



## NEWS RELEASE

### **For Immediate Release**

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### **PATHEON ANNOUNCES FIRST QUARTER RESULTS**

**Toronto, Canada (March 3, 2006)** – Patheon (TSX:PTI), a leading global provider of drug development and manufacturing services to the international pharmaceutical industry, announces its results for the first quarter ended January 31, 2006. (All amounts are in U.S. dollars unless otherwise indicated.)

- Revenues increased 3% to \$157.9 million;
- Revenues from MOVA operations were \$29.4 million compared with \$23.9 million for five weeks a year ago. Revenues from other sites were \$128.5 million compared with \$130.0 million a year ago;
- EBITDA was \$14.0 million compared with \$21.6 million; the EBITDA margin was 8.9% compared with 14.1%;
- The net loss (excluding the impact of one-time costs for debt prepayment charges and the write-off of deferred financing costs) was 5.8 cents per share, compared with net earnings of 10.6 cents per share a year ago;
- The net loss for the quarter was \$11.5 million, or 12.4 cents per share, compared with net earnings of \$6.0 million or 8.7 cents per share a year ago.

“As previously announced, our first quarter results were weaker than anticipated,” said Robert Tedford, Chief Executive Officer, Patheon Inc. “In addition to normal seasonality and holiday shutdowns associated with the first quarter, revenues and profitability were affected by difficulties with the production of Omnicef® at our Carolina, Puerto Rico facility, lower demand for over-the-counter manufacturing services, temporary production issues at our Swindon and Whitby sites, and client orders deferred to later quarters at our Monza facility. In our PDS business, North American revenue growth was slower than we expected, in part because of capacity constraints at our Toronto Region site where several successful, newly launched R<sub>x</sub> products are being manufactured.”

## **Operating Review**

First-quarter revenues increased 3% to \$157.9 million. Prescription (R<sub>x</sub>) manufacturing revenues and pharmaceutical development services (PDS) revenues both increased by 5%, offset by over-the-counter (OTC) revenues that declined by 10%.

In Europe, year-over-year currency-adjusted revenue growth of 23% (12% as reported) was driven by R<sub>x</sub> volumes at Swindon, U.K. and the two Italian sites, as well as PDS activities. Revenue growth in Europe was lower than anticipated due to the deferral of client orders to later quarters in 2006, temporary production issues at the Swindon facility and regulatory-related delays in the transfer of a new sterile product at the Monza site that have since been resolved.

“We are encouraged by the overall year-over-year improvement in operating performance at Swindon, continued strong demand for our specialized lyophilization services in Italy and the solid growth in our European PDS business,” said Mr. Tedford. “We are also starting to see the benefits of carve-out initiatives in France and Italy, where two clients are transferring a range of products to our sites as they re-align their own manufacturing networks.”

In North America, revenues from the Puerto Rico operations were \$29.4 million compared with \$23.9 million for five weeks in the first quarter of 2005. Revenues in Puerto Rico were affected primarily by a decision taken by the Company to voluntarily suspend production of Omnicef® while it resolved issues identified in a Warning Letter from the U.S. Food and Drug Administration. Although production resumed in December, volumes were constrained by slower line speeds and lower yields. In addition, the validation of a third line was not completed until early February.

“With the new line now operational and other productivity improvement initiatives that we have put in place, we expect to achieve continuous improvements in run rates for this high-volume product beginning in the second quarter through to the end of 2006,” said Mr. Tedford.

At other North American sites, commercial revenues were impacted by lower volumes at Whitby and at the Canadian OTC sites. Growth in PDS revenues was lower than expected due, in part, to the lack of available capacity at the Toronto Region high-potency facility, which is currently manufacturing several newly launched R<sub>x</sub> products. The latter issue is being addressed by internal transfers of products not requiring high-potency capabilities to other sites, including those in Puerto Rico, and by expanding PDS operations at other sites, most notably our Toronto York Mills facility.

EBITDA amounted to \$14.0 million, a decrease of \$7.6 million, or 35%, from the first quarter of 2005. The EBITDA margin in the quarter was 8.9% compared with 14.1% a year earlier. The decline in the overall EBITDA margin was attributable to significantly lower capacity utilization at MOVA operations compared with the same period a year ago. The EBITDA margin for the other sites in the Company's network was higher than a year ago.

Depreciation and amortization expense in the quarter was \$9.8 million, compared with \$7.8 million in the first quarter of 2005. Approximately \$1.1 million of the increase reflects the inclusion of depreciation of MOVA assets for a full quarter versus five weeks a year ago.

Amortization of intangible assets was \$3.4 million, compared with \$1.3 million last year, with the increase due to the inclusion of a full quarter of amortization relating to the MOVA operations. Interest expense was \$5.1 million, an increase of \$2.8 million over last year, reflecting a full quarter of interest expense related to the additional debt associated with the MOVA acquisition.

On December 15, 2005, Patheon completed new credit facilities in North America in the aggregate amount of \$290.0 million to refinance existing debt of the Company and its U.S. subsidiaries, including its subsidiaries in Puerto Rico. As a result of the refinancing, there was a charge during the first quarter of \$1.6 million in connection with the cancellation and prepayment of certain credit facilities. The Company also wrote off \$6.3 million in related deferred financing costs.

The effective tax rate in the quarter was 8.8%, compared with 21.5% in the same period a year ago. The decrease reflects the impact of losses incurred by the MOVA operations, which are at the lowest tax rate in the Patheon group.

The net loss in the first quarter of 2006, before one-time debt prepayment charges and the write-off of deferred financing costs of \$6.2 million, was \$5.3 million, or 5.8 cents per share, compared with net earnings of \$7.3 million, or 10.6 cents per share last year. The net loss for the first quarter of 2006 was \$11.5 million, or 12.4 cents per share, compared with net earnings of \$6.0 million or 8.7 cents per share a year ago. First quarter net earnings last year included a one-time charge of \$1.3 million, or 1.9 cents per share, for the write-off of deferred financing costs.

In the first quarter, cash provided by operating activities amounted to \$7.8 million compared with \$20.5 million in the same period a year ago. Capital expenditures in the quarter were \$13.9 million, which included project-related expenditures in relation to the establishment of sterile cephalosporin lyophilization capacity at Swindon, U.K. and high-potency capabilities at Bourgoin-Jallieu, France. While additions to capital assets in the quarter exceeded cash from operating activities by \$6.2 million, the Company has received \$9.6 million from a client in connection with the Swindon, U.K. expansion, which has been recorded as deferred revenues.

At quarter end, the Company's consolidated interest-bearing debt to shareholders' equity was 52%, compared with 67% a year ago and 56% at the end of the 2005 fiscal year. The improvement relative to the first quarter of 2005 reflects the repayments of long-term debt financed from the release of \$22.8 million held in escrow in connection with the MOVA acquisition during the third quarter of 2005, and the release of \$7.8 million in restricted cash during the first quarter of 2006.

## **Outlook**

"The impact of operating challenges in the first quarter on revenues and profitability will be difficult to overcome in the remainder of 2006," commented Mr. Tedford.

"While we continue to expect that the second half of the year will be better than the first half, overall growth will be lower than anticipated due to declines in North American base business that are more significant than usual," added Mr. Tedford.

"We are encouraged by the growth in our European operations, the success of our high-potency capabilities at our Toronto Region site where a total of nine new products have been launched since 2001, as well as our continued success in developing our PDS pipeline," said Mr. Tedford. "At quarter end, we were providing development services for 152 projects, including six that are in line for regulatory approval.

"As a result of operating challenges in the first quarter together with lower-than-expected revenues in 2006, both EBITDA and net earnings will be lower than in fiscal 2005," said Mr. Tedford. "We expect improved results in the second quarter, with further improvement in the second half.

"We continue to view 2006 as a transition year as we address the challenges in our Puerto Rico operations, complete the transfer of two groups of products to our Bourgoin and Italian operations, complete our new cephalosporin lyophilization facility in Swindon and continue to develop additional PDS capacity both in existing facilities as well as in India.

"In addition to these specific initiatives, we have also engaged in a broader course of action focused on improving efficiency and reducing operating costs across the organization," concluded Mr. Tedford. "This includes a global procurement program to consolidate and leverage our global purchasing power, and the implementation of company-wide cost saving programs."

## **FORWARD-LOOKING STATEMENTS**

### **Cautionary Note**

This news release 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 NEWS RELEASE.

*Patheon Inc. will host a webcast conference call with financial analysts on its first quarter results on Friday, March 3, 2006 at 10:00 a.m. (Eastern Standard Time). Representing Patheon on the call will be: Robert Tedford, Chief Executive Officer; Nick DiPietro, President and Chief Operating Officer; and Rodger Roden, Chief Financial Officer. Interested parties are invited to access the call live, in listen-only mode, via telephone, at (416) 644-3426 or toll-free, at 1-800-814-4862 (Please call between five and fifteen minutes in advance.) A live audio webcast, with a slide presentation, will be available on [www.patheon.com](http://www.patheon.com). An archived version of the Q1 webcast will be available on [www.patheon.com](http://www.patheon.com) for three months.*

*Patheon Inc. will hold its Annual Meeting of Shareholders at 10:30 a.m. (Eastern Standard Time) on Thursday, March 9, 2006, in the Queen’s Park Ballroom of the Park Hyatt Toronto, 4 Avenue Road, Toronto, Canada. A live audio webcast, including the slide presentation by Patheon executives to shareholders and the subsequent question-and-answer period, will be available at [www.patheon.com](http://www.patheon.com). An archived version of the Annual Meeting of Shareholders webcast will be available on [www.patheon.com](http://www.patheon.com) for three months.*

## **ABOUT PATHEON**

*Patheon (TSX:PTI; [www.patheon.com](http://www.patheon.com)) is a leading global provider of drug development and manufacturing services to the international pharmaceutical industry. Patheon operates a network of 14 facilities in the United States, Canada and Europe, employing more than 5,900 people and serving a client base of more than 200 pharmaceutical and biotechnology companies.*

## Consolidated Statements of Earnings (Loss)

(unaudited)

	Three months ended January 31,		
	2006	2005	% change
<i>(in thousands of U.S. dollars, except per share amounts)</i>	\$	\$	
<b>Revenues</b>	<b>157,944</b>	153,947	2.6%
Operating expenses	<b>143,932</b>	132,300	8.8%
Earnings before the following:	<b>14,012</b>	21,647	-35.3%
<i>(as a % of revenues)</i>	<b>8.9%</b>	14.1%	
Depreciation and amortization	<b>9,811</b>	7,819	25.5%
Amortization of intangible assets	<b>3,423</b>	1,280	167.4%
Interest	<b>5,103</b>	2,333	118.7%
Debt prepayment charges (note 10)	<b>1,643</b>	-	
Amortization of deferred financing costs	<b>325</b>	577	-43.7%
Write-off of deferred financing costs (note 10)	<b>6,332</b>	1,994	217.6%
Earnings (loss) before income taxes	<b>(12,625)</b>	7,644	-265.2%
Provision for (recovery of) income taxes	<b>(1,115)</b>	1,640	-168.0%
<b>Net earnings (loss) for the period</b>	<b>(11,510)</b>	6,004	-291.7%
<i>(as a % of revenues)</i>	<b>-7.3%</b>	3.9%	
<b>Earnings (loss) per share</b>			
Basic	<b>(12.4¢)</b>	8.7¢	-242.5%
Diluted	<b>(12.4¢)</b>	8.7¢	-242.5%
Average number of shares (note 3) outstanding during period:			
Basic (in thousands)	<b>92,846</b>	68,969	34.6%
Diluted (in thousands)	<b>93,074</b>	69,317	34.3%

see accompanying notes

## Consolidated Statements of Retained Earnings

(unaudited)

	Three months ended January 31,	
	2006	2005
<i>(in thousands of U.S. dollars)</i>	\$	\$
Retained earnings, beginning of the year	<b>98,250</b>	76,629
Net earnings (loss) for the period	<b>(11,510)</b>	6,004
Retained earnings, end of period	<b>86,740</b>	82,633

see accompanying notes

# Consolidated Balance Sheets

(unaudited)

	As at January 31,	As at October 31,
	2006	2005
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Assets</b>		
Current		
Cash and cash equivalents	13,241	22,507
Restricted cash	-	7,805
Accounts receivable	128,049	143,646
Inventories	82,270	72,818
Prepaid expenses and other	6,290	4,258
Total current assets	<u>229,850</u>	<u>251,034</u>
Capital assets		
Intangible assets	486,415	474,793
Deferred costs	110,670	110,095
Future tax assets	8,790	12,342
Goodwill	20,071	21,368
Investment	187,359	180,665
	1,318	1,271
	<u>1,044,473</u>	<u>1,051,568</u>
<b>Liabilities and Shareholders' equity</b>		
Current		
Bank indebtedness	705	14,357
Accounts payable and accrued liabilities	124,727	129,067
Income taxes payable	1,998	5,650
Current portion of long-term debt (note 9)	15,567	11,360
Total current liabilities	<u>142,997</u>	<u>160,434</u>
Long-term debt (note 9)	270,355	277,181
Other long-term liabilities	22,542	22,755
Deferred revenues	23,932	14,587
Future tax liabilities	38,283	36,760
Total liabilities	<u>498,109</u>	<u>511,717</u>
Shareholders' equity		
Share capital	400,594	400,594
Contributed surplus	3,241	2,901
Retained earnings	86,740	98,250
Cumulative translation adjustment	55,789	38,106
Total shareholders' equity	<u>546,364</u>	<u>539,851</u>
	<u>1,044,473</u>	<u>1,051,568</u>

see accompanying notes

# Consolidated Statements of Cash Flows

(unaudited)

Three months ended January 31,

	2006	2005
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Operating activities</b>		
Net earnings (loss) for the period	(11,510)	6,004
Add (deduct) charges to operations not requiring a current cash payment		
Depreciation and amortization	13,559	9,676
Write-off of deferred financing costs (note 10)	6,332	1,994
Employee future benefits	(786)	717
Future income taxes	2,315	107
Amortization of deferred revenues	(497)	43
Other	498	495
	<u>9,911</u>	<u>19,036</u>
Net change in non-cash working capital balances related to operations	<u>(2,147)</u>	<u>1,418</u>
<b>Cash provided by operating activities</b>	<u>7,764</u>	<u>20,454</u>
<b>Investing activities</b>		
Acquisition	-	(145,181)
Cash acquired on acquisition	-	645
Acquisition net of cash acquired	-	(144,536)
Increase in escrow cash related to acquisition	-	(87,825)
Additions to capital assets - sustaining	(2,740)	(1,150)
- project - related	(11,180)	(12,313)
Increase in deferred pre-operating costs	(518)	(1,059)
<b>Cash used in investing activities</b>	<u>(14,438)</u>	<u>(246,883)</u>
<b>Financing activities</b>		
Decrease in bank indebtedness	(13,596)	(451)
Increase in long-term debt	283,580	164,039
Repayment of long-term debt	(287,352)	(103,385)
Decrease (increase) in restricted cash	7,805	(260)
Increase in deferred financing costs	(2,765)	(8,720)
Increase in deferred revenues	9,614	-
Proceeds on issue of common shares before costs	-	199,241
Share issue costs	-	(8,942)
<b>Cash provided by (used in) financing activities</b>	<u>(2,714)</u>	<u>241,522</u>
Effect of exchange rate changes on cash and cash equivalents	<u>122</u>	<u>(6,612)</u>
<b>Net increase (decrease) in cash and cash equivalents during the period</b>	<u>(9,266)</u>	<u>8,481</u>
Cash and cash equivalents, beginning of year	<u>22,507</u>	<u>7,626</u>
<b>Cash and cash equivalents, end of period</b>	<u>13,241</u>	<u>16,107</u>

see accompanying notes

## Patheon Inc.

### Notes to Unaudited Consolidated Financial Statements for the Three Months Ended January 31, 2006

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

#### 1. Accounting policies

The accompanying unaudited consolidated financial statements have been prepared by Patheon Inc. (the "Company") in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the most recent audited financial statements. 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 included in the Company's Annual Report for the year ended October 31, 2005.

#### 2. MOVA Acquisition

On December 23, 2004, the Company completed the acquisition of MOVA Pharmaceutical Corporation and MOVA Investments, Inc. (collectively "MOVA"), a leading U.S. prescription pharmaceutical manufacturer located in Puerto Rico, U.S.A.

The acquisition was accounted for using the purchase method and the accompanying unaudited consolidated financial statements include the results of operations from the date of purchase.

#### 3. Average number of shares

The following is a reconciliation of the weighted average number of basic and diluted shares:

	Three months ended January 31,	
	2006	2005
Weighted average number of common shares outstanding	92,845,688	68,969,459
Effect of dilutive stock options	228,097	347,274
Weighted average number of common shares outstanding – diluted	93,073,785	69,316,733

#### 4. Share capital

The following table summarizes information on share capital and related matters at January 31, 2006:

	Outstanding	Exercisable
Common shares	92,845,688	
Common share stock options	4,090,011	3,506,157

## 5. Segmented information

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

North American and European operations consist of:

	Three months ended January 31, 2006			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	10,036	253	289	10,578
U.S.A.	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>-</b>	<b>187,359</b>

	Three months ended January 31, 2005			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	6,183	163	494	6,840
U.S.A.	42,125	51,206	1,917	95,248
Europe	10,606	245	39,401	50,252
Other geographic areas	1,092	116	399	1,607
<b>Total revenues</b>	<b>60,006</b>	<b>51,730</b>	<b>42,211</b>	<b>153,947</b>
<b>Capital assets</b>	<b>110,691</b>	<b>176,322</b>	<b>192,062</b>	<b>479,075</b>
<b>Goodwill</b>	<b>2,784</b>	<b>81,282</b>	<b>-</b>	<b>84,066</b>

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:

	Three months ended January 31,			
	2006		2005	
	\$		\$	
Commercial manufacturing - prescription	112,039	71%	106,244	69%
Commercial manufacturing - over-the-counter	23,895	15%	26,682	17%
Development services	22,010	14%	21,021	14%
	<b>157,944</b>	<b>100%</b>	<b>153,947</b>	<b>100%</b>

## 6. 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. At January 31, 2006, the total number of common shares available for issuance under the plan was 6,963,427, of which 4,090,011 were reserved for options granted and outstanding 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. The weighted average fair value of the 225,000 options granted for the three months ended January 31, 2006 was \$1.85. The weighted average fair value of stock options granted for the comparable three-month period in 2005 was \$2.94. The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model. The following assumptions were used in arriving at the fair value of options issued during the three months ended January 31, 2006:

Risk free interest rate	4%
Expected volatility	42%
Expected weighted average life of the options	3 years
Expected dividend yield	0%

Stock-based compensation expense recorded in the three months ended January 31, 2006 was \$340,000 (2005 - \$495,000) for options granted on or after November 1, 2003.

Stock options granted prior to November 1, 2003 are accounted for using the intrinsic value method, which does not give rise to compensation expense. Had these stock options been accounted for at fair value, the impact on pro-forma net earnings (loss) and earnings (loss) per share would have been:

	<b>Three months ended January 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>\$</b>	<b>\$</b>
Net earnings (loss) as reported	<b>(11,510)</b>	6,004
Pro-forma adjustments for the fair value of stock options granted prior to November 1, 2003	<b>(6)</b>	(51)
Pro-forma net earnings (loss)	<b>(11,516)</b>	5,953
Pro-forma earnings (loss) per share:		
Basic	<b>(12.4¢)</b>	8.6¢
Diluted	<b>(12.4¢)</b>	8.6¢

## **7. Other information**

### **Cumulative translation adjustment**

The cumulative translation adjustment amount is impacted by fluctuations in the value of the U.S. dollar relative to the Canadian dollar, the euro and U.K. sterling.

Unrealized translation adjustments, which arise on the translation to U.S. dollars of the Company's self-sustaining foreign operations, resulted in an unrealized currency translation gain of \$17,683,000 for the three months ended January 31, 2006 (2005 - unrealized currency translation loss of \$1,188,000).

The net unrealized gain in the quarter of \$17,683,000 is attributable to the weakening of the U.S. dollar against the Canadian dollar, the euro and U.K. sterling, as measured at January 31, 2006 and October 31, 2005.

### **Foreign exchange**

During the three months ended January 31, 2006, the foreign exchange loss was \$252,000 (2005 gain - \$2,261,000).

## **8. Financial instruments**

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

The Company has entered into interest rate swap contracts that exchange a notional amount of US\$107,500,000 of debt from floating to fixed interest rates with contracts that expire in December 2010 and 2011. At January 31, 2006, the mark-to-market value of these swap agreements was an unrealized loss of \$686,000.

At January 31, 2006, the Company had no foreign exchange hedge contracts in place.

## **9. Long-term debt**

On December 15, 2005, the Company completed new credit facilities in North America in the aggregate amount of \$290,000,000 to refinance existing debt of the Company and its U.S. subsidiaries including its subsidiaries in Puerto Rico. The new facilities replaced (i) existing credit facilities that were available to the Company's North American operations including those that were established at the time of acquisition of MOVA in December 2004, and (ii) debt of MOVA that was assumed at the time of acquisition by the Company. The new credit facilities comprise two term loans in the aggregate amount of \$215,000,000 and three year revolving facilities in aggregate amount of \$75,000,000. The term loans consist of a five-year term loan of \$50,000,000 and a six-year term loan of \$165,000,000. At January 31, 2006, no amounts were drawn on the revolving facilities. The new credit facilities bear interest at floating rates based on bankers' acceptances, Canadian and U.S. prime, U.S. base rate, or U.S. LIBOR, plus spreads between 0.75% and 2.5%. The new facilities are collateralized by the North American assets of Patheon and its subsidiaries, including those of Puerto Rico.

On December 22, 2005, the Company's Italian subsidiary entered into a new long-term debt facility. The new loan replaced four separate term loans it had with an Italian bank. The new loan in the amount of €28,500,000 (\$33,856,000), bearing interest at floating rates based on 3-month Euribor maturing in 2014, has equal semi-annual principal payments over the term of the nine year loan, and is collateralized by a mortgage over land and buildings.

## **10. 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.

During the first quarter of 2005, the Company wrote off deferred financing costs of \$2.0 million associated with commitment fees paid for financing that was not required in connection with the MOVA acquisition.

## **11. Comparative amounts**

Certain of the comparative amounts have been reclassified to conform to the current year 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, 2006 and 2005 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 3, 2006.

The purpose of this 2006 first quarter report is to provide an update to the information contained in the Management's Discussion and Analysis section of the Company's 2005 Annual Report, 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 section of the Company's 2005 Annual Report. 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" are to earnings before depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs and income taxes. Free cash flow is defined as cash provided by operating activities in excess of additions to capital assets in the period. "EBITDA margin" is EBITDA divided by revenues. EBITDA and EBITDA margin are measures of earnings or earnings margin not recognized by generally accepted accounting principles in Canada ("Canadian GAAP"). Free cash flow is a measure of cash flows not recognized by generally accepted accounting principles in Canada. 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 or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows. The Company has included these measures because it believes that this information is used by certain investors to assess financial performance.

### *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 and manufactures Rx products in various sterile dosage forms. Conventional dosage forms include compressed tablets, hard-shell capsules, powders, ointments, creams, gels, syrups, suspensions, solutions and suppositories. Sterile dosage forms include liquids 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, 2006, there were a total of 152 client products in the Patheon's PDS pipeline, including 6 drug candidates at the New Drug Application ("NDA") stage. This compares with a total of 116 client products a year ago. During the first quarter, one product being developed on behalf of a client received regulatory approval and was launched from the Company's facilities.

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

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

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

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

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

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

In Patheon's 2005 Annual Report, several key performance drivers were identified for the Company: (i) increasing the percentage of more profitable Rx products at its facilities; (ii) expand its pharmaceutical development services ("PDS") capabilities in North America and Europe; (iii) improving capacity utilization at the Company's sites, which have a largely fixed-cost base in the short term; 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 in U.S. dollars, but the operating expenses of its six Canadian sites are primarily in Canadian dollars. An update on our interim performance relating to these key measures is provided in the section below entitled "Results of Operations."

## ***Acquisition of MOVA in the first quarter of 2005***

On December 23, 2004, the Company completed the acquisition of MOVA Pharmaceutical Corporation and MOVA Investments, Inc. (collectively "MOVA"), a leading U.S. prescription pharmaceutical contract manufacturer located in Puerto Rico, U.S.A.

The acquisition was accounted for using the purchase method and the accompanying unaudited consolidated financial statements include the results of operations from the date of purchase.

## ***Results of Operations***

### **Three Months Ended January 31, 2006 Compared with Three Months Ended January 31, 2005**

The results for the three-month period ended January 31, 2006 include the operations of MOVA for the full quarter, while the results of the comparative period include the operations of MOVA from December 23, 2004 until January 31, 2005.

#### **Revenues by Geographic Region and Service Activity**

	<b>Three months ended January 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>% Change</b>
<b><u>North America</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	<b>69,303</b>	68,365	1%
Over-the-counter	<b>23,519</b>	26,118	-10%
	<b>92,822</b>	94,483	-2%
<b>Development Services</b>			
	<b>17,718</b>	17,253	3%
	<b>110,540</b>	<b>111,736</b>	<b>-1%</b>
<b><u>Europe</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	<b>42,736</b>	37,879	13%
Over-the-counter	<b>376</b>	564	-33%
	<b>43,112</b>	38,443	12%
<b>Development Services</b>			
	<b>4,292</b>	3,768	14%
	<b>47,404</b>	<b>42,211</b>	<b>12%</b>
<b><u>TOTAL</u></b>			
<b>Commercial Manufacturing</b>			
Prescription	<b>112,039</b>	106,244	5%
Over-the-counter	<b>23,895</b>	26,682	-10%
	<b>135,934</b>	132,926	2%
<b>Development Services</b>			
	<b>22,010</b>	21,021	5%
<b>CONSOLIDATED REVENUES</b>	<b>157,944</b>	<b>153,947</b>	<b>3%</b>

#### ***Revenues***

Consolidated revenues for the three-month period ended January 31, 2006 increased 3% or \$4.0 million to \$157.9 million from \$153.9 million in the same period in 2005. In the first quarter, growth came from Rx manufacturing and PDS in both North America and Europe. On a consolidated basis, commercial manufacturing revenues grew 2%, with Rx manufacturing up 5%, while revenues from OTC manufacturing declined by 10% compared with the first quarter of 2005. PDS revenues were up 5% compared with the same period in 2005.

Revenues from the MOVA operations were \$29.4 million compared with \$23.9 million for five weeks of operations included in the first quarter of 2005. Virtually all of MOVA's revenues are from Rx manufacturing. Revenues from existing sites were \$1.5 million lower than the first quarter of 2005; of this

change, revenues in North America were down \$6.7 million, or 8%, while revenues in Europe increased by \$5.2 million, or 12%. The decline in North America was spread across all service activities. In Europe, growth was attributable principally to Rx manufacturing which was up \$4.9 million, or 13% compared with the same period in 2005. On a constant exchange rate basis compared to prior year, internal growth in Europe was 23% in the first quarter of 2006.

Prescription manufacturing and development services represented 85% of revenues, compared with 83% for the comparable period in 2005, a result of internal growth in Rx manufacturing and PDS in Europe and from the additional contribution from MOVA.

In North America, MOVA revenues in the first quarter of 2006 were impacted principally by a decision taken by the Company to voluntarily suspend production of Omnicef® while it resolved issues identified in a Warning Letter from the U.S. Food and Drug Administration. While normal production of the product was re-initiated in December, production volumes were constrained by slower line speeds, lower yields and delays in the validation of a third manufacturing line. In the non-MOVA operations, commercial revenues were impacted by lower volumes at Whitby and the Canadian OTC sites.

In Europe, revenues for the first quarter of 2006 were 12% higher than the same period of 2005. The year-over-year increase in revenues is due to improved performance at the sites in Monza and Ferentino, Italy, Swindon, U.K. and growth in the PDS business. European currencies weakened against the U.S. dollar in the first quarter of fiscal 2006 compared with the prior year. The euro weakened approximately 10% and U.K. sterling weakened approximately 7% against the U.S. dollar, reducing reported revenues by approximately \$4.6 million. On a constant exchange rate basis, the net loss in the first quarter of 2006 would have been 0.6¢ lower.

#### ***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 2006, operating expenses were \$143.9 million, compared with \$132.3 million in the same period a year ago, an increase of 9%. Operating expenses as a percentage of revenues were 91.1%, compared with 85.9% in the same period a year ago. Excluding the impact of the MOVA operations, operating expenses as a percentage of revenues were 88.5% compared with 90.4% in the same period a year ago.

#### ***EBITDA and EBITDA Margin***

On a consolidated basis in the first quarter of 2006, EBITDA, representing earnings before depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs and income taxes was \$14.0 million, a decrease of \$7.6 million, or 35%, from the comparable period in 2005. As a percentage of revenues, the EBITDA margin was 8.9% in the three-month period, compared with 14.1% in the same period a year ago. The lower EBITDA margin reflects significantly lower capacity utilization and holiday shutdowns at MOVA. EBITDA margins for the operations excluding MOVA overall were higher than the same period last year; improvements in margins due to higher volumes at the Italian sites, related to the continuing strong growth of the lyophilization and large volume parenterals business, and significantly improved financial performance at the Swindon, U.K. operations, were partially offset by lower capacity utilization at Whitby and the Canadian OTC operations.

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

Depreciation and amortization expense was \$9.8 million in the first quarter of 2006, compared with \$7.8 million in the first quarter of 2005, an increase of \$2.0 million, or 25%. Of the increase, \$1.1 million was attributable to the inclusion of a full quarter charge for depreciation of the MOVA assets.

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

Amortization of intangible assets was \$3.4 million in the first quarter of 2006, compared with \$1.3 million for the first quarter of 2005. The amortization of intangible assets relates to the MOVA operations. The increase was due to the inclusion of a full quarter of amortization, compared with five weeks in the first quarter of 2005.

### ***Interest Expense***

Interest expense for the first quarter of 2006 was \$5.1 million, an increase of \$2.8 million over the same period in the prior year. The increase was attributable to the inclusion of a full quarter of interest expense related to the additional debt associated with the MOVA acquisition, compared with five weeks in the first quarter of 2005.

### ***Amortization of Deferred Financing Costs***

Amortization of deferred financing costs in the first quarter of 2006 was \$0.3 million, compared with \$0.6 million in the first quarter of 2005. The charge for 2006 includes the amortization of costs in relation to the Company's new North American credit facilities that were completed on December 15, 2005.

### ***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.

During the first quarter of 2005, the Company wrote off deferred financing costs of \$2.0 million associated with commitment fees paid for financing that was not required in connection with the MOVA acquisition.

### ***Earnings (Loss) Before Income Taxes***

The Company reported a loss before income taxes of \$12.6 million compared with earnings before income taxes of \$7.6 million in the same period a year ago.

### ***Income Taxes***

The effective tax rate on the loss before income taxes in the first quarter of 2006 was 8.8% compared with an effective tax rate of 21.5% on earnings before income taxes in the same period a year ago. The effective tax rate in the first quarter of 2006 reflects the impact of losses incurred in MOVA which are taxed at the lowest tax rate in the Patheon group.

### ***Net Earnings (Loss) and Earnings (Loss) Per Share***

The Company recorded a net loss in the first quarter of 2006 of \$11.5 million, compared with net earnings of \$6.0 million in the same period last year. The loss per share was 12.4¢ compared with earnings per share of 8.7¢ a year earlier. The net loss in the first quarter of 2006 included one-time after tax costs for debt prepayment charges and the write-off of deferred financing costs of \$6.2 million, or 6.6¢ per share. The net earnings in the first quarter of 2005 included one-time after tax costs for the write-off of deferred financing costs of \$1.3 million, or 1.9¢ per share.

The average number of shares outstanding during the three-month period, determined on both the basic and diluted bases, increased by 35% and 34%, respectively, as compared with the same period in the prior year. The increase reflects the impact of shares issued during the first quarter of 2005 in connection with the acquisition of MOVA.

The diluted loss per share was 12.4¢ compared with diluted earnings per share of 8.7¢ in the first quarter of 2005. Dilution arises solely from options issued under the Company's stock option plan.

## Seasonal Variability of Results

Typically, the Company's manufacturing and PDS revenues are lower in the first fiscal quarter. While this pattern was followed in 2006, in the first quarter of 2005 the Company experienced high revenues in its North American commercial and PDS operations and in European PDS.

## Liquidity and Capital Resources

### Summary of Cash Flows

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

	Three months ended January 31,	
	2006	2005
	\$	\$
Net earnings (loss)	(11,510)	6,004
Depreciation and amortization	13,559	9,676
Write-off of deferred financing costs	6,332	1,994
Employee future benefits	(786)	717
Future income taxes	2,315	107
Amortization of deferred revenues	(497)	43
Other	498	495
Working capital	(2,147)	1,418
Cash provided by operating activities	7,764	20,454
Cash provided by (used in) financing activities	(2,714)	241,522
Cash used in investing activities	(14,438)	(246,883)
Other	122	(6,612)
Net increase (decrease) in cash and cash equivalents	(9,266)	8,481

### Free Cash Flow

Free cash flow generated in the first quarter of 2006 was a deficit of \$6.2 million. This compares with free cash flow of \$7.0 million in the first quarter of 2005. The deficit in the first quarter of 2006 reflects lower earnings before non cash charges. Free cash flow is defined as cash provided by operating activities in excess of additions to capital assets in the period. Free cash flow is a non-GAAP measure. Please refer to the section describing the use of non-GAAP measures in this MD&A.

### Cash Provided by Operating Activities

Cash provided by operating activities was \$7.8 million in the first quarter of 2006 compared with \$20.5 million for the comparable period in 2005. The decrease reflects lower earnings before non cash charges.

### Cash Used in Investing Activities

Cash used in investing activities for the first quarter of 2006 was \$14.4 million. In the first quarter of 2005, cash used in investing activities was \$246.9 million. The 2005 amount included cash used in connection with the acquisition of MOVA of \$232.4 million. In the first quarter of 2006, additions to capital assets were \$13.9 million and were comparable to the same period a year ago. Capital additions in 2006 related principally to the establishment of sterile cephalosporin lyophilization capacity at Swindon, U.K. and the establishment of high-potency capabilities at Bourgoin-Jallieu, France.

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

	<b>Three months ended January 31,</b>	
	<b>2006</b>	<b>2005</b>
	<u>\$</u>	<u>\$</u>
Acquisition net of cash acquired	-	144,536
Increase in escrow cash related to acquisition	-	87,825
Additions to capital assets-sustaining	<b>2,740</b>	1,150
-project-related	<b>11,180</b>	12,313
Increase in deferred pre-operating costs	<u><b>518</b></u>	<u>1,059</u>
Cash used in investing activities	<u><b>14,438</b></u>	<u>246,883</u>

### ***Cash Provided by Financing Activities***

The principal financing activities for the three months ended January 31, 2006 were 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.

During the first quarter of 2006 the Company received \$9.6 million from a client for the reimbursement of costs the Company is incurring in connection with the sterile cephalosporin lyophilization capacity being installed in Swindon, U.K. This amount is recorded as an increase in deferred revenues.

A summary of cash provided by (used in) financing activities is as follows:

	<b>Three months ended January 31,</b>	
	<b>2006</b>	<b>2005</b>
	<u>\$</u>	<u>\$</u>
Decrease in bank indebtedness	<b>(13,596)</b>	(451)
Increase in long-term debt	<b>283,580</b>	164,039
Repayment of long-term debt	<b>(287,352)</b>	(103,385)
Decrease (increase) in restricted cash	<b>7,805</b>	(260)
Increase in deferred financing costs	<b>(2,765)</b>	(8,720)
Increase in deferred revenues	<b>9,614</b>	-
Proceeds on issue of common shares before costs	-	199,241
Share issue costs	-	(8,942)
Cash provided by (used in) financing activities	<u><b>(2,714)</b></u>	<u>241,522</u>

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

At January 31, 2006, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 52.5%, compared with 66.7% at January 31, 2005 and 56.1% at the end of the 2005 fiscal year. The improvement relative to the first quarter of 2005 reflects the repayments of long-term debt financed from the release of \$22.8 million held in escrow in connection with the MOVA acquisition during the third quarter of 2005, and the release of \$7.8 million in restricted cash during the first quarter of 2006.

On December 15, 2005, the Company completed new credit facilities in North America in the aggregate amount of \$290.0 million to refinance existing debt of the Company and its U.S. subsidiaries, including its

subsidiaries in Puerto Rico. The new facilities replace: (i) existing credit facilities that were available to the Company's North American operations, including those that were established at the time of acquisition of MOVA in December 2004; and (ii) debt of MOVA that was assumed at the time of acquisition by the Company. The new credit facilities comprise two term loans in the aggregate amount of \$215.0 million and three-year revolving facilities in the aggregate totaling \$75.0 million. The term loans consist of a five-year term loan of \$50.0 million and six-year term loan of \$165.0 million. At January 31, 2006 no amounts were drawn on the revolving facilities. The new facilities are secured by the North American assets of Patheon and its subsidiaries, including those in Puerto Rico.

On December 22, 2005, the Company's Italian subsidiary entered into a new long-term debt facility. The new loan replaced four separate term loans it had with an Italian bank. The new loan in the amount of 28.5 million euros (\$33.9 million) is collateralized by a mortgage over land and buildings.

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

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

## **Critical Accounting Policies and Estimates**

### ***General***

Patheon's significant accounting policies are described in Note 1 to the 2005 audited consolidated financial statements. The most critical of these policies are those related to revenue recognition, deferred revenues, intangible assets, goodwill, employee future benefits, and income taxes, (Notes 1, 6, 8, 12 and 16 of the 2005 audited financial statements).

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based upon management's historical experience and are believed by management to be reasonable under the circumstances. Such estimates and assumptions are evaluated on an ongoing basis and form the basis for making 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.

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 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 2006, \$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 nine years. During the first quarter of 2006, \$3.4 million was charged to the loss.

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 2006.

### ***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 the reporting unit's fair value, any excess represents an impairment loss.

The goodwill shown on the financial statements for the period ended January 31, 2006 was \$187.4 million and relates to the acquisition in 2000 of the remaining shares of Global Pharm Inc., which now operates as Toronto York Mills Operations, and from the acquisition of MOVA on December 23, 2004. As at January 31, 2006, goodwill shown on the financial statements relating to the MOVA acquisition was \$184.4 million and goodwill shown relating to Toronto York Mills acquisition was \$3.0 million.

### ***Income Taxes***

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

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

Future tax assets of \$20.1 million have been recorded at January 31, 2006. These assets are primarily composed of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, the tax benefit of net operating loss carryforwards related to the U.K. operations and share issue costs in relation to the acquisition of MOVA. The Company evaluates quarterly the ability to realize its future tax assets. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets. The Company has available to it tax planning strategies to realize future tax assets in order to avoid the potential loss of benefits.

Future tax liabilities of \$38.3 million have been recorded at January 31, 2006. This liability has arisen primarily on tax depreciation in excess of book depreciation.

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

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

The Company provides pensions and 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 12 to the Company's 2005 audited consolidated financial statements.

## **Risk Management**

The following are updates to certain of the risks and uncertainties described in the Management's Discussion and Analysis section of Patheon's 2005 Annual Report, 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 65% to 75% of revenues of the Canadian operations and approximately 15% to 25% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience trading and translation gains or losses because of volatility in the exchange rate between the Canadian and U.S. dollar. Based on the Company's current U.S. denominated net inflows, for each one-cent change in the Canadian-U.S. rate, the impact on annual net earnings is approximately \$0.7 million.

The Company mitigates its foreign exchange risk by engaging in foreign currency hedging activities using derivative financial instruments. The Company does not purchase any derivative instruments for speculative purposes. During the first quarter of 2006, the Company sold US\$12.5 million in connection with forward contracts that were in place at October 31, 2005. At January 31, 2006 the Company had no outstanding foreign exchange contracts in place.

Translation gains and losses related to the carrying value of the Company's foreign operations and certain foreign denominated debt held by the Company as a hedge against the carrying value of certain foreign operations, are deferred and included in the cumulative translation account in shareholders' equity. At January 31, 2006, the balance in the account was a \$55.8 million gain compared with a \$38.1 million gain at October 31, 2005.

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

The Company has exposure to movements in interest rates. During the first quarter of 2006, the Company put in place interest rate swap contracts that convert \$107.5 million of debt drawn on the Company's new North American term facilities from floating interest rates to fixed interest rates. At October 31, 2005, 83% of the Company's total debt portfolio was subject to movements in floating interest rates. As a result of putting in place the interest rate swap contracts, at January 31, 2006, 58% 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 net earnings of approximately \$1.1 million.

## **Additional Information**

### ***Share Capital***

As of March 3, 2006, the Company had 92,845,688 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**

The Company expects that the impact of operating challenges in the first quarter on revenues and profitability will be difficult to overcome in the remainder of 2006.

While the Company expects that the second half of the year will be better than the first half, overall growth is expected to be lower than anticipated due to declines in North American base business that are more significant than usual.

The Company is encouraged by the growth in European operations, the success of the high-potency capabilities at the Toronto Region site where a total of nine new products have been launched since 2001, as well as the success in developing the PDS pipeline. At the end of the first quarter, the Company was providing development services for 152 projects, including six that are in line for regulatory approval.

As a result of operating challenges in the first quarter together with lower-than-expected revenues in 2006, both EBITDA and net earnings are expected to be lower than in fiscal 2005. The Company expects improved results in the second quarter, with further improvement in the second half.

The Company continues to view 2006 as a transition year as the Company addresses the challenges in the Puerto Rican operations, completes the transfer of two groups of products to the Bourgoin-Jallieu and the Italian operations, completes the new cephalosporin lyophilization facility in Swindon and continues to develop additional PDS capacity both in existing facilities as well as in India.

In addition to these specific initiatives, the Company has also engaged in a broader course of action focused on improving efficiency and reducing operating costs across the organization. This includes a global procurement program to consolidate and leverage our global purchasing power and the implementation of company-wide cost saving programs.

### ***No Auditor Review***

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of management. The Company's independent auditor has not performed a review of the financial statements for the three-month period ended January 31, 2006 or for the comparative period ended January 31, 2005.

## **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 market demand for client products; dependence on key clients; the ability to identify and secure new contracts; regulatory matters, including compliance with pharmaceutical regulations; management of expanded operations; international operations risks; currency risks; competition; product liability claims; integration of new operations; financing risks and interest rate risks. Although the Company has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date of this 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.