



NEWS RELEASE

For Immediate Release

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PATHEON ANNOUNCES PERFORMANCE ENHANCEMENT PROGRAM AND SECOND QUARTER RESULTS

Toronto, Canada (June 2, 2006) – Patheon (TSX:PTI), a leading global provider of drug development and manufacturing services to the international pharmaceutical industry, today announced a performance enhancement program and its results for the second quarter ended April 30, 2006. (All amounts are in U.S. dollars unless otherwise indicated.)

Performance Enhancement Program

“Our Board of Directors and management team are confident that Patheon has established its position as a market leader in the pharmaceutical outsourcing industry,” said Mr. Peter Green, Chairman of Patheon Inc. “However, we are dissatisfied with the Company’s financial performance. It is clear that now is the time to unlock the inherent economic value of the Company through an immediate and aggressive plan to improve the profitability and cash generation capability of our business model.”

The Office of the Chief Executive Officer has initiated a performance enhancement program, aimed at improving the productivity and cost effectiveness of Patheon’s operations.

“We are committed to swift and decisive action, and look forward to reporting on our progress as we enter this new phase of Patheon’s development,” said Mr. Green.

CEO Succession

The Board’s Succession Committee is actively engaged in the search for the new Chief Executive Officer and expects to complete the process during the fourth quarter.

“In the meantime,” Mr. Green said, “the Office of the Chief Executive Officer is working closely with senior management to develop and implement the performance enhancement program, with the objective of improving Patheon’s operational and financial strength, flexibility and profitability, both in the short and longer term.”

Company Financial Results

Second Quarter Ended April 30, 2006

Compared With Second Quarter Ended April 30, 2005

- Revenues increased 3% to \$189.9 million;
- EBITDA was \$24.2 million (12.8% of revenues) compared with \$24.3 million (13.2% of revenues);
- Net earnings were \$3.0 million (3.2 cents per share), compared with net earnings of \$3.8 million (3.4 cents per share).

Six Months Ended April 30, 2006

Compared With Six Months Ended April 30, 2005

- Revenues increased 3% to \$347.8 million;
- EBITDA was \$38.2 million (11.0% of revenues), compared with \$45.9 million (13.6% of revenues);
- The net loss was \$8.5 million or 9.2 cents per share compared with net earnings of \$9.8 million (12.1 cents per share).

“Our financial performance improved compared with the first quarter of this year across most key measures, including revenues, EBITDA, and net earnings,” said Douglas L. Ludwig, Chief Financial Officer and Executive Vice-President. “While we continue to view 2006 as a challenging year, we will be focused on establishing the performance enhancement plan, with quantifiable objectives and timetables that we will communicate to our stakeholders so that our progress can be actively monitored.”

Consolidated EBITDA of \$24.2 million represented an increase of \$10.2 million over the first quarter of 2006, but was comparable to \$24.3 million in the second quarter of last year. As a percentage of revenues, the EBITDA margin was 12.8% in the second quarter of 2006, compared with 13.2% in the same period a year ago.

In North America, EBITDA from the Puerto Rico commercial manufacturing operations was \$4.4 million, declining 55% from the same period a year ago. This decline was primarily attributable to lower revenues from a generic product, where the Company’s client lost a major customer, and additional costs incurred as part of the corrective action plan to address FDA issues relating to Omnicef® production. Volume declines at the Caguas and Manati facilities were offset in part by improved revenue performance at Carolina, where volumes exceeded those in the same period a year ago.

Higher capacity utilization at the Canadian commercial manufacturing operations resulted in an increase in EBITDA over the same period a year ago of \$4.9 million, or 101%. The increases in Canada were driven by the Toronto Region facility, where EBITDA of \$9.2 million was \$2.8 million higher than a year ago, and the Whitby facility, which reported EBITDA of \$1.8 million, compared with a loss of \$2.0 million in the same period a year ago. EBITDA from commercial manufacturing operations at Cincinnati were comparable to those in the same period a year ago.

In Europe, EBITDA from commercial manufacturing improved by 49% to \$7.5 million over the same period a year ago. This improvement was primarily attributable to increased large-volume parenteral volumes at the Italian sites resulting from one of two client carve-out initiatives underway in Europe, and continued improved performance at Swindon, U.K.

EBITDA from the global PDS operations declined by 31% to \$3.4 million in the second quarter. Growth at the Cincinnati and Puerto Rico PDS units was offset by lower earnings from the Canadian PDS operations, where there were fewer late-stage projects and where the strengthening of the Canadian dollar also had an impact.

Outlook

“Overall, we expect that revenues in the second half of 2006 will be slightly higher than in the second half of 2005, but EBITDA will be similar, due to the impact of the continuing strength of the Canadian dollar relative to the U.S. dollar,” said Mr. Ludwig. “This has the effect of reducing the profitability of the Canadian operations, where most of the revenues are denominated in US dollars, but costs are largely denominated in Canadian dollars. Depreciation, amortization and interest costs will be marginally higher than the second quarter run rate. Effective tax rates will be impacted largely by changes in profitability of the Puerto Rico and Italian operations. Tax rates in the third quarter are expected to be in the 50-55% range, falling to 40-45% in the fourth quarter.”

Business Development

During the second quarter, Patheon entered into a seven-year contract with a major pharmaceutical company client to provide commercial manufacturing services from its Swindon, U.K. facility for a promising innovative cephalosporin product designed to be effective against methicillin-resistant *Staphylococcus aureus* (MRSA). The client is planning to launch the product for the U.S. market in 2007, subject to receiving FDA approval.

During the second quarter, Patheon also entered into a technology transfer agreement with another major pharmaceutical company client to transfer an existing commercial product to Patheon’s Manati plant in Puerto Rico. An agreement on a second product is also nearing completion. Long-term manufacturing and supply agreements are under

negotiation, and technical teams are already working on the transfer of the products. PDS work on both of these projects will take place throughout the balance of 2006 and early 2007, while the majority of commercial revenues will be generated in 2007 and beyond.

Furthermore, the Manati facility is being qualified to handle additional volumes of a recently launched product currently manufactured at Patheon's Toronto facility. This will be of benefit to the client, who will have a dual sourcing strategy and additional capacity for this important product. For Patheon, it will enable the Toronto facility to take on more high-potency work for which there is significant demand, and the Manati facility will gain from the addition of new volumes.

"These and other important new sources of revenues will help to offset declines in base business, including lower Zocor® production as its patent expires in June 2006," said Nick DiPietro, President and Chief Operating Officer.

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 second quarter results on Friday, June 2, 2006 at 10:00 a.m. (Eastern Daylight Time). Representing Patheon on the call will be: Peter Green, Chairman, Patheon Inc.; Nick DiPietro, President and Chief Operating Officer; Douglas Ludwig, Chief Financial Officer and Executive Vice-President; and Shelley Jourard, Director, Corporate Communications. The call will begin with a brief presentation, followed by a question-and-answer period with investment analysts. Interested parties are invited to access the live call, via telephone, in listen-only mode, at (416) 644-3433 (Toronto and International) or toll free at (800) 814-4941 (U.S., including Puerto Rico). Listeners are encouraged to dial in five to 15 minutes in advance to avoid delays. A live audio webcast, with a slide presentation, will also be available via the web at www.patheon.com. An archived version of the Q2 webcast will be available on www.patheon.com for three months.

ABOUT PATHEON

Patheon (TSX:PTI; 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 6,100 people and serving a client base of more than 200 pharmaceutical and biotechnology companies.

Consolidated Statements of Earnings (Loss)

(unaudited)

	Three months ended April 30,			Six months ended April 30,		
	2006	2005	% change	2006	2005	% change
(in thousands of U.S. dollars, except per share amounts)	\$	\$		\$	\$	
Revenues	189,902	184,088	3.2%	347,846	338,035	2.9%
Operating expenses	165,689	159,802	3.7%	309,621	292,102	6.0%
Earnings before the following: (as a % of revenues)	24,213	24,286	-0.3%	38,225	45,933	-16.8%
	12.8%	13.2%		11.0%	13.6%	
Depreciation and amortization	9,920	8,858	12.0%	19,731	16,677	18.3%
Amortization of intangible assets	3,472	3,244	7.0%	6,895	4,524	52.4%
Interest	4,795	4,681	2.4%	9,898	7,014	41.1%
Debt prepayment charges (note 10)	-	-		1,643	-	
Amortization of deferred financing costs	137	1,570	-91.3%	462	2,147	-78.5%
Write-off of deferred financing costs (note 10)	-	16	-100.0%	6,332	2,010	215.0%
Earnings (loss) before income taxes	5,889	5,917	-0.5%	(6,736)	13,561	-149.7%
Provision for income taxes	2,900	2,134	35.9%	1,785	3,774	-52.7%
Net earnings (loss) for the period	2,989	3,783	-21.0%	(8,521)	9,787	-187.1%
(as a % of revenues)	1.6%	2.1%		-2.4%	2.9%	
Earnings (loss) per share						
Basic	3.2¢	3.4¢	-5.9%	(9.2¢)	12.1¢	-176.0%
Diluted	3.2¢	3.4¢	-5.9%	(9.2¢)	12.1¢	-176.0%
Average number of shares (note 3) outstanding during period:						
Basic (in thousands)	92,846	92,846	0.0%	92,846	80,710	15.0%
Diluted (in thousands)	93,110	93,384	-0.3%	92,846	81,152	14.4%

see accompanying notes

Consolidated Statements of Retained Earnings

(unaudited)

	Six months ended April 30,	
	2006	2005
(in thousands of U.S. dollars)	\$	\$
Retained earnings, beginning of the year	98,250	76,629
Net earnings (loss) for the period	(8,521)	9,787
Retained earnings, end of period	89,729	86,416

see accompanying notes

Consolidated Balance Sheets

(unaudited)

	As at April 30,	As at October 31,
	2006	2005
<i>(in thousands of U.S. dollars)</i>	\$	\$
Assets		
Current		
Cash and cash equivalents	6,227	22,507
Restricted cash	-	7,805
Accounts receivable	129,608	143,646
Inventories	82,208	72,818
Income taxes receivable	5,125	-
Prepaid expenses and other	9,227	4,258
Total current assets	<u>232,395</u>	<u>251,034</u>
Capital assets	499,854	474,793
Intangible assets	109,179	110,095
Deferred costs	8,320	12,342
Future tax assets	32,657	21,368
Goodwill	190,878	180,665
Investment	1,317	1,271
	<u>1,074,600</u>	<u>1,051,568</u>
Liabilities and Shareholders' equity		
Current		
Bank indebtedness	1,776	14,357
Accounts payable and accrued liabilities	131,104	129,067
Income taxes payable	-	5,650
Current portion of long-term debt (note 9)	17,491	11,360
Total current liabilities	<u>150,371</u>	<u>160,434</u>
Long-term debt (note 9)	274,682	277,181
Other long-term liabilities	23,833	22,755
Deferred revenues	24,127	14,587
Future tax liabilities	39,803	36,760
Total liabilities	<u>512,816</u>	<u>511,717</u>
Shareholders' equity		
Share capital	400,594	400,594
Contributed surplus	3,393	2,901
Retained earnings	89,729	98,250
Cumulative translation adjustment	68,068	38,106
Total shareholders' equity	<u>561,784</u>	<u>539,851</u>
	<u>1,074,600</u>	<u>1,051,568</u>

see accompanying notes

Consolidated Statements of Cash Flows

(unaudited)

	Three months ended April 30,		Six months ended April 30,	
	2006	2005	2006	2005
(in thousands of U.S. dollars)	\$	\$	\$	\$
Operating activities				
Net earnings (loss) for the period	2,989	3,783	(8,521)	9,787
Add (deduct) charges to operations not requiring a current cash payment				
Depreciation and amortization	13,529	13,672	27,088	23,348
Write-off of deferred financing costs (note 10)	-	16	6,332	2,010
Employee future benefits	860	92	74	809
Future income taxes	459	175	2,774	282
Amortization of deferred revenues	(498)	(381)	(995)	(338)
Other	373	348	871	843
	17,712	17,705	27,623	36,741
Net change in non-cash working capital balances related to operations	(15,387)	(14,563)	(17,534)	(13,145)
Cash provided by operating activities	2,325	3,142	10,089	23,596
Investing activities				
Acquisition	-	636	-	(145,190)
Cash acquired on acquisition	-	-	-	645
Acquisition net of cash acquired	-	636	-	(144,545)
Increase in escrow cash related to acquisition	-	-	-	(87,825)
Additions to capital assets - sustaining	(3,597)	(3,180)	(6,337)	(4,330)
- project - related	(10,028)	(9,683)	(21,208)	(21,996)
Decrease (increase) in deferred pre-operating costs	61	(995)	(457)	(2,054)
Cash used in investing activities	(13,564)	(13,222)	(28,002)	(260,750)
Financing activities				
Increase (decrease) in bank indebtedness	905	(1,392)	(12,691)	(1,843)
Increase in long-term debt	27,563	66,872	311,143	230,911
Repayment of long-term debt	(23,993)	(55,775)	(311,345)	(159,160)
Decrease (increase) in restricted cash	-	(187)	7,805	(447)
Increase in deferred financing costs	(25)	(815)	(2,790)	(9,535)
Increase in deferred revenues	-	-	9,614	-
Proceeds on issue of common shares before costs	-	-	-	199,241
Share issue costs	-	(5)	-	(8,947)
Cash provided by financing activities	4,450	8,698	1,736	250,220
Effect of exchange rate changes on cash and cash equivalents	(225)	(1,468)	(103)	(7,435)
Net increase (decrease) in cash and cash equivalents during the period	(7,014)	(2,850)	(16,280)	5,631
Cash and cash equivalents, beginning of period	13,241	16,107	22,507	7,626
Cash and cash equivalents, end of period	6,227	13,257	6,227	13,257

see accompanying notes

Patheon Inc.

Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 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 consolidated 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.

The Company has adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities". The Guideline requires consolidation of entities that are deemed to be subject to control on a basis other than through ownership of a voting interest in the entity. The Company has concluded that it does not have any variable interest entities and there is no impact on the financial statements as a result of adopting the Guideline.

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 April 30,	
	2006	2005
Weighted average number of common shares outstanding	92,845,688	92,845,688
Effect of dilutive stock options	264,160	537,988
Weighted average number of common shares outstanding – diluted	93,109,848	93,383,676

	Six months ended April 30,	
	2006	2005
Weighted average number of common shares outstanding	92,845,688	80,709,704
Effect of dilutive stock options	-	442,631
Weighted average number of common shares outstanding – diluted	92,845,688	81,152,335

4. Share capital

The following table summarizes information on share capital and related matters at April 30, 2006:

	Outstanding	Exercisable
Common shares	92,845,688	
Common share stock options	4,252,979	3,553,801

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Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2006

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

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 April 30, 2006			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	11,020	35	119	11,174
U.S.A.	40,218	64,970	1,902	107,090
Europe	15,290	74	53,324	68,688
Other geographic areas	1,289	90	1,571	2,950
Total revenues	67,817	65,169	56,916	189,902
Capital assets	129,453	170,819	199,582	499,854
Goodwill	3,091	187,787	-	190,878

	Three months ended April 30, 2005			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	6,262	383	660	7,305
U.S.A.	42,947	70,420	2,435	115,802
Europe	10,694	58	48,326	59,078
Other geographic areas	1,425	103	375	1,903
Total revenues	61,328	70,964	51,796	184,088
Capital assets	109,974	177,344	191,546	478,864
Goodwill	2,746	86,350	-	89,096

	Six months ended April 30, 2006			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	21,056	288	408	21,752
U.S.A.	73,595	120,283	3,928	197,806
Europe	25,295	335	97,640	123,270
Other geographic areas	2,503	171	2,344	5,018
Total revenues	122,449	121,077	104,320	347,846

	Six months ended April 30, 2005			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	12,445	546	1,154	14,145
U.S.A.	85,072	121,626	4,352	211,050
Europe	21,300	303	87,727	109,330
Other geographic areas	2,517	219	774	3,510
Total revenues	121,334	122,694	94,007	338,035

Patheon Inc.

Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2006

(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:

	Three months ended April 30,			
	2006		2005	
	\$		\$	
Commercial manufacturing - prescription	140,160	74%	132,710	72%
Commercial manufacturing - over-the-counter	27,395	14%	29,249	16%
Development services	22,347	12%	22,129	12%
	189,902	100%	184,088	100%

	Six months ended April 30,			
	2006		2005	
	\$		\$	
Commercial manufacturing - prescription	252,199	72%	238,954	70%
Commercial manufacturing - over-the-counter	51,290	15%	55,931	17%
Development services	44,357	13%	43,150	13%
	347,846	100%	338,035	100%

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 April 30, 2006, the total number of common shares available for issuance under the plan was 6,963,427, of which 4,252,979 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 222,500 options granted for the three months ended April 30, 2006 was \$2.77 (2005-\$2.94). The weighted average fair value of stock options granted for the six months ended April 30, 2006 was \$2.30 (2005-\$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 April 30, 2006:

Risk free interest rate	4.3%
Expected volatility	42%
Expected weighted average life of the options	6 years
Expected dividend yield	0%

Patheon Inc.

Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2006

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

Stock-based compensation expense recorded in the three months ended April 30, 2006 was \$152,000 (2005 - \$348,000) for options granted on or after November 1, 2003. Stock based compensation expense recorded for the six months ended April 30, 2006 was \$492,000 (2005-\$843,000) 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 pro-forma net earnings (loss) and earnings (loss) per share would have been:

	Three months ended April 30,		Six months ended April 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Net earnings (loss) as reported	2,989	3,783	(8,521)	9,787
Pro-forma adjustments for the fair value of stock options granted prior to November 1, 2003	(22)	(47)	(28)	(98)
Pro-forma net earnings (loss)	<u>2,967</u>	<u>3,736</u>	<u>(8,549)</u>	<u>9,689</u>
Pro-forma earnings (loss) per share:				
Basic	3.2¢	3.4¢	(9.2¢)	12.0¢
Diluted	3.2¢	3.3¢	(9.2¢)	11.9¢

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 \$12,279,000 for the three months ended April 30, 2006 (2005 - unrealized currency translation loss of \$5,308,000). For the six months ended April 30, 2006, the unrealized currency translation gain is \$29,962,000 (2005 - unrealized currency translation loss of \$6,496,000).

The net unrealized gain of \$12,279,000 in the quarter and \$29,962,000 year-to-date is attributable to the weakening of the U.S. dollar against the Canadian dollar, the euro and U.K. sterling, as measured at April 30, 2006, January 31, 2006 and October 31, 2005.

Foreign exchange

During the three months ended April 30, 2006, the foreign exchange gain was \$441,000 (2005 gain - \$1,116,000). For the six months ended April 30, 2006, the foreign exchange gain was \$189,000 (2005 - \$3,377,000)

Employee future benefits

The employee future benefit expense for the three months ended April 30, 2006 was \$860,000 (2005 - \$92,000). For the six months ended April 30, 2006, the employee future benefit expense was \$74,000 (2005 - \$809,000).

Patheon Inc.

Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2006

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

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 foreign exchange forward contracts with an aggregate amount of US\$35,000,000 as at April 30, 2006. These contracts mature at the latest on September 27, 2006 at exchange rates varying between 1.16996 and 1.1728 Canadian. The mark-to-market value on these financial instruments as at April 30, 2006 was an unrealized gain of US\$1,449,000.

In the second quarter of 2006, the Company unwound its interest rate swap contracts that exchanged a notional amount of US\$107,500,000 of debt from floating to fixed interest rates. The gain of \$1,097,000 that was realized on the unwinding of the swaps is being amortized to interest expense over approximately six years, reflecting the maturity dates of the original contracts.

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 an 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 April 30, 2006, \$2,000,000 was 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 in the first quarter of 2006.

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.

Patheon Inc.

Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2006

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

11. Contingent liability

During the second quarter of 2006, MOVA received a notice from the Puerto Rico Industrial Development Company ("PRIDCO") requesting the accelerated repayment of a grant that MOVA received in 1996. In accordance with the terms of the original agreement with PRIDCO, MOVA has been repaying the grant in the form of royalty payments that are tied to revenues generated from specific products that MOVA manufactures for its clients. Such royalty payments are charged to earnings as they are incurred.

The Company is in the process of investigating whether the accelerated repayment of the grant is the responsibility of the previous owners of MOVA. Because of the uncertainty of the outcome of these investigations, no liability has been recorded on the balance sheet at April 30, 2006. The amount outstanding on the grant at April 30, 2006 is \$4,749,000.

12. Comparative amounts

Certain of the 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 and six-month periods ended April 30, 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 June 2, 2006.

The purpose of this 2006 second 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 or from the SEDAR web site for Canadian regulatory filings at 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, or Patheon at 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. "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"). 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 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 April 30, 2006, there were a total of 158 client products in the Patheon's pharmaceutical development services ("PDS") pipeline, including five drug candidates at the New Drug Application ("NDA") stage. This compares with a total of 128 client products a year ago. During the second 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) expanding its 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 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 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", or the "Puerto Rico operations"), 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 April 30, 2006 Compared with Three Months Ended April 30, 2005

Revenues by Geographic Region and Service Activity

	Three months ended April 30,			Six months ended April 30,		
	2006	2005	% Change	2006	2005	% Change
<u>North America</u>						
Commercial Manufacturing						
Prescription	88,231	85,891	3%	157,534	154,256	2%
Over-the-counter	26,900	28,877	-7%	50,419	54,995	-8%
	115,131	114,768	0%	207,953	209,251	-1%
Development Services						
	17,855	17,524	2%	35,573	34,777	2%
	132,986	132,292	1%	243,526	244,028	0%
<u>Europe</u>						
Commercial Manufacturing						
Prescription	51,929	46,819	11%	94,665	84,698	12%
Over-the-counter	495	372	33%	871	936	-7%
	52,424	47,191	11%	95,536	85,634	12%
Development Services						
	4,492	4,605	-2%	8,784	8,373	5%
	56,916	51,796	10%	104,320	94,007	11%
<u>TOTAL</u>						
Commercial Manufacturing						
Prescription	140,160	132,710	6%	252,199	238,954	6%
Over-the-counter	27,395	29,249	-6%	51,290	55,931	-8%
	167,555	161,959	3%	303,489	294,885	3%
Development Services						
	22,347	22,129	1%	44,357	43,150	3%
CONSOLIDATED REVENUES	189,902	184,088	3%	347,846	338,035	3%

Revenues

Consolidated revenues for the three-month period ended April 30, 2006 increased 3%, or \$5.8 million, to \$189.9 million from \$184.1 million in the same period in 2005. In the second quarter, growth came principally from Rx commercial manufacturing services in both North America and Europe. On a consolidated basis, commercial manufacturing revenues grew 3%, with Rx manufacturing up 6%, offset in part by a 6% decline in OTC manufacturing revenues compared with the second quarter of 2005. PDS revenues were comparable with the same period in 2005.

Prescription manufacturing and development services represented 86% of revenues, compared with 84% for the comparable period in 2005, a result of the Company's focus on attracting more profitable Rx manufacturing and PDS business to its facilities.

Geographically, in North America, revenue growth in the second quarter was limited to \$0.7 million or 1% over the same period a year ago. Revenues from the Puerto Rico operations were \$38.6 million, down from \$45.1 million in the same period a year ago, but up sequentially from \$29.4 million in the first quarter of 2006. The declines reflect a reduction in base business at Caguas and Manatí. Revenues from one generic product alone, where the Company's client lost a major customer, accounted for most of this decline. The Carolina operations, that were impacted by a voluntary shut down in production of Omnicef® oral powder for suspension during the first quarter of 2006 to address issues identified in a Warning Letter from the U.S. Food and Drug Administration, showed marked improvement during the second quarter, with revenues exceeding the same period last year. This product is now being manufactured on three production lines and volumes have returned to pre-Warning Letter levels.

Revenues from the existing operations in North America were \$7.2 million, or 8% higher than the same period last year, including a \$9.7 million, or 23% increase in Rx revenues. Revenues from the Toronto Region operations increased principally as a result of two products that the Company launched for clients in 2005, along with additional volumes from a range of oral contraceptives. Revenues also increased at Whitby, as the site started to see improvements in manufacturing efficiencies. These gains were partially offset by lower OTC business in both Canada and Cincinnati.

Revenues from PDS services in North America increased 2% over the same period a year ago as growth in the business in Cincinnati and Puerto Rico was partially offset by lower revenues in Canada, where there were fewer late-stage higher value projects than in 2005.

In Europe, revenues for the second quarter of 2006 were \$5.1 million or 10% higher than the same period of 2005. The year-over-year increase in revenues is due to improved commercial revenues at the two Italian sites and Swindon, U.K. In the case of Italy the improvements reflect volume increases from a carve-out project where the Company is manufacturing a range of products for a client that is re-aligning its own manufacturing network, and from increased sterile lyophilization volumes. The revenue increase in Swindon, UK reflects services being provided in connection with the lyophilized cephalosporin product that the Company will be launching for a client. European currencies weakened against the U.S. dollar in the second quarter of fiscal 2006 compared with the prior year. The euro weakened approximately 7% and U.K. sterling weakened approximately 8% against the U.S. dollar, reducing reported revenues by approximately \$4.6 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 19% higher than the same period in 2005.

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 second quarter of 2006, operating expenses were \$165.7 million, compared with \$159.8 million in the same period a year ago, an increase of 4%. The increase principally reflects the higher revenue base, annual payroll related increases, additional GMP-related costs in Carolina and the impact of the strengthening Canadian dollar relative to the U.S. dollar. These increases were offset in part by lower bonus costs, savings from global procurement initiatives and from weakening European currencies relative to the U.S. dollar. Operating expenses as a percentage of revenues were 87.2%, compared with 86.8% in the same period a year ago.

EBITDA and EBITDA Margin

On a consolidated basis in the second quarter of 2006, EBITDA, representing earnings before depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs and income taxes was \$24.2 million, compared with \$24.3 million in the same period a year ago. As a percentage of revenues, the EBITDA margin was 12.8% in the three-month period, compared with 13.2% in the same period a year ago.

EBITDA from the Puerto Rico commercial operations was \$4.4 million representing a decline of 55% relative to the same period last year. This reflects volume declines in Caguas and Manatí, offset in part by the improved performance in Carolina.

The profitability of Canadian operations was impacted by the strengthening of the Canadian dollar relative to the U.S. dollar. The Canadian dollar strengthened by approximately 7% relative to the second quarter of 2005. Had exchange rates remained the same as last year, EBITDA from the Canadian operations, net of hedging activities, would have been approximately \$1.6 million higher than was reported.

Higher capacity utilization at the Canadian and European commercial manufacturing operations resulted in an EBITDA increase over the prior year of \$4.9 million, or 101% and \$2.4 million, or 49% respectively. The increases in Canada were driven by the Toronto Region facility, where EBITDA of \$9.2 million was \$2.8 million higher than 2005 and the Whitby facility, which reported EBITDA of \$1.8 million, compared with an EBITDA loss of \$1.9 million and \$2.0 million in the first quarter of 2006 and the second quarter of 2005, respectively.

EBITDA from the PDS operations was \$1.6 million, or 31% lower than the same period in 2005. The Canadian operations were negatively impacted by lower revenues and from the continuing strengthening of the Canadian dollar against the U.S. dollar.

Depreciation and Amortization Expense

Depreciation and amortization expense was \$9.9 million in the second quarter of 2006, compared with \$8.9 million in the second quarter of 2005, an increase of \$1.0 million, or 12%. The increase principally reflects completed capital programs in the Italian sites and from the Toronto Region operations. Depreciation and amortization expense includes the amortization of deferred pre-operating costs.

Amortization of Intangible Assets

Amortization of intangible assets was \$3.5 million in the second quarter of 2006, compared with \$3.2 million for the second quarter of 2005. The amortization of intangible assets relates entirely to the Puerto Rico operations.

Interest Expense

Interest expense for the second quarter of 2006 was \$4.8 million and was comparable with the \$4.7 million charge in the second quarter of 2005.

Amortization of Deferred Financing Costs

Amortization of deferred financing costs in the second quarter of 2006 was \$0.1 million, compared with \$1.6 million in the second quarter of 2005. The charges in both years relate principally to the amortization of costs associated with the North American credit facilities. The Company consolidated its North American borrowing requirements in new credit facilities that were completed during the first quarter of 2006. All unamortized costs associated with the old facilities were charged to earnings at the time the new facility was put in place.

Earnings Before Income Taxes

The Company reported earnings before income taxes of \$5.9 million, which was comparable with the amount reported in the same period a year ago.

Income Taxes

The effective tax rate on earnings before income taxes in the second quarter of 2006 was 49.2% compared with an effective tax rate of 36.1% in the same period a year ago. The increase in tax rates reflects a pre-tax loss in the Puerto Rico operations, where the Company's tax rate averaged 5% and increased earnings from Italian operations, where the effective tax rate averaged 59%.

Net Earnings and Earning Per Share

The Company recorded net earnings in the second quarter of 2006 of \$3.0 million, compared with net earnings of \$3.8 million in the same period last year. The earnings per share were 3.2¢, comparable with earnings per share of 3.4¢ a year earlier.

The diluted earnings per share were 3.2¢ compared with 3.4¢ in the second quarter of 2005. Dilution arises solely from options issued under the Company's stock option plan.

Six Months Ended April 30, 2006 Compared with Six Months Ended April 30, 2005

The results for the six-month period ended April 30, 2006 include the operations of MOVA for a full two quarters, while the results of the comparative period include the operations of MOVA from the date of acquisition on December 23, 2004 until April 30, 2005.

Revenues

Consolidated revenues for the six-month period ended April 30, 2006 increased 3% or \$9.8 million to \$347.8 million from \$338.0 million in the same period in 2005. In the six-month period, growth was driven by Rx manufacturing and PDS. On a consolidated basis, Rx manufacturing revenues grew 6% and PDS revenues were up 3%. Offsetting this was a decline in OTC manufacturing revenues of 8%.

Revenues from the Puerto Rico operations were \$68.0 million, or \$1.0 million lower than 2005. The 2006 results include a full first quarter of operations compared with only five weeks of operations in 2005. Revenues in the second quarter were \$6.5 million lower than prior year. The 2006 year-to-date revenues in Puerto Rico reflect the impact of the temporary suspension of production in the Carolina facility during the first quarter to resolve issues identified in a Warning Letter from the U.S. Food and Drug Administration and from declines in base business volumes in Caguas and Manatí.

Excluding the Puerto Rico operations, growth from existing sites was \$10.8 million, or 4%, in the six-month period of 2006. Virtually all of this increase was derived from the European operations. The growth in Europe was attributable principally to Rx manufacturing services, which were up \$10.0 million, or 12% compared with the same period in 2005.

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 and PDS services and the inclusion of a full two quarters of MOVA, where commercial services are all Rx. OTC revenues declined 8% in the first six months of 2006, as compared with the same period a year ago, reflecting a continued decline in demand for these manufacturing services at the Canadian OTC sites and Cincinnati. PDS six-month revenue growth was 3% overall; 2% in North America and 5% in Europe, as compared with the same period a year ago.

Geographically, North American revenues were \$243.5 or \$0.5 million lower than the same period in the prior year. The decrease reflects a net decline in revenue from the Puerto Rico operations of \$1.0 million and lower OTC volumes in both Canada and Cincinnati, offset by significant increases in volumes from the Toronto Region high-potency facility, principally as a result of two products that the Company launched for clients in 2005, along with additional volumes from a range of oral contraceptives.

In Europe, revenues for the first six months of 2006 were 11% higher than the same period of 2005. The increase reflects higher Rx manufacturing revenues from the Italian and UK operations. European currencies weakened against the U.S. dollar in the first six months of fiscal 2006 compared with the prior year. The euro weakened approximately 8% and the British sterling weakened approximately 7% against the U.S. dollar, reducing reported revenues by approximately \$9.2 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 21% higher than the same period in 2005.

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 six months of 2006, operating expenses were \$309.6 million, compared with \$292.1 million in the same period a year ago, an increase of 6%. The increase principally reflects an additional seven weeks of operations in Puerto Rico, the higher revenue base, annual payroll-related increases, additional GMP-related costs in Carolina

and the impact of the strengthening Canadian dollar relative to the U.S. dollar. These increases were offset in part by lower bonus costs, savings from global procurement initiatives and from weakening European currencies relative to the U.S. dollar.

Operating expenses as a percentage of revenues were 89.0%, compared with 86.4% in the prior year. Excluding the impact of the Puerto Rico operations, operating expenses as a percentage of revenue were 87.8% compared with 90.0% in the same period a year ago. The improvement in margins in the existing operations principally reflects the higher capacity utilization.

EBITDA and EBITDA Margin

On a consolidated basis in the first six months of 2006, EBITDA, representing earnings before depreciation and amortization, interest, debt prepayment charges, write-off of deferred financing costs and income taxes was \$38.2 million, a decline of \$7.7 million, or 17%, from the comparable period in 2005. As a percentage of consolidated revenues, EBITDA was 11.0% in the six-month period, compared with 13.6% in the same period a year ago.

EBITDA from the Puerto Rico commercial operations was \$3.3 million, representing a decline of \$15.5 million compared with the same period last year. This reflects declines in base business volumes in Caguas and Manatí and the impact of the shut down in production in Carolina during the first quarter of 2006.

On a year-to-date basis the Canadian dollar has strengthened by approximately 5% relative to the same period last year. Had the exchange rate remained the same as last year, EBITDA from the Canadian operations, net of hedging activities, would have been approximately \$2.2 million higher than was reported.

Higher capacity utilization at the European commercial operations resulted in an EBITDA increase over the prior year of \$8.2 million, or 136%. EBITDA in the Canadian commercial operations was \$1.3 million, or 11% higher than the same period last year as improvements in the Toronto Region and Whitby operations were partially offset by declining profitability in the OTC sites and from the impact of the strengthening Canadian dollar.

EBITDA from PDS operations was \$2.7 million, or 25% lower than 2005 as the Canadian operations were negatively impacted by lower revenues and from the continuing strength in the Canadian dollar.

Depreciation and Amortization Expense

Depreciation and amortization expense was \$19.7 million in the first six months of 2006, compared with \$16.7 million in the same period of 2005, an increase of \$3.0 million, or 18%. Of the increase, \$1.1 million is attributable to additional amounts relating to depreciation of the MOVA assets in the first quarter of 2006 compared with the same period last year. The remaining increase is attributable to completion of capital programs, in particular at the Italian sites and the Toronto Region operations. Depreciation and amortization expense includes the amortization of deferred pre-operating costs.

Amortization of Intangible Assets

The amortization of intangible assets was \$6.9 million in the first six months of 2006, compared with \$4.5 million in the first six months of 2005. The amortization of intangible assets relates to the Puerto Rico operations. The increase was due to the inclusion of a full quarter of amortization in the first quarter of 2006, compared with five weeks in the first quarter of 2005.

Interest Expense

Interest expense for the first six months of 2006 was \$9.9 million compared with \$7.0 million in the same period a year ago. The increase of \$2.9 million, compared with the prior year, was attributable to the inclusion of a full quarter of interest expense in the first quarter of 2006 related to the additional debt associated with the MOVA acquisition, compared with five weeks in the first quarter of 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.

Amortization of Deferred Financing Costs

Amortization of deferred financing costs in the first six months of 2006 was \$0.5 million, compared with \$2.1 million in the same period of 2005. The decrease reflects lower amortization charges associated with the Company's new North American financing facilities that were completed on December 15, 2005.

Earnings (Loss) Before Income Taxes

The Company reported a loss before income taxes of \$6.7 million in the first six months of 2006, compared with earnings before income taxes of \$13.6 million in the same period a year ago.

Income Taxes

The income tax expense for the six months ended April 30, 2006 was \$1.8 million despite a loss before taxes of \$6.7 million. This compares with a tax charge of \$3.8 million and an effective tax rate of 27.8% for the same period a year ago. In 2006 the Company has incurred pre tax losses from the Puerto Rico operations, where the effective tax rate averaged 5%. This compares with a significant pre-tax profit for the same period last year. In addition, pre-tax earnings in higher tax jurisdictions, in particular Italy, were higher than in 2005.

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

The Company recorded a net loss in the first six months of 2006 of \$8.5 million, compared with net earnings of \$9.8 million in the same period a year ago. The loss per share was 9.2¢ compared with earnings per share of 12.1¢ a year earlier. The net loss in the first six months 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 half 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 diluted loss per share was 9.2¢ compared with diluted earnings per share of 12.1¢ in the first six months of 2005. Dilution arises solely from options issued under the Company's stock option plan.

The average number of shares outstanding during the six-month period of 2006, determined on the basic and diluted bases, was 15% and 14% higher, respectively than for the same period last year. The increase is the result of shares issued in the first quarter of 2005 in connection with the MOVA acquisition.

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 April 30,		Six months ended April 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Net earnings (loss)	2,989	3,783	(8,521)	9,787
Depreciation and amortization	13,529	13,672	27,088	23,348
Write-off of deferred financing costs	-	16	6,332	2,010
Employee future benefits	860	92	74	809
Future income taxes	459	175	2,774	282
Amortization of deferred revenues	(498)	(381)	(995)	(338)
Other	373	348	871	843
Working capital	(15,387)	(14,563)	(17,534)	(13,145)
Cash provided by operating activities	2,325	3,142	10,089	23,596
Cash provided by financing activities	4,450	8,698	1,736	250,220
Cash used in investing activities	(13,564)	(13,222)	(28,002)	(260,750)
Other	(225)	(1,468)	(103)	(7,435)
Net increase (decrease) in cash and cash equivalents	(7,014)	(2,850)	(16,280)	5,631

Cash Provided by Operating Activities

Cash provided by operating activities was \$2.3 million in the second quarter of 2006 compared with \$3.1 million for the comparable period in 2005. On a year-to-date basis, cash provided by operating activities was \$10.1 million, compared with \$23.6 million in the first half of 2005. The year-to-date decrease reflects lower earnings before non-cash charges.

Cash Used in Investing Activities

Cash used in investing activities for the second quarter of 2006 was \$13.6 million, compared with \$13.2 million in the same period a year ago.

Cash used in investing activities for the first six months ended April 30, 2006 was \$28.0 million, compared with \$260.8 million in the same period of 2005. The 2005 amount included cash used in connection with the acquisition of MOVA of \$232.4 million.

On a year-to-date basis, additions to capital assets in 2006 were \$27.5 million, compared with \$26.3 million in 2005. The major capital project in 2006 relates to the construction of a new 65,000 square foot facility in Swindon, U.K. that will be dedicated to the manufacture of a new lyophilized cephalosporin product for an established client. Year-to-date spending on this project is \$10.0 million. The project is planned to be completed in 2007. Year to date the Company has also spent \$1.6 million on the establishment of high-potency capabilities in Bourgoin-Jallieu, France. Further spending on this project will be deferred until 2007, to align with the client's revised timing requirements for the capability.

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

	Three months ended April 30,		Six months ended April 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Acquisition net of cash acquired	-	(636)	-	144,545
Increase in escrow cash related to acquisition	-	-	-	87,825
Additions to capital assets-sustaining	3,597	3,180	6,337	4,330
-project-related	10,028	9,683	21,208	21,996
Increase (decrease) in deferred pre-operating costs	(61)	995	457	2,054
Cash used in investing activities	<u>13,564</u>	<u>13,222</u>	<u>28,002</u>	<u>260,750</u>

Cash Provided by Financing Activities

The principal financing activities for the six months ended April 30, 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, completed during the first quarter. 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 financing activities is as follows:

	Three months ended April 30,		Six months ended April 30,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Increase (decrease) in bank indebtedness	905	(1,392)	(12,691)	(1,843)
Increase in long-term debt	27,563	66,872	311,143	230,911
Repayment of long-term debt	(23,993)	(55,775)	(311,345)	(159,160)
Decrease (increase) in restricted cash	-	(187)	7,805	(447)
Increase in deferred financing costs	(25)	(815)	(2,790)	(9,535)
Increase in deferred revenues	-	-	9,614	-
Proceeds on issue of common shares before costs	-	-	-	199,241
Share issue costs	-	(5)	-	(8,947)
Cash provided by financing activities	<u>4,450</u>	<u>8,698</u>	<u>1,736</u>	<u>250,220</u>

Financing Arrangements and Ratios

At April 30, 2006, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 52.3%, compared with 68.5% at April 30, 2005 and 56.1% at the end of the 2005 fiscal year. The improvement relative to the second 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, the release of \$7.8 million in restricted cash during the first quarter of 2006 and reduced cash balances.

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 April 30, 2006, the Company was drawing \$2.0 million 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.

Contingent Liability

During the second quarter of 2006, MOVA received a notice from the Puerto Rico Industrial Development Company ("PRIDCO") requesting the accelerated repayment of a grant that MOVA received in 1996. In accordance with the terms of the original agreement with PRIDCO, MOVA has been repaying the grant in the form of royalty payments that are tied to revenues generated from specific products that MOVA manufactures for its clients. Such royalty payments are charged to earnings as they are incurred.

The Company is in the process of investigating whether the accelerated repayment of the grant is the responsibility of the previous owners of MOVA. Because of the uncertainty of the outcome of these investigations, no liability has been recorded on the balance sheet at April 30, 2006. The amount outstanding on the grant at April 30, 2006 is \$4,749,000.

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 consolidated financial statements).

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

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 second quarter of 2006, \$0.5 million was recognized as earnings. During the first six months of 2006, \$1.0 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 second quarter of 2006, \$3.5 million was charged to earnings. During the first six months of 2006, \$6.9 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 earnings in the second quarter of 2006, nor to the net loss in the first six months 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 April 30, 2006 was \$190.9 million and relates to the acquisition in 2000 of the remaining shares of Global Pharm Inc., which now operates as Toronto York Mills Operations, and from the acquisition of MOVA on December 23, 2004. As at April 30, 2006, goodwill shown on the financial statements relating to the MOVA acquisition was \$187.8 million and goodwill shown relating to Toronto York Mills acquisition was \$3.1 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 \$32.7 million have been recorded at April 30, 2006. This amount includes \$11.9 million relating to investment tax credits arising from Scientific Research and Experimental Development claims in the Canadian operations, that were recorded in accounts receivable in prior periods. The future tax assets are also 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. and Canadian 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 \$39.8 million have been recorded at April 30, 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.

Variable Interest Entities

The Company has adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities". The Guideline requires consolidation of entities that are deemed to be subject to control on a basis other than through ownership of a voting interest in the entity. The Company has concluded that it does not have any variable interest entities and there is no impact on the consolidated financial statements as a result of adopting the Guideline

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) or on Patheon's website (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 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 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. At April 30, 2006 the Company had outstanding foreign exchange contracts to sell US\$35 million. The contracts mature at the latest on September 27, 2006 and the mark-to-market value at April 30, 2006 was an unrealized gain of \$1.4 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 as a hedge against the carrying value of certain foreign operations, are deferred and included in the cumulative translation account in shareholders' equity. At April 30, 2006, the balance in the account was a \$68.1 million gain compared with a \$17.9 million gain at April 30, 2005.

Interest Rate Exposure

The Company has exposure to movements in interest rates. During the second quarter of 2006, the Company unwound the interest rate swap contracts that were put in place during the first quarter of 2006 to convert \$107.5 million of debt drawn on the Company's new North American term facilities from floating interest rates to fixed interest rates. The Company realized a gain of \$1.1 million on the unwinding of the swap. The gain is being amortized as a credit to the interest expense over six years, reflecting the term of the original swap contracts.

At April 31, 2006, 95% 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 \$1.8 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.

Additional Information

Share Capital

As of April 30, 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.

Outlook

In the second half of 2006, the Company expects continuing improvements in its commercial manufacturing businesses in Canada and Europe. In Canada, operating efficiencies at Whitby that were starting to be realized in the second quarter are expected to continue through the balance of the year and the Company expects to have completely worked through the back order position at the site by the fourth quarter. The Toronto Region Operations will continue to benefit from higher volumes of high-potency products, including those that were launched for clients in 2005, while in Europe, revenue growth will be driven by the two carve-out initiatives in France and Italy and from additional sterile volumes in Italy. Collectively, these carve-outs reflect 25 products in more than 900 dosage and packaging formats. To date, six products have been transferred to Patheon's Italian facilities and three to its facility in Bourgoin-Jallieu, France, including three in the second quarter. The transfers will be completed in 2007 and in total are expected to contribute in the range of \$35 million to \$40 million to the revenue base of Patheon's European operations in 2008.

Revenues from commercial operations in the U.S., including Puerto Rico, are expected to be lower in the second half of the year compared with 2005, reflecting a decline in base business volumes in Caguas, Manatí and Cincinnati, offset in part by continuing volume and manufacturing efficiency improvements in Carolina. While revenues from the manufacturing of Zocor® are expected to decline as a result of its patent expiry in June 2006, the full impact will be deferred until 2007, as the Company expects to manufacture an authorized generic version of the product for at least the six months following the patent expiry. In the first six months of 2006 Zocor® represented less than 3% of the Company's consolidated revenues. Revenues

from the branded and generic versions of the product in the second half of 2006 are expected to be approximately one-third lower than in the first half of the year.

In the PDS operations, the Company expects that revenue growth will accelerate in the second half of the year, driven by gains in the Cincinnati and Swindon PDS operations.

Overall, revenues in the second half of 2006 are expected to be slightly higher than 2005, but EBITDA will be similar, due to the impact of the continuing strength of the Canadian dollar relative to the US dollar. This has the effect of reducing the profitability of the Canadian operations, where most of the revenues are denominated in U.S. dollars, but costs are largely incurred in Canadian dollars. Depreciation, amortization and interest costs will be marginally higher than the second quarter run rate. Effective tax rates will be impacted largely by changes in profitability in the Puerto Rican and Italian operations. The effective tax rate in the third quarter is expected to be in the 50% - 55% range, reflecting the expectation of increasing earnings in Italy and continuing pre-tax losses in Puerto Rico. The effective tax rate in the fourth quarter is expected to be in the 40% - 45% range as the Puerto Rico operations are expected to return to profitability..

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 and six-month periods ended April 30, 2006 or for the comparative periods ended April 30, 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.