dependent upon the successful completion of the review of strategic and financial alternatives. If the Company is not able to implement a long term improvement in its capital structure as a result of this review, it anticipates that it will be in default of the covenants under the North American loan facilities as at April 30, 2007.

These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

### ***Changes in Significant Accounting Policies***

Effective November 1, 2006 the Company adopted the Canadian Institute of Chartered Accountants Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, Section 3865 “Hedges”, Section 1530 “Comprehensive Income” and Section 3861 “Financial Instruments – Disclosure and Presentation”. 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 accumulated other comprehensive income. The comparative interim consolidated financial statements have not been restated, except for the reclassification of amounts previously recorded as cumulative translation adjustment, which are now included in accumulated other comprehensive income. For a description of the principal changes in accounting policy see Note 1 to the consolidated financial statements.

### ***General***

Patheon’s significant accounting policies are described in Note 1 to the 2006 audited consolidated financial statements. The most critical of these policies are those related to revenue recognition, deferred revenues, intangible assets, goodwill, employee future benefits, and income taxes, (Notes 1, 7, 9, 13 and 17 of the 2006 audited consolidated financial statements).

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

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

### ***Revenue Recognition***

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

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

### ***Deferred Revenues***

The costs of certain capital assets are reimbursed to the Company by the pharmaceutical companies that are to benefit from the improvements in connection with the manufacturing and packaging agreements in force. These reimbursements are recorded as deferred revenues and are recognized as income over the remaining minimum term of the agreements. During the first quarter of 2007, \$0.5 million was recognized as earnings.

### ***Intangible Assets***

Intangible assets represent the values assigned to acquired client contracts and relationships. They are amortized on a straight-line basis over their estimated economic life. During the first quarter of 2007, \$2.2 million was charged to earnings.

On an ongoing basis, the Company reviews whether there are any indicators of impairment. If such indicators are present, the Company assesses the recoverability of intangible assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to net earnings. No amounts in connection with impairment were charged to the net loss in the first quarter of 2007.

### ***Valuation of Goodwill***

The Company evaluates goodwill for impairment at least annually and reviews if there are any indicators of impairment on an ongoing basis. If the carrying value of the reporting unit exceeds its fair value, the fair value of the reporting units goodwill, determined in the same manner as in a business combination, is compared with its carrying amount to measure the amount of any impairment loss, if any.

The goodwill shown on the financial statements for the period ended January 31, 2007 was \$2.9 million and relates to the acquisition in 2000 of the remaining shares of Global Pharm Inc., which now operates as Toronto York Mills Operations.

### ***Income Taxes***

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

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

Future tax assets of \$24.3 million have been recorded at January 31, 2007. The future tax assets are primarily composed of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, the tax benefit of net operating loss carry forwards related to the U.K., 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 \$34.9 million have been recorded at January 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.

### ***Employee Future Benefits***

The Company provides to certain retired employees pensions and post-employment benefits, including medical benefits and dental care. The determination of the obligation and expense for defined benefit pensions and post-employment benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are disclosed in Note 13 to the Company's 2006 audited consolidated financial statements.

### **Risk Management**

The following are updates to certain of the risks and uncertainties described in the Company's Management's Discussion and Analysis for the Year Ended October 31, 2006, available on SEDAR ([www.sedar.com](http://www.sedar.com)) or on Patheon's website ([www.patheon.com](http://www.patheon.com)).

#### ***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 60% to 70% of revenues of the Canadian operations and approximately 10% to 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 dollar and the 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 pretax earnings, excluding any hedging activities, is approximately \$1.1 million.

The Company mitigates its foreign exchange risk by engaging in foreign currency hedging activities using derivative financial instruments. At January 31, 2007 the Company had outstanding foreign exchange contracts to sell US\$81.0 million. The contracts mature at the latest on October 29, 2007 and cover approximately 90% of the Company's expected foreign exchange exposure for the balance of the 2007 fiscal year. The mark-to-market value at January 31, 2007 that is recorded in accumulated comprehensive income is a loss of \$3.6 million. The Company does not purchase any derivative instruments for speculative purposes.

Translation gains and losses related to the carrying value of the Company's foreign operations and certain foreign denominated debt held by the Company designated as a hedge against the carrying value of certain foreign operations, are included in accumulated comprehensive income in shareholders' equity. At January 31, 2007, the Company had designated \$204 million US dollar denominated debt as a hedge against its investment in the U.S.A. and Puerto Rico.

#### ***Interest Rate Exposure***

The Company has exposure to movements in interest rates. At January 31, 2007, 93% of the Company's total debt portfolio was subject to movements in floating interest rates. Assuming no change to the structure of the debt portfolio, a 1% change in floating interest rates has an impact on annual pre-tax earnings of approximately \$3.2 million.

The Company continues to monitor floating and long-term interest rates and may enter into new arrangements in the future that reduce the Company's exposure to changes in floating interest rates.

## 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, 2006 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. There have been no changes, since this last formal assessment, that have materially affected, or are reasonably likely to materially affect the Company's disclosure controls and procedures.

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.

## Selected Quarterly Financial Information

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

QUARTER ENDED	REVENUES	EBITDA BEFORE REPOSITIONING EXPENSES		NET EARNINGS (LOSS)	EARNINGS (LOSS) PER SHARE	
					Basic	Diluted
<i>(In thousands of U.S. dollars, except per share amounts)</i>	\$	\$	\$	\$	\$	\$
<b>2007</b>						
<b>January 31</b>	<b>171,695</b>	<b>23,234</b>		<b>(2,636)</b>	<b>(\$0.03)</b>	<b>(\$0.03)</b>
2006						
October 31	175,115	19,565		(22,416)	(\$0.24)	(\$0.24)
July 31	189,191	15,999		(257,213)	(\$2.77)	(\$2.77)
April 30	189,902	24,213		2,989	\$0.03	\$0.03
January 31	157,944	14,012		(11,510)	(\$0.12)	(\$0.12)
2005						
October 31	181,893	26,203		8,379	\$0.09	\$0.09
July 31	178,390	25,826		3,455	\$0.04	\$0.04
April 30	184,088	24,286		3,783	\$0.03	\$0.03

## Additional Information

### Share Capital

As of January 31, 2007, the Company had 92,950,688 common shares outstanding.

### ***Public Securities Filings***

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

### **Outlook**

Revenues for the second quarter of 2007 are expected to be approximately the same as in the first quarter of 2007. Revenues are expected to be slightly higher across the network with the exception of the U.S. operations, where we are experiencing lower client demand for products currently being manufactured at those operations.

### **FORWARD-LOOKING STATEMENTS**

This news release and 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 news release and 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 inability to close the offering as a result of the failure to achieve the closing conditions; market demand for client products; credit and client concentration; the ability to identify and secure new contracts; regulatory matters, including compliance with pharmaceutical regulations; management of expanded operations; international operations risks; currency; competition; product liability claims; intellectual property; environmental; financial restructuring including the inability to close the offering of the convertible preferred shares as a result of the failure to achieve the closing conditions, including the receipt of regulatory or shareholder approvals on terms acceptable to the Company and subscriber; restrictive covenants; going-concern uncertainty; substantial financial leverage; interest rates; and conditions of MOVA's tax exemptions. 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 news release and MD&A and, except as required by law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

## Shareholder and Investor Information

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### Share Information

As at January 31, 2007, except recent price  
Listing: Toronto Stock Exchange (TSX)  
Symbol: PTI  
Shares Outstanding: 92,950,688  
Public Float: 81,572,000  
52-Week High/Low/Close: \$8.44/\$4.67/\$5.47  
Recent Price: March 8, 2007 \$4.81

### Audio Webcast

Patheon hosted an audio webcast of its quarterly call with analysts at 11.00 a.m. (EDT) on Friday, March 9, 2007. An archived version of the webcast is available on Patheon's website at [www.patheon.com](http://www.patheon.com).