



NEWS RELEASE

For Immediate Release

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PATHEON ANNOUNCES THIRD QUARTER RESULTS

Toronto, Canada (September 14, 2006) – Patheon (TSX:PTI), a global provider of drug development and manufacturing services to the international pharmaceutical industry, today announced its results for the third quarter ended July 31, 2006. (All amounts are in U.S. dollars unless otherwise indicated.)

Financial Results

Third Quarter Ended July 31, 2006

Compared With Third Quarter Ended July 31, 2005

- Revenues increased 6% to \$189.2 million;
- EBITDA was \$16.0 million (8.5% of revenues) compared with \$25.8 million (14.5% of revenues);
- Before the write down, the loss was \$5.1 million (5.5 cents per share) vs. net earnings of \$3.5 million (3.5 cents per share);
- The net loss was \$257.2 million (\$2.77 per share), including the net effect of the \$254.7 million non-cash asset impairment charge, compared with net earnings of \$3.5 million (3.5 cents per share).

Nine Months Ended July 31, 2006

Compared With Nine Months Ended July 31, 2005

- Revenues increased 4% to \$537.0 million;
- EBITDA was \$54.2 million (10.1% of revenues), compared with \$71.8 million (13.9% of revenues);
- Before the write down, the loss was \$13.6 million (14.7 cents per share) vs. net earnings of \$13.2 million (15.6 cents per share);
- The net loss was \$265.7 million (\$2.86 per share), including the net effect of the \$254.7 million non-cash asset impairment charge in the third quarter, compared with net earnings of \$13.2 million (15.6 cents per share).

Asset Impairment Charge

For the third quarter ended July 31, 2006, Patheon recognized a \$254.7 million non-cash asset impairment charge, principally in respect of goodwill, depreciable intangible assets and tangible capital assets related to its MOVA Pharmaceutical operations. The Company determined that the carrying value of these assets was impaired as a result of the continued deterioration of MOVA's financial results during the quarter. This asset impairment charge is a non-cash item recognized to write these assets down to their estimated fair value.

Operating Results

“Our third quarter results are overshadowed by the effect of the write-down of assets related to our Puerto Rico operations,” said Riccardo Trecroce, Chief Executive Officer. “We have had significant problems with our Puerto Rico operations, but we have acknowledged them and are focusing on improving these operations on an expedited basis going forward.

“Overall, our third-quarter financial results, measured by EBITDA, were weak compared with last year,” Mr. Trecroce continued. “While our Canadian, European and Cincinnati operations performed well, our earnings were significantly affected by difficulties with two high-volume products in Puerto Rico.”

Consolidated EBITDA of \$16.0 million in the third quarter represented a decline of \$9.8 million, or 38%, compared with the same period a year ago. The EBITDA margin was 8.5% in the third quarter of 2006, compared with 14.5% in the same period a year ago.

The Puerto Rico commercial manufacturing operations generated an EBITDA loss of \$3.5 million in the third quarter, compared with EBITDA of \$4.8 million in the same period last year. This decline was primarily attributable to a decision taken during the quarter to temporarily suspend production and shipment of a major product due to stability concerns, and a temporary disruption in the supply of a non-active ingredient for a different product. The decrease also reflects a year-over-year decline in volumes of a generic product where the Company's client lost a major account earlier this year.

The profitability of the Canadian operations was affected by continued appreciation of the Canadian dollar, which strengthened relative to the U.S. dollar by approximately 11% year-over-year. The Company estimates that, had exchange rates remained constant, its EBITDA, net of hedging activities, would have been approximately \$2.4 million higher than was reported.

In Canada, EBITDA from commercial manufacturing operations was \$6.6 million, or \$0.2 million lower than the same period a year ago. Gains from higher capacity utilization, particularly at the Whitby and Toronto York Mills facilities, were offset by the impact of the strengthening of the Canadian dollar relative to the U.S. dollar.

In Europe, EBITDA from commercial manufacturing was \$8.3 million, or \$1.0 million lower than the same period a year ago. Gains in sterile product volumes at the two sites in Italy were offset by declines in mature product volumes at Swindon, U.K. and Bourgoin-Jallieu, France.

EBITDA from the global pharmaceutical development services (PDS) operations was \$5.9 million, or \$1.6 million higher than the same period in 2005. Growth at the Swindon, U.K. PDS unit was supported by additional laboratory space that the Company brought on line in the third quarter. Located at Milton Park in Abingdon, Oxfordshire, the new facility has allowed for the establishment of a rapid Phase I unit, providing the Swindon PDS unit with additional capacity with which to meet its longer-term growth objectives. The Cincinnati PDS unit also achieved good year-over-year growth, attracting new business based on its specialized capabilities, particularly in the area of liquid-filled capsules. Earnings from the Canadian PDS operations were flat on a year-over-year basis, reflecting modest revenue growth and the negative impact of the strengthening Canadian dollar on profitability.

Outlook

Revenues in the fourth quarter of 2006 are expected to be slightly lower than the third quarter. In Canada, there will be a reduction in volumes at the Whitby facility as the back order position has been resolved. In Europe, results will be impacted by normal summer shut downs. Revenues from the Puerto Rico operations are expected to improve, as shipments resumed in early September of the product manufactured in Caguas for which stability-related issues had been previously identified. Volumes are also expected to increase in Carolina, Puerto Rico, as clients build inventory levels in preparation for the cough and cold season.

Financing Arrangements

In July 2006, Patheon negotiated amendments to its North American loan facilities that were required so that the Company would be in compliance with its debt-to-EBITDA and fixed charge coverage ratio covenants as at July 31, 2006. The Company will endeavour to enter into an agreement with its lenders for additional amendments required to permit it to be in compliance with its financial covenants under its North American loan facilities as at October 31, 2006 and for future periods.

The Company is currently able to borrow under its North American revolving loan facility. As at August 31, 2006, \$33.2million was borrowed under this facility.

Performance Enhancement Program and Strategic Alternatives Review

During the third quarter, the Company initiated its Performance Enhancement Program, implementing certain immediate operational improvements identified in consultation with external specialists and identifying additional cost reduction initiative proposals that could be implemented in fiscal 2007.

On September 11, 2006, Patheon announced that its Board of Directors has formed a special committee to evaluate a range of strategic and financial alternatives for the company. Greenhill & Co. and RBC Capital Markets have been retained as financial advisors to assist the Company and the special committee. As part of this strategic alternatives review, the special committee will review and supervise the implementation, where feasible, of the additional cost reduction initiative proposals identified under the Performance Enhancement Program.

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 third quarter results on Friday, September 15, 2006 at 10:00 a.m. (Eastern Daylight Time). Representing Patheon on the call will be: Peter Green, Chairman, Patheon Inc.; Riccardo Trecroce, Chief Executive Officer; Nick DiPietro, President and Chief Operating Officer; Nicholas Dowd, Vice-President and Controller; 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 Q3 webcast will be available on www.patheon.com for three months.

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 auditors have been engaged to perform a review of these financial statements. The independent auditors have advised the Company that they have satisfactorily completed their review, except for procedures that have not yet been completed in respect of the asset impairment charge that the Company recognized for the third quarter ended July 31, 2006. The independent auditors were unable to complete the review procedures in respect of the asset impairment charge before the filing of the accompanying unaudited interim financial statements because the valuation of the relevant assets related to the Company's MOVA Pharmaceutical operations was not substantially completed until shortly before the deadline for filing the financial statements.

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 5,900 people and serving a client base of 200 pharmaceutical and biotechnology companies.

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Consolidated Statements of Earnings (Loss)

(unaudited)

	Three months ended July 31,			Nine months ended July 31,		
	2006	2005	% change	2006	2005	% change
<i>(in thousands of U.S. dollars, except per share amounts)</i>						
	\$	\$		\$	\$	
Revenues	189,191	178,390	6.1%	537,037	516,425	4.0%
Operating expenses	173,192	152,564	13.5%	482,813	444,666	8.6%
Earnings before the following:	15,999	25,826	-38.1%	54,224	71,759	-24.4%
(as a % of revenues)	8.5%	14.5%		10.1%	13.9%	
Asset impairment charge (note 3)	254,661	-		254,661	-	
Depreciation and amortization	10,203	8,868	15.1%	29,934	25,545	17.2%
Amortization of intangible assets	2,794	3,221	-13.3%	9,689	7,745	25.1%
Interest	5,188	4,783	8.5%	15,086	11,797	27.9%
Debt prepayment charges (note 11)	-	-		1,643	-	
Amortization of deferred financing costs	136	1,374	-90.1%	598	3,521	-83.0%
Write-off of deferred financing costs (note 11)	-	-		6,332	2,010	215.0%
Earnings (loss) before income taxes	(256,983)	7,580	-3490.3%	(263,719)	21,141	-1347.4%
Provision for income taxes	230	4,125	-94.4%	2,015	7,899	-74.5%
Net earnings (loss) for the period	(257,213)	3,455	-7544.7%	(265,734)	13,242	-2106.8%
(as a % of revenues)	-136.0%	1.9%		-49.5%	2.6%	
Earnings (loss) per share						
Basic	(277.0¢)	3.5¢	-8014.3%	(286.2¢)	15.6¢	-1934.6%
Diluted	(277.0¢)	3.4¢	-8247.1%	(286.2¢)	15.5¢	-1946.5%
Average number of shares (note 4)						
outstanding during period:						
Basic (in thousands)	92,860	92,846	0.0%	92,851	84,799	9.5%
Diluted (in thousands)	92,860	93,242	-0.4%	92,851	85,227	8.9%

see accompanying notes

Consolidated Statements of Retained Earnings

(unaudited)

	Nine months ended July 31,	
	2006	2005
<i>(in thousands of U.S. dollars)</i>		
	\$	\$
Retained earnings, beginning of the year	98,250	76,629
Net earnings (loss) for the period	(265,734)	13,242
Retained earnings, end of period	(167,484)	89,871

see accompanying notes

Consolidated Balance Sheets

(unaudited)

	As at July 31, 2006	As at October 31, 2005
<i>(in thousands of U.S. dollars)</i>		
	\$	\$
Assets		
Current		
Cash and cash equivalents	19,997	22,507
Restricted cash	-	7,805
Accounts receivable	130,412	143,646
Inventories	76,882	72,818
Prepaid expenses and other	9,971	4,258
Total current assets	<u>237,262</u>	<u>251,034</u>
Capital assets	491,234	474,793
Intangible assets	29,301	110,095
Deferred costs	8,812	12,342
Future tax assets	40,709	21,368
Goodwill	3,054	180,665
Investment (Note 3)	546	1,271
	<u>810,918</u>	<u>1,051,568</u>
Liabilities and Shareholders' equity		
Current		
Bank indebtedness	545	14,357
Accounts payable and accrued liabilities	126,597	129,067
Income taxes payable	3,453	5,650
Current portion of long-term debt (note 10)	249,461	11,360
Total current liabilities	<u>380,056</u>	<u>160,434</u>
Long-term debt (note 10)	65,111	277,181
Other long-term liabilities	25,028	22,755
Deferred revenues	23,866	14,587
Future tax liabilities	39,421	36,760
Total liabilities	<u>533,482</u>	<u>511,717</u>
Shareholders' equity		
Share capital	400,674	400,594
Contributed surplus	3,826	2,901
Retained earnings	(167,484)	98,250
Cumulative translation adjustment	40,420	38,106
Total shareholders' equity	<u>277,436</u>	<u>539,851</u>
	<u>810,918</u>	<u>1,051,568</u>

see accompanying notes

Consolidated Statements of Cash Flows

(unaudited)

	Three months ended July 31,		Nine months ended July 31,	
	2006	2005	2006	2005
(in thousands of U.S. dollars)	\$	\$	\$	\$
Operating activities				
Net earnings (loss) for the period	(257,213)	3,455	(265,734)	13,242
Add (deduct) charges to operations not requiring a current cash payment				
Asset impairment charge (note 3)	254,661	-	254,661	-
Depreciation and amortization	13,133	13,463	40,221	36,811
Write-off of deferred financing costs (note 11)	-	-	6,332	2,010
Employee future benefits	1,056	586	1,130	1,395
Future income taxes	(5,495)	389	(2,721)	671
Amortization of deferred revenues	(498)	(280)	(1,493)	(618)
Other	562	531	1,433	1,374
	6,206	18,144	33,829	54,885
Net change in non-cash working capital balances related to operations	2,979	2,831	(14,555)	(10,314)
Cash provided by operating activities	9,185	20,975	19,274	44,571
Investing activities				
Acquisition	-	(69,976)	-	(215,166)
Cash acquired on acquisition	-	-	-	645
Acquisition net of cash Acquired	-	(69,976)	-	(214,521)
Decrease in escrow cash related to acquisition	-	87,825	-	-
Additions to capital assets - sustaining	(3,912)	(4,998)	(10,249)	(9,328)
- project - related	(10,687)	(7,557)	(31,895)	(29,553)
Increase in deferred pre-operating costs	(1,122)	(497)	(1,579)	(2,551)
Cash provided by (used in) Investing activities	(15,721)	4,797	(43,723)	(255,953)
Financing activities				
Decrease in bank indebtedness	(1,446)	(5,888)	(14,137)	(7,731)
Increase in long-term debt	62,803	64,179	373,946	295,090
Repayment of long-term debt	(41,665)	(90,011)	(353,010)	(249,171)
Decrease in restricted cash	-	695	7,805	248
Decrease (Increase) in deferred financing costs	-	86	(2,790)	(9,449)
Increase in deferred revenues	-	8,271	9,614	8,271
Proceeds on issue of common shares before costs	80	-	80	199,241
Share issue costs	-	-	-	(8,947)
Cash provided by (used in) financing activities	19,772	(22,668)	21,508	227,552
Effect of exchange rate changes on cash and cash equivalents	534	(12)	431	(7,447)
Net increase (decrease) in cash and cash equivalents during the period	13,770	3,092	(2,510)	8,723
Cash and cash equivalents, beginning of period	6,227	13,257	22,507	7,626
Cash and cash equivalents, end of period	19,997	16,349	19,997	16,349

see accompanying notes

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

1. Accounting policies

Going Concern

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. As at July 31, 2006 the Company had a working capital deficiency of \$142,794,000. The deficiency includes the reclassification of \$232,350,000 of debt from long term to short term (see note 10). The Company's ability to continue as a going concern is uncertain and is dependent upon further amendments being made to its North American Loan Facilities agreement. The Company is in discussions with the lenders in this regard, but the successful outcome of these discussions cannot be determined at this time.

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by 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", or the "Puerto Rico operations"), a 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.

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 certain products that MOVA manufactures for its clients. At the time of the acquisition, escrow funds were set aside as a protection against PRIDCO exercising a right to an accelerated repayment of the grant, but these funds were released to the former owners of MOVA at the end of the escrow period in circumstances where, in retrospect, the Company did not have a full understanding of PRIDCO's position on whether it would exercise its right to accelerate repayment of the grant. The potential repayment obligation was noted as a contingent liability in the Company's second quarter financial statements pending investigation of whether the accelerated repayment of the grant was the responsibility of the former owners of MOVA. The Company has now reached a settlement with the former owners, who have agreed to reimburse MOVA 50% of the amounts owing to PRIDCO. MOVA's remaining

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

liability is \$2,387,000. The Company would have reflected this liability in the purchase price allocation had it been aware of it at the time it was finalized, accordingly an adjustment has been made to goodwill, accounts payable and future tax liabilities. The adjustment to goodwill had the effect of increasing the goodwill impairment charge (note 3).

3. Asset Impairment Charge

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

The Company tested the recoverability of MOVA's long lived depreciable assets and determined that expected future cash flows over the economic life of the principal assets was less than the carrying value of the long-lived depreciable assets. As a result the Company recorded an impairment charge of \$66,249,000 for intangible assets and \$15,179,000 for tangible capital assets to write them down to their fair value. The fair value of the intangible assets was determined using a discounted cash flow methodology and the fair value of tangible capital assets was based on a value in continued use, taking into account utilization levels.

The Company also tested the recoverability of the goodwill associated with MOVA using a discounted cash flow methodology, and recorded an impairment charge of \$172,477,000 representing the full value of the MOVA goodwill. The goodwill impairment charge is an estimate. The valuation of MOVA will be finalized in the fourth quarter of 2006. If the final goodwill impairment amount is different, the adjustment will be recognized in the fourth quarter of 2006.

The Company, as part of its ongoing review of long term investments, concluded that its investment in the shares of a drug technology company which is accounted for on the cost basis had a permanent impairment and wrote down its value by \$756,000 to its market value as of July 31, 2006.

A summary of the asset impairment charges is as follows:

(in thousands of U.S. dollars)

	Three months and nine months ended, July 31, 2006
	<u>\$</u>
MOVA intangible asset impairment	66,249
MOVA tangible capital asset impairment	15,179
MOVA goodwill impairment	172,477
Other investment impairment	756
	<u>254,661</u>

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

4. Average number of shares

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

	Three months ended July 31,	
	2006	2005
Weighted average number of common shares outstanding	92,860,090	92,845,688
Effect of dilutive stock options	-	396,674
Weighted average number of common shares outstanding – diluted	92,860,090	93,242,362

	Nine months ended July 31,	
	2006	2005
Weighted average number of common shares outstanding	92,850,542	84,799,487
Effect of dilutive stock options	-	427,312
Weighted average number of common shares outstanding – diluted	92,850,542	85,226,799

5. Share capital

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

	Outstanding	Exercisable
Common shares	92,910,688	
Common share stock options	4,257,012	3,709,501

6. 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 July 31, 2006			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	8,440	204	185	8,829
U.S.A.	44,078	53,182	6,055	103,315
Europe	18,055	172	55,637	73,864
Other geographic areas	1,693	19	1,471	3,183
Total revenues	72,266	53,577	63,348	189,191
Capital assets	127,780	155,103	208,351	491,234
Goodwill	3,054	-	-	3,054

	Three months ended July 31, 2005			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	8,282	272	255	8,809
U.S.A.	39,086	63,457	3,106	105,649
Europe	10,281	41	52,165	62,487
Other geographic areas	449	65	931	1,445
Total revenues	58,098	63,835	56,457	178,390
Capital assets	115,701	178,914	180,792	475,407
Goodwill	2,823	160,117	-	162,940

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

<i>(in thousands of U.S. dollars)</i>	Nine months ended July 31, 2006			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	29,496	492	593	30,581
U.S.A.	117,673	173,465	9,983	301,121
Europe	43,350	507	153,277	197,134
Other geographic areas	4,196	190	3,815	8,201
Total revenues	194,715	174,654	167,668	537,037

	Nine months ended July 31, 2005			
	Canada	U.S.A.	Europe	Total
	\$	\$	\$	\$
Revenues				
Canada	20,727	818	1,409	22,954
U.S.A.	124,158	185,083	7,458	316,699
Europe	31,581	344	139,892	171,817
Other geographic areas	2,966	284	1,705	4,955
Total revenues	179,432	186,529	150,464	516,425

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:

<i>(in thousands of U.S. dollars)</i>	Three months ended July 31,			
	2006		2005	
	\$		\$	
Commercial manufacturing - prescription	129,917	69%	131,463	74%
Commercial manufacturing - over-the-counter	33,407	17%	25,547	14%
Development services	25,867	14%	21,380	12%
	189,191	100%	178,390	100%

	Nine months ended July 31,			
	2006		2005	
	\$		\$	
Commercial manufacturing - prescription	382,116	71%	370,417	72%
Commercial manufacturing - over-the-counter	84,697	16%	81,478	16%
Development services	70,224	13%	64,530	12%
	537,037	100%	516,425	100%

7. 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 July 31, 2006, the total number of common shares available for issuance under the plan was 6,963,427, of which 4,257,012 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

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

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 100,000 options granted for the three months ended July 31, 2006 was \$1.22 (2005-\$3.65). The weighted average fair value of stock options granted for the nine months ended July 31, 2006 was \$2.11 (2005-\$3.00). 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 July 31, 2006 and nine months ended July 31, 2006 were:

	Three months ended July 31, 2006	Nine months ended July 31, 2006
Risk free interest rate	4.3%	4.2%
Expected volatility	42%	42%
Expected weighted average life of Options	1 year	4 years
Expected Dividend Yield	0%	0%

Stock-based compensation expense recorded in the three months ended July 31, 2006 was \$433,000 (2005 - \$366,000) for options granted on or after November 1, 2003. Stock based compensation expense recorded for the nine months ended July 31, 2006 was \$925,000 (2005-\$1,209,000) 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:

(in thousands of U.S. dollars)

	Three months ended July 31,		Nine months ended July 31,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Net earnings (loss) as reported	(257,213)	3,455	(265,734)	13,242
Pro-forma adjustments for the fair value of stock options granted prior to November 1, 2003	-	(27)	(28)	(125)
Pro-forma net earnings (loss)	(257,213)	3,428	(265,762)	13,117
Pro-forma earnings (loss) per share:				
Basic	(277.0¢)	3.5¢	(286.2¢)	15.5¢
Diluted	(277.0¢)	3.5¢	(286.2¢)	15.4¢

8. Other information

Foreign exchange

During the three months ended July 31, 2006, the foreign exchange loss was \$111,000 (2005 loss - \$633,000). For the nine months ended July 31, 2006, the foreign exchange gain was \$78,000 (2005 gain - \$2,744,000)

Employee future benefits

The employee future benefit expense for the three months ended July 31, 2006 was \$1,056,000 (2005 - \$586,000). For the nine months ended July 31, 2006, the employee future benefit expense was \$1,130,000 (2005 - \$1,395,000).

9. 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.

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

The Company has entered into foreign exchange forward contracts with an aggregate amount of US\$85,000,000 as at July 31, 2006. These contracts mature at the latest on October 29, 2007 at exchange rates varying between 1.0856 and 1.1695 Canadian. The mark-to-market value on these financial instruments as at July 31, 2006 was an unrealized loss of US\$1,591,000.

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.

10. Long-term debt

On December 15, 2005, the Company completed new credit facilities in North America (the "North American Loan Facilities") 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 July 31, 2006, \$20,023,000 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.

During the third quarter of 2006, certain of the financial covenant tests included in the North American Loan Facilities were amended to ensure that the Company remained in compliance as at July 31, 2006. The need for the amendment was the declining earnings in MOVA. Further amendments will have to be made in order for the Company to remain in compliance with the financial covenant tests in future reporting periods. The Company is currently in discussion with its lenders in this regard. In accordance with EIC-59 the Company has re-classified \$224,786,000 of debt from long-term to short-term, representing the long-term portion of debt outstanding under the North American loan facilities. Any future default under the Company's North American Loan Facilities would cause a cross default under a lending facility in its UK subsidiary. Accordingly, the Company has also reclassified \$7,564,000 of related debt from long-term to short-term.

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.

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

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

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.

Notes to Unaudited Consolidated Financial Statements for the Nine Months Ended July 31, 2006

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

12. Related Party Transactions

Revenues and recharges for cost recoveries from companies controlled by a director and significant shareholder of the Company were in the amount of \$2,274,000 and \$2,885,000 for the three and nine months ended July 31, 2006 respectively. These transactions were conducted in the normal course of business at fair value. Accounts receivables at July 31, 2006 include a balance of \$2,801,000 resulting from these transactions.

13. Comparative amounts

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

14. Subsequent Events

On September 11, 2006 the Company announced that its Board of Directors had established a special committee to evaluate a range of strategic and financial alternatives for the Company. Financial advisors were also appointed to assist the special committee and the Company in this process.

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 nine-month periods ended July 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 September 14, 2006.

The purpose of this 2006 third 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, asset impairment charges, 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 ("R_x") and over-the-counter ("OTC") products in solid, semi-solid and liquid dosage forms and manufactures R_x 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 July 31, 2006, there were a total of 165 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 137 client products a year ago. During the third 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. At the end of the second quarter of 2006 the Company also initiated a performance enhancement program aimed at improving the productivity and cost effectiveness of its operations. An update on our interim performance relating to these key measures is provided in the section below entitled "Results of Operations."

Recent Developments

Financing Arrangements and Strategic Alternatives

As a result of lower-than-expected earnings and EBITDA for the third quarter ended July 31, 2006, in July 2006 Patheon commenced negotiations with its lenders in respect of amendments to certain financial covenants under its North American loan facilities because of concern that, based on its latest internal forecast at that time, the Company would not be in compliance with its debt-to-EBITDA ratio and fixed charge coverage financial covenants as at July 31, 2006. As a result of the amendments, the Company was in compliance with the terms and conditions of its North American loan facilities as at July 31, 2006. The Company believes that it will not be in compliance with its debt-to-EBITDA ratio and other financial covenants in its North American credit facilities as at October 31, 2006 and in future periods unless further amendments are agreed to by its lenders. If the lenders do not agree to the required amendments and the Company does not satisfy its financial covenants under these credit facilities as at October 31, 2006 or in future periods, the loan facilities would be in default and the lenders could demand repayment of all amounts outstanding under these credit facilities. As at August 31, 2006, \$238 million was outstanding under these facilities (\$230 million as at July 31, 2006). In addition, any such default would constitute a default under a lending facility of the company's U.K. subsidiary, allowing the lender under this facility to immediately demand repayment of all amounts outstanding under that facility. As at August 31, 2006, \$6.9 million was outstanding under that facility (\$8.0 million as at July 31, 2006).

Patheon is currently in discussions with the lenders under its North American loan facilities regarding potential additional amendments to its debt-to-EBITDA ratio and other covenants required to ensure that the Company remains in compliance as at October 31, 2006 and in future quarters. There can be no assurance that the Company's lenders will agree to these amendments or that the Company will be able to comply with the terms of any amendments in future periods.

The Company is able to borrow under its \$75 million North American revolving loan facility. As at August 31, 2006, \$33.2 million was borrowed under this facility (\$20 million as at July 31, 2006). The maximum amount that may be borrowed under this facility from time-to-time is a function of borrowing base calculations prescribed in the credit agreement. The Company estimates that, based on these borrowing base calculations, as at August 31, 2006, an additional \$22.3 million was available to be drawn under this facility. The Company is satisfied that it has sufficient liquidity to carry on its business in the ordinary course.

On September 11, 2006, Patheon announced that its Board of Directors has formed a special committee to evaluate a range of strategic and financial alternatives for the company. Greenhill & Co. and RBC Capital Markets have been retained as financial advisors to assist the Company and the special committee.

Going Concern Note

As at July 31, 2006, the Company has reclassified the long-term debt outstanding under its North American loan facilities (\$224.8 million) and its U.K. subsidiary's loan facility (\$7.6 million) as current indebtedness, in accordance with EIC-59, which requires such reclassification unless a violation of the covenants under these credit facilities at a future compliance date within one year of the balance sheet date is not likely. See "Liquidity and Capital Resources – Adequacy of Financial Resources" and "Critical Accounting Policies and Estimates – Going Concern", below. As a result of this reclassification, the Company had a working capital deficiency as at July 31, 2006 of \$142.8 million. Consequently, the Company's financial statements for the third quarter include a going concern note, stating that the Company's ability to continue as a going concern is uncertain and is dependent upon amendments being made to its North American loan facilities, which the Company is currently discussing with its lenders. The Company's financial statements as at and for the third quarter ended

July 31, 2006 do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern.

Developments relating to MOVA

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 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.

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 certain products that MOVA manufactures for its clients. At the time of the acquisition, escrow funds were set aside as a protection against PRIDCO exercising a right to an accelerated repayment of the grant, but these funds were released to the former owners of MOVA at the end of the escrow period in circumstances where, in retrospect, the Company did not have a full understanding of PRIDCO's position on whether it would exercise its right to accelerate repayment of the grant. The potential repayment obligation was noted as a contingent liability in the Company's second quarter financial statements pending investigation of whether the accelerated repayment of the grant was the responsibility of the former owners of MOVA. The Company has now reached a settlement with the former owners, who have agreed to reimburse MOVA 50% of the amounts owing to PRIDCO. MOVA's remaining liability is \$2.4 million. The Company would have reflected this liability in the purchase price allocation had it been aware of it at the time it was finalized, accordingly an adjustment has been made to goodwill, accounts payable and future tax liabilities. The adjustment to goodwill had the effect of increasing the goodwill impairment charge (note 3).

During the third quarter of 2006, the Company determined that the carrying value of MOVA's intangible assets, tangible capital assets and goodwill were impaired. Accordingly, the Company recognized an aggregate asset impairment charge of \$254 million in respect of these assets for the quarter (\$66 million in respect of intangible assets; \$15 million in respect of tangible capital assets; and \$173 million in respect of goodwill). See "Results of Operations – Asset Impairment Charge", below. The effect of this charge is to write down the book value of these assets to their current fair value.

Results of Operations

Three Months Ended July 31, 2006 Compared with Three Months Ended July 31, 2005

Revenues by Geographic Region and Service Activity

	Three months ended July 31,			Nine months ended July 31,		
	2006	2005	% Change	2006	2005	% Change
North America						
Commercial Manufacturing						
Prescription	74,437	79,937	-7%	231,971	234,193	-1%
Over-the-counter	31,802	24,922	28%	82,221	79,917	3%
	106,239	104,859	1%	314,192	314,110	0%
Development Services						
	19,604	17,074	15%	55,177	51,851	6%
	125,843	121,933	3%	369,369	365,961	1%
Europe						
Commercial Manufacturing						
Prescription	55,480	51,526	8%	150,145	136,224	10%
Over-the-counter	1,605	625	157%	2,476	1,561	59%
	57,085	52,151	9%	152,621	137,785	11%
Development Services						
	6,263	4,306	45%	15,047	12,679	19%
	63,348	56,457	12%	167,668	150,464	11%
TOTAL						
Commercial Manufacturing						
Prescription	129,917	131,463	-1%	382,116	370,417	3%
Over-the-counter	33,407	25,547	31%	84,697	81,478	4%
	163,324	157,010	4%	466,813	451,895	3%
Development Services						
	25,867	21,380	21%	70,224	64,530	9%
CONSOLIDATED REVENUES	189,191	178,390	6%	537,037	516,425	4%

Revenues

Consolidated revenues for the three-month period ended July 31, 2006 increased 6%, or \$10.8 million, to \$189.2 million from \$178.4 million in the same period in 2005. In the third quarter, revenue growth came principally from R_x commercial manufacturing services in Europe, OTC manufacturing in North America, and PDS growth in both North America and Europe. On a consolidated basis, commercial manufacturing revenues grew 4%, with OTC revenues up 31% and R_x manufacturing down 1% compared with the third quarter of 2005. PDS revenues increased 21% over the same period in 2005.

Prescription manufacturing and development services represented 82% of revenues, compared with 86% for the comparable period in 2005.

Geographically, in North America, revenue growth in the third quarter was \$3.9 million or 3% over the same period a year ago. Revenues from the Puerto Rico operations were \$27.9 million, down from \$39.4 million, or 29%, in the same period a year ago. The year-over-year decline was primarily attributable to the following; 1) the loss, earlier this year, of revenues from a generic product where the Company's client lost a major customer, 2) a decision taken by the Company during the third quarter to temporarily stop production of a high-volume product due to concerns about the product's stability. Despite a temporary delay in production at the Carolina facility due to the unavailability of an ingredient, revenues for that facility exceeded prior year levels.

Revenues from the other operations in North America were \$97.9 million, or 19% higher than the same period last year, including a \$6.5 million, or 15%, increase in Rx revenues, and a \$6.9 million, or 28%, increase in OTC revenues. Rx and OTC revenues increased significantly at Whitby, as the site continued to see improvements in manufacturing efficiencies. The site has now worked through all of its back orders. Revenues from the Toronto Region operations also increased principally as a result of one of the products that the Company launched for its client in 2005. Revenues from PDS services in North America increased 15% over the same period a year ago, with growth being driven by continuing gains in Cincinnati.

In Europe, revenues for the third quarter of 2006 were \$6.9 million or 12% higher than the same period of 2005. The year-over-year increase in revenues is due to improved commercial revenues for sterile products at the two Italian sites offset in part by the decline in volumes of more mature products in Swindon, U.K. and Bourgoin-Jallieu, France. The improvements in Italy reflect volume increases from a carve-out project where the Company is manufacturing a range of products that is re-aligning its own manufacturing network and from increased sterile lyophilization volumes. PDS revenues in Swindon also increased over prior year supported by additional laboratory space that the Company brought on line during the quarter. European currencies strengthened against the U.S. dollar in the third quarter of fiscal 2006 compared with the prior year. The euro strengthened approximately 3% and U.K. sterling strengthened approximately 2% against the U.S. dollar, increasing reported revenues by approximately \$1.9 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 9% higher than the same period in 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 third quarter of 2006, operating expenses were \$173.2 million, compared with \$152.6 million in the same period a year ago, an increase of 14%. The increase principally reflects the higher revenue base, annual payroll-related increases and the impact of the strengthening Canadian dollar relative to the U.S. dollar. These increases were offset in part by lower bonus costs and savings from global procurement initiatives. Operating expenses as a percentage of revenues were 91.5%, compared with 85.5% in the same period a year ago.

EBITDA and EBITDA Margin

On a consolidated basis in the third quarter of 2006, EBITDA, representing earnings before depreciation and amortization, asset impairment charges, interest, debt prepayment charges, write-off of deferred financing costs and income taxes was \$16.0 million, compared with \$25.8 million in the same period a year ago. As a percentage of revenues, the EBITDA margin was 8.5% in the three-month period, compared with 14.5% in the same period a year ago.

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 11% relative to the U.S. dollar, compared with the third quarter of 2005. The Company estimates that, had exchange rates remained the same as last year, its EBITDA, net of hedging activities, would have been approximately \$2.4 million higher than was reported.

EBITDA from the Puerto Rico commercial operations was a loss of \$3.5 million, compared with a profit of \$4.8 million in the same period last year. This reflects volume declines in Caguas and Manatí, offset in part by higher capacity utilization in Carolina. The temporary production suspension of a product in Caguas, due to shelf life concerns, had the effect of reducing EBITDA in the quarter by approximately \$4.0 million.

In the Cincinnati commercial operations, EBITDA was \$2.3 million, being \$1.0 million lower than the same period last year, principally a result of price concessions given to a client on a major Rx product.

In Canada, EBITDA from the commercial operations was \$6.6 million, being \$0.2 million lower than the same period last year. Gains from higher capacity utilization were offset by the impact of the strengthening Canadian dollar.

In Europe, EBITDA from the commercial manufacturing operations was \$8.3 million, being \$1.0 million lower than same period a year ago, as gains from higher capacity utilization in Italy, were offset by volume related declines in Swindon, U.K. and in Bourgoin-Jallieu, France.

EBITDA from the PDS operations was \$5.9 million, being \$1.6 million higher than the same period in 2005. The improvement reflects the business growth at the Cincinnati and Swindon facilities.

The Company incurred additional corporate costs of \$1.0 million in the third quarter of 2006, relative to the same period last year.

Depreciation and Amortization Expense

Depreciation and amortization expense was \$10.2 million in the third quarter of 2006, compared with \$8.9 million in the third quarter of 2005, an increase of \$1.3 million, or 15%. 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 \$2.8 million in the third quarter of 2006, compared with \$3.2 million for the third quarter of 2005. The amortization of intangible assets relates entirely to the Puerto Rico operations.

Asset Impairment Charge

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

The Company tested the recoverability of MOVA's long lived depreciable assets and determined that expected future cash flows over the economic life of the principal assets was less than the carrying value of the long-lived depreciable assets. As a result the Company recorded an impairment charge of \$66.2 million for intangible assets and \$15.2 million for tangible capital assets to write them down to their fair value. The fair value of the intangible assets was determined using a discounted cash flow methodology and the fair value of tangible capital assets was based on a value in continued use, taking into account utilization levels.

The Company also tested the recoverability of the goodwill associated with MOVA using a discounted cash flow methodology, and recorded an impairment charge of \$172.5 million, representing the full value of the MOVA goodwill. The goodwill impairment charge is an estimate. The valuation of MOVA will be finalized in the fourth quarter of 2006. If the final goodwill impairment amount is different, the adjustment will be recognized in the fourth quarter of 2006.

The Company, as part of its ongoing review of long term investments, concluded that its investment in the shares of a drug technology company which is accounted for on the cost basis had a permanent impairment and wrote down its value by \$0.8 million to its market value as of July 31, 2006.

Interest Expense

Interest expense for the third quarter of 2006 was \$5.2 million, up from the \$4.8 million charge in the third quarter of 2005. The increase reflects expenses related to the amendment of the Company's North American credit facilities.

Amortization of Deferred Financing Costs

Amortization of deferred financing costs in the third quarter of 2006 was \$0.1 million, compared with \$1.4 million in the third 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 (Loss) Before Income Taxes

The Company reported a loss before income taxes of \$257.0 million, compared with earnings before income taxes of \$7.6 million in the same period a year ago.

Income Taxes

The Company recorded an income tax charge of \$0.2 million compared with a charge of \$4.1 million in the same period last year. The income tax charge in the third quarter of 2006 includes a recovery associated with the asset impairment charge of \$2.6 million. No income tax recovery was recorded in relation to the goodwill impairment charge. The income tax charge from ongoing operations is principally impacted by earnings levels in Puerto Rico and Italy. The charge from ongoing operations reflects a pre-tax loss in the Puerto Rico operations, where the Company's tax rate averaged 7% and increased earnings from Italian operations, where the effective tax rate averaged 56%.

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

The Company recorded a net loss in the third quarter of 2006 of \$257.2 million, compared with net earnings of \$3.5 million in the same period last year. The loss per share was 277.0¢, compared with earnings per share of 3.5¢ a year earlier. The net loss in the third quarter of 2006 included the asset impairment charge of \$254.7 million which had the impact of reducing net earnings by \$252.1 million, or 271.5¢

The diluted loss per share was 277.0¢ compared with diluted earning per share of 3.4¢ in the third quarter of 2005. Dilution arises solely from options issued under the Company's stock option plan.

Nine Months Ended July 31, 2006 Compared with Nine Months Ended July 31, 2005

The results for the nine-month period ended July 31, 2006 include the operations of MOVA for a full three quarters, while the results of the comparative period include the operations of MOVA from the date of acquisition on December 23, 2004 until July 31, 2005.

Revenues

Consolidated revenues for the nine-month period ended July 31, 2006 increased 4% or \$20.6 million to \$537.0 million from \$516.4 million in the same period in 2005. In the nine-month period, all service activities contributed to the growth. On a consolidated basis, R_x manufacturing revenues grew 3%, OTC manufacturing revenues grew 4% and PDS revenues were up 9%.

Revenues from the Puerto Rico operations were \$96.0 million, \$12.4 million lower than 2005. The 2006 results include a full first quarter of operations compared with only five weeks of operations in 2005. 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, a temporary suspension in the manufacturing of another product at the Caguas facility during the third quarter to resolve stability issues, and from declines in base business volumes in Caguas and Manatí.

Excluding the Puerto Rico operations, revenue growth from the Company's other sites was \$33.0 million, or 8%, in the nine-month period ended July 31, 2006. Of this increase, slightly more than half, or \$17.2 million, was derived from the European operations, attributable to R_x manufacturing services, which were up \$13.9 million, or 10%, and PDS revenues, which were up \$2.4 million, or 19%, compared with the same period a year ago. North American revenues grew \$15.8 million, or 6%, compared with the same period a year ago, with R_x manufacturing revenues up \$12.7 million, or 10%, and PDS revenues up \$0.7 million, or 2%.

Prescription manufacturing and development services, collectively represented 84% of revenues, being comparable with the same period last year.

Geographically, North American revenues were \$3.4 million or 1% higher than the same period in the prior year. The decrease reflects a net decline in revenue from the Puerto Rico operations and OTC business at Niagara/Burlington, offset by significant increases in volumes at Whitby and at the Toronto Region Operations.

In Europe, revenues for the first nine months of 2006 were 11% higher than the same period of 2005. The increase reflects higher R_x manufacturing revenues from the Italian and UK operations. European currencies weakened against the U.S. dollar in the first nine months of fiscal 2006 compared with the prior year. The euro weakened approximately 5% and the British pound sterling weakened approximately 4% against the U.S. dollar, reducing reported revenues by approximately \$8.0 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 17% 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 nine months of 2006, operating expenses were \$482.8 million, compared with \$444.7 million in the same period a year ago, an increase of 9%. The increase principally reflects an additional seven weeks of operations in Puerto Rico, the higher revenue base in the other operations, 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 89.9%, compared with 86.1% in the prior year. Excluding the impact of the Puerto Rico operations, operating expenses as a percentage of revenue were 87.9% compared with 88.5% in the same period a year ago. Operating expenses as a percentage of revenues for the Puerto Rico operations were 98.8% compared with 77.2% in the same period a year ago.

EBITDA and EBITDA Margin

On a consolidated basis in the first nine months of 2006, EBITDA, representing earnings before depreciation and amortization, asset impairment charges, interest, debt prepayment charges, write-off of deferred financing costs and income taxes was \$54.2 million, a decline of \$17.5 million, or 24%, from the comparable period in 2005. As a percentage of consolidated revenues, EBITDA was 10.1% in the nine-month period, compared with 13.9% in the same period a year ago.

On a year-to-date basis the Canadian dollar has strengthened by approximately 7% relative to the U.S. dollar, compared with the same period last year. The Company estimates that, had the exchange rate remained the same as last year, its EBITDA, net of hedging activities, would have been approximately \$4.5 million higher than was reported.

EBITDA from the Puerto Rico commercial operations was a loss of \$0.2 million, compared with a profit of \$23.6 million in 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.

EBITDA from the Cincinnati commercial operations was \$8.5 million, being \$0.6 million lower than the same period last year.

The Canadian commercial operations reported EBITDA of \$18.9 million, or \$1.1 million 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.

In Europe, EBITDA from commercial operations was \$22.6 million being \$7.3 million higher than the same period last year. The improvement reflects increased capacity utilization at the Italian and Swindon, U.K. facilities.

EBITDA from PDS operations was \$13.9 million, being \$1.1 million lower than 2005. Improvements in profitability at Cincinnati and Swindon were offset by lower profitability in the Canadian operations, as a result of lower revenues in the first half of the year and from the continuing strength in the Canadian dollar.

The remaining decline in EBITDA of approximately \$0.4 million resulted from increased corporate administration expenses.

Depreciation and Amortization Expense

Depreciation and amortization expense was \$29.9 million in the first nine months of 2006, compared with \$25.5 million in the same period of 2005, an increase of \$4.4 million, or 17%. 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 when MOVA was acquired five weeks before the end of the quarter. 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 \$9.7 million in the first nine months of 2006, compared with \$7.7 million in the first nine 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 nine months of 2006 was \$15.1 million, compared with \$11.8 million in the same period a year ago. The increase of \$3.3 million, or 28%, compared with the prior year, was principally 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 nine months of 2006 was \$0.6 million, compared with \$3.5 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 \$263.7 million in the first nine months of 2006, compared with earnings before income taxes of \$21.1 million in the same period a year ago.

Income Taxes

The income tax expense for the nine months ended July 31, 2006 was \$2.0 million. The income tax charge in the nine months ended July 31, 2006 includes a recovery of \$2.6 million associated with the asset impairment charge. No income tax recovery was recorded in relation to the goodwill impairment charge. Excluding the impact of the asset impairment charge, the tax expense was \$4.5 million, despite a loss before taxes of \$9.8 million. This compares with a tax charge of \$7.9 million and an effective tax rate of 37.4% for the same period a year ago. The charge from ongoing operations in 2006 includes pre-tax losses from the Puerto Rico operations, where the effective tax rate averaged 6%. This compares with a significant pre-tax profit from ongoing operations for the same period last year. In addition, pre-tax earnings in higher tax jurisdictions, in particular Italy, were higher than in the same period of 2005.

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

The Company recorded a net loss in the first nine months of 2006 of \$265.7 million, compared with net earnings of \$13.2 million in the same period a year ago. The loss per share was 286.2¢ compared with earnings per share of 15.6¢ a year earlier. The net loss in the first nine months of 2006 included the asset impairment charge of \$254.7 million which had the impact of reducing net earnings by \$252.1 million, or 271.5¢, 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 nine months 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 286.2¢ compared with diluted earnings per share of 15.5¢ in the first nine months of 2005. Dilution arises solely from options issued under the Company's stock option plan.

The average number of shares outstanding during the nine-month period ended July 31, 2006, determined on both basic and diluted bases, was 9% higher, 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 observed in 2006, in the first quarter of 2005 the Company experienced relatively 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 July 31,		Nine months ended July 31,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Net earnings (loss)	(257,213)	3,455	(265,734)	13,242
Asset Impairment Charge	254,661	-	254,661	-
Depreciation and amortization	13,133	13,463	40,221	36,811
Write-off of deferred financing costs	-	-	6,332	2,010
Employee future benefits	1,056	586	1,130	1,395
Future income taxes	(5,495)	389	(2,721)	671
Amortization of deferred revenues	(498)	(280)	(1,493)	(618)
Other	562	531	1,433	1,374
Working capital	2,979	2,831	(14,555)	(10,314)
Cash provided by operating activities	9,185	20,975	19,274	44,571
Cash provided by (used in) financing activities	19,772	(22,668)	21,508	227,552
Cash provided by (used in) investing activities	(15,721)	4,797	(43,723)	(255,953)
Other	534	(12)	431	(7,447)
Net increase (decrease) in cash and cash equivalents	13,770	3,092	(2,510)	8,723

Cash Provided by Operating Activities

Cash provided by operating activities was \$9.2 million in the third quarter of 2006 compared with \$21.0 million for the comparable period in 2005. On a year-to-date basis, cash provided by operating activities was \$19.3 million, compared with \$44.6 million in the first nine months of 2005. The year-to-date decrease reflects lower earnings before non-cash charges and an increased investment in non-cash working capital.

Cash Provided by (Used in) Investing Activities

Cash used in investing activities in the third quarter of 2006 was \$15.7 million, compared with a net cash inflow of \$4.8 million in the same period a year ago. The cash inflow in 2005 principally related to the release of funds held in escrow in connection with the acquisition of MOVA, partially offset by the payment of earn-out purchase consideration for MOVA.

Cash used in investing activities for the nine months ended July 31, 2006 was \$43.7 million, compared with \$256.0 million in the same period of 2005. The 2005 amount included cash used in connection with the acquisition of MOVA of \$214.5 million.

On a year-to-date basis, additions to capital assets in 2006 were \$42.1 million, compared with \$38.9 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 \$21.1 million. The project is planned to be completed in 2007.

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

	Three months ended July 31,		Nine months ended July 31,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Acquisition net of cash acquired	-	(69,976)	-	(214,521)
Decrease in escrow cash related to acquisition	-	87,825	-	-
Additions to capital assets-sustaining	(3,912)	(4,998)	(10,249)	(9,328)
-project-related	(10,687)	(7,557)	(31,895)	(29,553)
Increase in deferred pre-operating costs	(1,122)	(497)	(1,579)	(2,551)
Cash provided by (used in) investing activities	(15,721)	4,797	(43,723)	(255,953)

Cash Provided by (Used in) Financing Activities

The principal financing activities for the nine months ended July 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, 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 (used in) financing activities is as follows:

	Three months ended July 31,		Nine months ended July 31,	
	2006	2005	2006	2005
	\$	\$	\$	\$
Decrease in bank indebtedness	(1,446)	(5,888)	(14,137)	(7,731)
Increase in long-term debt	62,803	64,179	373,946	295,090
Repayment of long-term debt	(41,665)	(90,011)	(353,010)	(249,171)
Decrease in restricted cash	-	695	7,805	248
Decrease (Increase) in deferred financing costs	-	86	(2,790)	(9,449)
Increase in deferred revenues	-	8,271	9,614	8,271
Proceeds on issue of common shares before costs	80	-	80	199,241
Share issue costs	-	-	-	(8,947)
Cash provided by (used in) financing activities	19,772	(22,668)	21,508	227,552

Financing Arrangements and Ratios

At July 31, 2006, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 113.6%, compared with 60.3% at July 31, 2005 and 56.1% at the end of the 2005 fiscal year. The significant increase at July 31, 2006 reflects a reduction in shareholders' equity arising from the asset impairment charge.

On December 15, 2005, the Company completed new credit facilities in North America (the “North American Loan Facilities”) 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 July 31, 2006, the Company had outstanding borrowing of \$20.0 million under the revolving facilities. The new facilities are secured by the North American assets of Patheon and its subsidiaries, including those in Puerto Rico.

In July 2006, Patheon commenced negotiations with the lenders under its North American Loan Facilities in respect of amendments to certain financial covenants under its these facilities because of concern that, based on its latest internal forecast at that time, the Company would not be in compliance with its debt-to-EBITDA ratio and fixed charge coverage financial covenants as at July 31, 2006. As a result of the amendments, the Company was in compliance with the terms and conditions of the North American Loan Facilities as at July 31, 2006. The Company believes that it will not be in compliance with its debt-to-EBITDA ratio and other financial covenants in its North American credit facilities as at October 31, 2006 and in future periods unless further amendments are agreed to by its lenders. Patheon is currently in discussions with the lenders under its North American Loan Facilities regarding potential additional amendments to its debt-to-EBITDA ratio and other covenants required for the Company to remain in compliance with its financial covenants as at October 31, 2006 and in future quarters. There can be no assurance that the Company’s lenders will agree to these amendments or that the Company will be able to comply with the terms of any amendments in future periods.

If the lenders do not agree to the required amendments and the Company does not satisfy its financial covenants under these credit facilities as at October 31, 2006 or in future periods, the lenders may immediately demand repayment of all amounts outstanding under these credit facilities. As at August 31, 2006, \$238 million was outstanding under these facilities (\$230 million as at July 31, 2006). In addition, any such default would constitute a default under a lending facility of the company’s U.K. subsidiary, allowing the lender under this facility to demand repayment of all amounts outstanding under that facility. As at August 31, 2006, \$6.9 million was outstanding under that facility (\$8.0 million as a July 31, 2006).

In accordance with EIC-59, the Company has re-classified \$232.4 million of debt from long-term debt to current indebtedness. This amount represents the long-term portion of the Company's indebtedness under its North American Loan Facilities (\$224.8 million) and the indebtedness of the Company's U.K. subsidiary under its credit facility (\$7.6 million), which was previously classified as long-term debt. EIC-59 requires this reclassification, in light of the North American Loan Facilities amendments to prevent a default, unless a violation of the covenants under these credit facilities at a determination date within one year of the balance sheet date is not likely.

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

As at July 31, 2006 the Company has a working capital deficiency of \$142.8 million due to the reclassification of long-term debt to short term debt as noted above. The Company is able to borrow under its million North American revolving loan facility, and as at July 31, 2006, \$20 million was borrowed under this facility (\$33.2 million as at August 31, 2006). The Company’s ability to fund its normal operating activities and debt service requirements is dependent on the amendments to its North American Loan Facilities agreement.

Critical Accounting Policies and Estimates

Going Concern

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. As at July 31, 2006, the Company had a working capital deficiency of \$142.8 million as a result of the reclassification of \$232.4 million of debt from long term to short term, as discussed under “Liquidity and Capital Resources – Financing Arrangements and Ratios” above. The Company’s ability to continue as a going concern is uncertain and is dependent upon further amendments being made to its North American Loan Facilities agreement and the Company’s compliance with the amended terms of the North American Loan Facilities. There can be no assurance that the Company’s lenders will agree to these amendments or that the Company will be able to comply with the terms of any amendments in future periods.

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

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 third quarter of 2006, \$0.5 million was recognized as earnings. During the first nine months of 2006, \$1.5 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 third quarter of 2006, \$2.8 million was charged to earnings. During the first nine months of 2006, \$9.7 million was charged to the earnings.

On an ongoing basis, the Company reviews whether there are any indicators of impairment. If such indicators are present, the Company assesses the recoverability of intangible assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to net earnings. In the third quarter of 2006, the Company recorded an impairment charge of \$66.2 million. During the fourth quarter, the Company will re-evaluate the economic life of the remaining assets to determine if the amortization period of nine years is still appropriate.

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. In the third quarter of 2006, the Company recorded an impairment charge of \$172.5 million to reduce the carrying value of the MOVA goodwill to zero. The goodwill impairment charge is an estimate. The valuation of MOVA will be finalized in the fourth quarter of 2006. If the final goodwill impairment amount is different, the adjustment will be recognized in the fourth quarter of 2006.

The goodwill shown on the financial statements for the period ended July 31, 2006 was \$3.1 million and relates to the acquisition in 2000 of the remaining shares of Global Pharm Inc., which now operates as Toronto York Mills Operations.

Income Taxes

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

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

Future tax assets of \$40.7 million have been recorded at July 31, 2006. This amount includes \$14.1 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 \$39.4 million have been recorded at July 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.

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 July 31, 2006 the Company had outstanding foreign exchange contracts to sell US\$85 million. The contracts mature at the latest on October 29, 2007 and the mark-to-market value at July 31, 2006 was an unrealized loss of \$1.6 million. The Company does not purchase any derivative instruments for speculative purposes.

Translation gains and losses related to the carrying value of the Company's foreign operations and certain foreign denominated debt held by the Company as a hedge against the carrying value of certain foreign operations, are deferred and included in the cumulative translation account in shareholders' equity. At July 31, 2006, the balance in the account was a \$40.4 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 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 July 31, 2006, 96% 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 \$2.0 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 July 31, 2006, the Company had 92,910,688 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

Revenues in the fourth quarter of 2006 are expected to be slightly lower than the third quarter. In Canada, there will be a reduction in volumes at the Whitby facility as the back order position has been resolved. In Europe, results will be impacted by normal summer shut downs. Revenues from the Puerto Rico operations are expected to improve, as shipments resumed in early September of the product manufactured in Caguas for which stability-related issues had been previously identified. Volumes are also expected to increase in Carolina, Puerto Rico, as clients build inventory levels in preparation for the cough and cold season.

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 auditors have been engaged to perform a review of these financial statements. The independent auditors have advised the Company that they have satisfactorily completed their review, except for procedures that have not yet been completed in respect of the asset impairment charge that the Company recognized for the third quarter ended July 31, 2006. The independent auditors were unable to complete the review procedures in respect of the asset impairment charge before the filing of the accompanying unaudited interim financial statements because the valuation of the relevant assets related to the Company's MOVA Pharmaceutical operations was not substantially completed until shortly before the deadline for filing the financial statements.

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.