



## **NEWS RELEASE**

### **For Immediate Release**

Source: Patheon Inc.

Website: [www.patheon.com](http://www.patheon.com)

### **PATHEON ANNOUNCES SECOND QUARTER RESULTS**

**Toronto, Canada (June 8, 2007)** – Patheon (TSX:PTI), a global provider of drug development and manufacturing services to the international pharmaceutical industry, today announced its results for the second quarter ended April 30, 2007. (All amounts are in U.S. dollars unless otherwise indicated.)

### **Financial Results**

*Second Quarter Ended April 30, 2007*

*Compared With Second Quarter Ended April 30, 2006*

- Revenues were \$181.0 million, a decrease of 5%;
- EBITDA before repositioning expenses was \$24.0 million (13.3% of revenues) compared with \$24.2 million (12.8% of revenues);
- Repositioning expenses, relating to further workforce reductions, the Company's ongoing manufacturing efficiency review process, and costs associated with the Company's strategic review process were \$4.0 million (\$3.8 million after tax);
- Refinancing activities resulted in a one-time expense of \$13.5 million (\$12.6 million after tax) during the second quarter;
- Excluding repositioning costs and one-time refinancing expenses, the loss was \$5.6 million (6.0 cents per share);
- The net loss for the quarter was \$22.0 million (23.6 cents per share), compared with net earnings of \$3.0 million (3.2 cents per share) a year ago.

*Six Months Ended April 30, 2007*  
*Compared With Six Months Ended April 30, 2006*

- Revenues increased 1% to \$352.7 million;
- EBITDA before repositioning expenses was \$47.2 million (13.4% of revenues) compared with \$38.2 million (11.0% of revenues);
- Repositioning expenses, relating to workforce reductions, the Company's ongoing manufacturing efficiency review process, and costs associated with the Company's strategic review process were \$7.7 million (\$6.6 million after tax);
- Excluding repositioning expenses in the first half and one-time refinancing expenses in the second quarter, the loss was \$4.8 million (5.2 cents per share);
- The net loss was \$24.0 million (25.8 cents per share), compared with a net loss of \$8.5 million (9.2 cents per share) a year ago.

“Our European, Canadian and Cincinnati operations continued to perform well in the second quarter, achieving on a consolidated basis an EBITDA margin before repositioning costs of 17%,” said Riccardo Trecroce, Chief Executive Officer, Patheon Inc.

“This performance was moderated by the impact of significant year-over-year volume declines for two major products manufactured at our Caguas, Puerto Rico facility,” said Mr. Trecroce. “Returning our Puerto Rico operations to profitability is a top priority for the Company. As a first step, we are implementing a plan to reduce costs in line with reduced revenues.”

### **Capital restructuring completed**

During the second quarter, as previously announced, Patheon completed its financial restructuring process, with the purchase of US\$150 million of convertible preferred shares of the Company by JLL Partners, and the refinancing of its existing North American and U.K. debt through new credit facilities with J.P. Morgan Securities and GE Commercial Finance.

“The successful completion of our capital restructuring process was a major achievement, providing a stable, long-term financial foundation to grow and operate our business effectively,” said Mr. Trecroce.

The Company's net income in the second quarter was impacted by one-time expenses of \$13.5 million in connection with these refinancing activities. The expenses comprise transaction costs for the new credit facilities, transaction costs allocated to the debt portion of the convertible preferred shares, and prepayment charges in connection with the cancellation of certain of the Company's U.K. debt facilities. Net income was also impacted by repositioning expenses of \$4.0 million, comprising \$0.6 million in severance costs for further reductions in the size of the workforce (primarily in Puerto Rico), \$0.9 million in professional fees relating to a manufacturing efficiency review

process currently underway at several sites, and \$2.4 million in costs relating to work on the Company's strategic review process. Interest expense for the second quarter was \$7.2 million compared with \$4.8 million in the same period a year ago, reflecting higher debt levels and borrowing costs under the Company's previous North American loan facilities that were replaced by new financing arrangements on April 27, 2007.

### **Update on strategic initiatives**

During the second quarter, Patheon announced that as part of its strategy to focus on developing and manufacturing R<sub>x</sub> pharmaceutical products and to improve the Company's profitability, it plans to restructure its current network of six pharmaceutical manufacturing facilities in Canada. It plans to divest its Niagara Region and Burlington Gateway facilities, which are focused on the commercial manufacture of over-the-counter ("OTC") products, and transfer substantially all production from its York Mills facility to Whitby Operations, following which it will close the York Mills facility and sell the land and buildings.

"We are making good progress on our Canadian site restructuring initiative," Mr. Trecroce reported. "For the Niagara-Burlington divestiture, we have prepared and issued a confidential information memorandum to interested parties and expect to complete the process of identifying potential buyers by the end of June. On the York Mills-Whitby consolidation, we are working closely with our clients and our employees to develop detailed transfer plans, and have entered into a listing agreement with a realtor for the sale of the land and facility after the transfers have been completed."

### **Second quarter operating results**

Second-quarter revenues decreased by \$8.9 million, or 5%, over the same period a year ago. Revenues from R<sub>x</sub> manufacturing services declined by \$6.3 million, or 4%, primarily attributable to significant year-over-year volume declines for two major products manufactured at Caguas, Puerto Rico: Zocor®, which lost patent protection in June 2006, and Levothyroxine sodium, where the Company's client has experienced a significant loss of market share. R<sub>x</sub> revenues were also lower in Canada, due to lower volumes of a product for which the Company's client was building inventory levels last year following its commercial launch during fiscal 2006. These declines were partially offset by strong year-over-year gains in commercial R<sub>x</sub> volumes at the Company's operations in Italy and France, which continue to benefit from the transfer of multiple products from two clients into Patheon's facilities.

Revenues from over-the-counter (OTC) manufacturing services declined by \$8.8 million, or 32%, primarily attributable to lower volumes at Whitby and Cincinnati due to decisions taken by certain clients last year to repatriate products back to their own manufacturing networks.

Revenues from pharmaceutical development services (PDS) revenues increased by \$6.2 million, or 28%, due to strong growth at the Toronto Region, Cincinnati and Swindon PDS operations. During the second quarter, two newly approved products that Patheon had developed on behalf of clients were launched and are being manufactured at Company's Cincinnati and Toronto Region facilities, respectively. This brings the total number of new product launches since 2001 to 19.

Consolidated EBITDA before repositioning expenses was \$24.0 million in the second quarter, comparable to \$23.2 million in the first quarter and down slightly from \$24.2 million a year ago. The EBITDA margin before repositioning expense was 13.3% in the second quarter, compared with 12.8% in the second quarter of 2006.

In Canada, EBITDA before repositioning expenses from commercial manufacturing operations was \$8.2 million, or \$1.5 million lower than the same period a year ago. The decline principally reflects lower OTC volumes, as well as lower volumes of an R<sub>x</sub> product for which the Company's client was building inventory levels last year following its commercial launch. The impact of the revenue declines on earnings was partially offset by savings from the Company's performance enhancement program, particularly at Whitby Operations.

EBITDA before repositioning expenses from U.S. operations was a loss of \$3.2 million, compared with a profit of \$6.8 million in the same period a year ago. The decline reflects a significant decrease in volumes for two products manufactured at the Caguas, Puerto Rico facility. The Company has taken several steps to reduce operating costs in Puerto Rico, including reducing employment levels at all three sites by a total of 110 positions during the quarter, improving operating efficiencies at the Carolina site through the manufacturing excellence program, and closing underutilized production areas at the Caguas facility – a process that will be fully completed by the third quarter.

In Europe, EBITDA before repositioning expenses from the commercial manufacturing operations was \$13.0 million, or \$5.6 million higher than the same period a year ago, reflecting volume gains in Italy and France. The strengthening European currencies relative to the U.S. dollar also had the impact of increasing EBITDA before repositioning expenses by approximately \$1.2 million.

EBITDA before repositioning expenses from global pharmaceutical development services was \$7.6 million, or \$4.2 million higher than the same period a year ago. The increase reflects improved revenue growth across all operations.

## **Outlook**

Revenues for the third quarter of 2007 are expected to be approximately the same as the second quarter of 2007. Revenues are expected to be slightly higher across the network with the exception of the U.S. operations, where the Company expects to experience lower client demand for the products currently being manufactured at those operations. The Company continues to expect that revenues from current operations for 2007 will be comparable to 2006.

## **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.

## **WEBCAST CONFERENCE CALL WITH ANALYSTS**

*Patheon Inc. will host a webcast conference call with financial analysts on its second quarter results on Friday, June 8, 2007 at 10:00 a.m. (Eastern Daylight Time). Representing Patheon on the call will be: Riccardo Trecroce, Chief Executive Officer; Nick DiPietro, President and Chief Operating Officer; John Bell, Chief Financial Officer; 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) 644-3414 (Toronto and International) or toll free at (800) 733-7560 (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](http://www.patheon.com). An archived version of the Q2 webcast will be available on [www.patheon.com](http://www.patheon.com) for three months.*

## **ABOUT PATHEON**

*Patheon (TSX:PTI; [www.patheon.com](http://www.patheon.com)) is a leading global provider of drug development and manufacturing services to the international pharmaceutical industry. Patheon operates a network of 14 facilities in the United States, Canada and Europe, employing more than 5,200 people and serving a client base of 250 pharmaceutical and biotechnology companies.*

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## Consolidated Statements of Earnings (Loss)

(unaudited)

	Three months ended April 30,			Six months ended April 30,		
	2007	2006	% change	2007	2006	% change
(in thousands of U.S. dollars, except per share amounts)	\$	\$		\$	\$	
<b>Revenues</b>	<b>181,009</b>	189,902	-4.7%	<b>352,704</b>	347,846	1.4%
Operating expenses	<b>157,002</b>	165,689	-5.2%	<b>305,463</b>	309,621	-1.3%
Earnings before the following:	<b>24,007</b>	24,213	-0.9%	<b>47,241</b>	38,225	23.6%
(as a % of revenues)	<b>13.3%</b>	12.8%		<b>13.4%</b>	11.0%	
Repositioning expenses (note 5)	<b>3,952</b>	-		<b>7,653</b>	-	
Depreciation and amortization	<b>10,779</b>	9,920	8.7%	<b>21,249</b>	19,731	7.7%
Amortization of intangible assets	<b>2,182</b>	3,472	-37.2%	<b>4,363</b>	6,895	-36.7%
Foreign exchange loss (note 6)	<b>858</b>	-		<b>858</b>	-	
Interest	<b>7,224</b>	4,795	50.7%	<b>14,335</b>	9,898	44.8%
Refinancing expenses (note 9)	<b>13,471</b>	-		<b>13,471</b>	1,643	719.9%
Amortization of deferred financing costs	-	137		-	462	
Write-off of deferred financing costs (note 9)	-	-		-	6,332	
Earnings (loss) before income taxes	<b>(14,459)</b>	5,889	-345.5%	<b>(14,688)</b>	(6,736)	-118.1%
Provision for income taxes	<b>7,527</b>	2,900	159.6%	<b>9,322</b>	1,785	422.2%
<b>Net earnings (loss) for the period</b>	<b>(21,986)</b>	2,989	-835.6%	<b>(24,010)</b>	(8,521)	-181.8%
(as a % of revenues)	<b>-12.1%</b>	1.6%		<b>-6.8%</b>	-2.4%	
<b>Earnings (loss) per share</b>						
Basic and diluted	<b>(23.6¢)</b>	3.2¢	-837.5%	<b>(25.8¢)</b>	(9.2¢)	-180.4%
Average number of shares outstanding during period:						
Basic (in thousands)	<b>92,959</b>	92,846	0.1%	<b>92,959</b>	92,846	0.1%
Diluted (in thousands)	<b>92,959</b>	93,110	-0.2%	<b>92,959</b>	92,846	0.1%

see accompanying notes

# Consolidated Balance Sheets

(unaudited)

	As at April 30, 2007	As at October 31, 2006
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Assets</b>		
Current		
Cash and cash equivalents	46,538	50,723
Accounts receivable	122,282	121,956
Inventories	83,432	75,962
Prepaid expenses and other	5,541	6,800
Total current assets	<u>257,793</u>	<u>255,441</u>
Capital assets	501,446	494,088
Intangible assets	37,085	41,447
Deferred costs	7,612	9,717
Future tax assets	26,079	21,827
Goodwill	3,113	3,077
Investments	664	586
	<u>833,792</u>	<u>826,183</u>
<b>Liabilities and Shareholders' equity</b>		
Current		
Bank indebtedness	2,729	3,829
Accounts payable and accrued liabilities	136,614	142,781
Income taxes payable	8,179	879
Current portion of long-term debt	10,477	283,717
Total current liabilities	<u>157,999</u>	<u>431,206</u>
Long-term debt (note 8)	204,183	62,071
Deferred revenues	23,723	23,366
Future tax liabilities	35,774	33,128
Convertible preferred shares - debt component (note 8)	132,862	-
Other long-term liabilities	27,556	25,681
Total liabilities	<u>582,097</u>	<u>575,452</u>
Shareholders' equity		
Convertible preferred shares - equity component (note 8)	15,925	-
Restricted voting shares	400,745	400,721
Contributed surplus	3,923	3,829
Deficit	(215,659)	(189,900)
Accumulated other comprehensive income	46,761	36,081
Total shareholders' equity	<u>251,695</u>	<u>250,731</u>
	<u>833,792</u>	<u>826,183</u>

see accompanying notes

## Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

	Six months ended April 30,	
	2007	2006
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Convertible preferred shares - equity component</b>		
Balance at beginning of period	-	-
Shares Issued, net of issue costs	15,925	-
Balance at end of period	15,925	-
<b>Restricted voting shares</b>		
Balance at beginning of period	400,721	400,594
Issued during the period, net of issue costs	24	-
Balance at end of period	400,745	400,594
<b>Contributed surplus</b>		
Balance at beginning of period	3,829	2,901
Stock options	94	492
Balance at end of period	3,923	3,393
<b>Retained earnings (deficit)</b>		
Balance at beginning of period	(189,900)	98,250
Adjustment related to change in accounting policy (note 1)	(1,749)	-
Net loss for the period	(24,010)	(8,521)
Balance at end of period	(215,659)	89,729
<b>Accumulated other comprehensive income</b>		
Balance at beginning of period	36,081	38,106
Transition adjustment (note 1)	(762)	-
Other comprehensive income for the period	11,442	29,962
Balance at end of period	46,761	68,068
<b>Total shareholders' equity at end of period</b>	<b>251,695</b>	<b>561,784</b>

see accompanying notes

## Consolidated Statement of Comprehensive Loss

(unaudited)

	Six months ended April 30,	
	Three months ended April 30, 2007	2006
<i>(in thousands of U.S. dollars)</i>	\$	\$
<b>Net loss for the period</b>	(21,986)	(24,010)
<b>Other comprehensive income, net of income taxes (note 10)</b>		
Change in foreign currency gains on investments in subsidiaries, net of hedging activities	11,602	7,097
Foreign currency losses on investments in subsidiaries, net of hedging activities reclassified to consolidated statement of earnings (loss)	2,793	2,793
Change in value of derivatives designated as foreign currency cash flow hedges	3,340	831
Losses on foreign currency cash flow hedges reclassified to consolidated statement of earnings ( loss)	1,067	1,377
Gains on interest rate hedges reclassified to consolidated statement of earnings (loss)	(619)	(656)
Other comprehensive income for the period	18,183	11,442
<b>Comprehensive loss for the period</b>	<b>(3,803)</b>	<b>(12,568)</b>

see accompanying notes

## Consolidated Statements of Cash Flows

(unaudited)

	Three months ended April 30,		Six months ended April 30,	
	2007	2006	2007	2006
(in thousands of U.S. dollars)	\$	\$	\$	\$
<b>Operating activities</b>				
Net earnings (loss) for the period	(21,986)	2,989	(24,010)	(8,521)
Add (deduct) charges to operations not requiring a current cash payment				
Depreciation and amortization	12,961	13,392	25,612	26,626
Foreign exchange loss (note 6)	858	-	858	-
Write-off of deferred financing costs (note 9)	-	-	-	6,332
Amortization of deferred financing costs	1,311	137	1,380	462
Employee future benefits	164	860	635	74
Future income taxes	292	459	68	2,774
Amortization of deferred revenues	(483)	(498)	(969)	(995)
Other	(925)	373	(649)	871
	(7,808)	17,712	2,925	27,623
Net change in non-cash working capital balances related to operations	2,069	(15,387)	(4,183)	(17,534)
Increase in deferred revenues	-	-	-	9,614
<b>Cash provided by (used in) operating activities</b>	<b>(5,739)</b>	<b>2,325</b>	<b>(1,258)</b>	<b>19,703</b>
<b>Investing activities</b>				
Additions to capital assets - sustaining	(2,535)	(3,597)	(5,652)	(6,337)
- project - related	(2,268)	(10,028)	(7,215)	(21,208)
Decrease in investments	-	-	116	-
Increase in deferred pre-operating costs	(646)	61	(1,711)	(457)
<b>Cash used in investing activities</b>	<b>(5,449)</b>	<b>(13,564)</b>	<b>(14,462)</b>	<b>(28,002)</b>
<b>Financing activities</b>				
Increase (decrease) in bank indebtedness	(8,258)	905	(1,316)	(12,691)
Increase in long-term debt	166,470	27,563	175,840	311,143
Repayment of long-term debt	(288,483)	(23,993)	(312,953)	(311,345)
Issue of convertible preferred shares	150,000	-	150,000	-
Convertible preferred share issue costs - equity component	(1,213)	-	(1,213)	-
Issue of restricted voting shares	24	-	24	-
Decrease in restricted cash	-	-	-	7,805
Increase in deferred financing costs	-	(25)	-	(2,790)
<b>Cash provided by (used in) financing activities</b>	<b>18,540</b>	<b>4,450</b>	<b>10,382</b>	<b>(7,878)</b>
Effect of exchange rate changes on cash and cash equivalents	2,360	(225)	1,153	(103)
<b>Net increase (decrease) in cash and cash equivalents during the period</b>	<b>9,712</b>	<b>(7,014)</b>	<b>(4,185)</b>	<b>(16,280)</b>
Cash and cash equivalents, beginning of period	36,826	13,241	50,723	22,507
<b>Cash and cash equivalents, end of period</b>	<b>46,538</b>	<b>6,227</b>	<b>46,538</b>	<b>6,227</b>

see accompanying notes

## Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007

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

### 1. Accounting policies

#### Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“GAAP”) on a basis consistent with those followed in the most recent audited consolidated financial statements except as noted below. These consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and notes for the year ended October 31, 2006.

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

#### Changes in accounting policy

Effective November 1, 2006 the Company adopted the CICA Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, Section 3861 “Financial Instruments – Disclosure and Presentation”, Section 3865 “Hedges” and Section 1530 “Comprehensive Income”. The adoption of the new standards resulted in changes in accounting for financial instruments and hedges as well as the recognition of certain transition adjustments that have been recorded in accumulated other comprehensive income. The comparative interim consolidated financial statements have not been restated except as noted below. The principal changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described below:

#### Financial Assets and Financial Liabilities

An investment in shares of a publicly traded company have been designated as held for trading and are accounted for at fair value, with changes in the fair value being recorded in the consolidated statement of earnings (loss). Prior to the adoption of the new standards, this investment was accounted for on a cost basis, as adjusted for an other than temporary decline in value. All other financial assets are accounted for on an amortized cost basis and financial liabilities are accounted for on an accruals basis, consistent with prior accounting policies.

Costs of obtaining bank and other debt financing that were previously reported in deferred costs are now netted against the carrying value of the related debt and amortized into interest expense using the effective interest rate method. Prior to the adoption of the new standards, the amortization of deferred financing costs was reported as a separate line in the consolidated statement of earnings (loss).

In the second quarter of 2007 the Company also changed its accounting policy relating to costs of obtaining bank and other debt financing. Under the new policy all transaction costs, including fees paid to advisors and other related costs, are expensed as incurred. Financing costs, including underwriting and arrangement fees paid to lenders are deferred and netted against the carrying value of the related debt and amortized into interest expense using the effective interest rate method. The Company previously deferred all transaction and financing costs associated with obtaining bank and other debt financing. The Company believes that the new policy is reliable and more relevant as it results in a more transparent

## **Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

treatment of transaction costs that the Company has incurred in its recent refinancing activities and in the carrying value of debt.

The change in policy has been made retrospectively effective November 1, 2006 and had the effect of increasing the retained deficit at November 1, 2006 by \$1,749,000 and reducing the interest expense and net loss for the three months ended January 31, 2007 by \$612,000. Refinancing expenses for the three months ended April 30, 2007 include transaction costs incurred in connection with the completion of the Company's senior secured credit facilities and the debt component of the convertible preferred shares of \$11,889,000 (see note 9).

In 2006, the Company cancelled its interest rate swaps that were used as a hedge against changes in interest payments on floating rate debt. Deferred gains from the cancellation of these interest rate swaps that had previously been recorded in accounts payable and accrued liabilities were recorded in accumulated other comprehensive income. In the second quarter of 2007, all remaining deferred gains on the interest rate swap were reclassified to the consolidated statement of earnings (loss).

### Derivatives and Hedge Accounting

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

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

The effective portion of changes in the fair value of cash flow hedges and hedges of net investments in foreign operations are recognized in other comprehensive income. Amounts accumulated in other comprehensive income are reclassified to the consolidated statement of earnings (loss) in the period in which the hedged item affects the earnings (loss). Any gain or loss in the fair value relating to the ineffective portion of a hedge is recognized immediately in the consolidated statement of earnings (loss).

### Comprehensive Income (Loss) and Accumulated Other Comprehensive Income

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

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

## Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007

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

### Convertible preferred shares

On April 27, 2007 the Company issued \$150 million of convertible preferred shares. The shares are considered to be a compound financial instrument that contains both a debt component and an equity component.

On issuance of the convertible preferred shares, the fair value of the debt component is determined by discounting the expected future cash flows over the expected life using a market interest rate for a non-convertible debt instrument with similar terms. The value is carried as debt on an amortized cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated as a separate component of shareholders' equity, net of transaction costs. Transaction costs are apportioned between the debt and equity components based on their respective carrying amounts when the instrument was issued.

On conversion, the carrying amount of the debt component and the equity component are transferred to share capital and no gain or loss is recognized.

The interest cost recognized in respect of the debt component represents the accretion of the liability, over its expected life using the effective interest method, to the amount that would be payable if redeemed.

### 2. Convertible preferred shares and restricted voting shares

The following table summarizes information on convertible preferred shares, and restricted voting shares and related matters at April 30, 2007:

	Outstanding	Exercisable
Convertible preferred shares		
Class I preferred shares series C and D	150,000	
Restricted voting shares (previously common shares)	92,958,688	
Restricted voting share stock options	3,912,849	3,753,682

The Company's articles were amended on April 26, 2007 to re-designate the common shares as restricted voting shares. This occurred in connection with the issuance of the convertible preferred shares. The holders of the convertible preferred shares have the right to appoint three of nine members of the Board of Directors. The holders of Patheon's common shares have the right to elect the remaining members of the Board of Directors. Under the rules of the Toronto Stock Exchange, voting equity securities are not to be designated, or called, common shares unless they have a right to vote in all circumstances that is not less, on a per share basis, than the voting rights of each other class of voting securities. Accordingly, the Company has amended its articles to re-designate the common shares as restricted voting shares. This re-designation involves only a change in the name of the securities; the number of shares outstanding and the terms and conditions of the outstanding shares are not affected by the change.

**Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

**3. Segmented information**

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

Canadian and foreign operations consist of:

	Manufacturing location			Total
	Three months ended Apr 30, 2007			
	Canada	USA	Europe	
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	7,535	111	487	8,133
USA	39,897	51,029	2,936	93,862
Europe	10,920	523	64,384	75,827
Other geographic areas	891	83	2,213	3,187
<b>Total revenues</b>	<b>59,243</b>	<b>51,746</b>	<b>70,020</b>	<b>181,009</b>
<b>Capital assets</b>	<b>127,551</b>	<b>139,280</b>	<b>234,615</b>	<b>501,446</b>
<b>Goodwill</b>	<b>3,113</b>	<b>-</b>	<b>-</b>	<b>3,113</b>

	Manufacturing location			Total
	Three months ended Apr 30, 2006			
	Canada	USA	Europe	
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	11,020	35	119	11,174
USA	40,218	64,970	1,902	107,090
Europe	15,290	74	53,324	68,688
Other geographic areas	1,289	90	1,571	2,950
<b>Total revenues</b>	<b>67,817</b>	<b>65,169</b>	<b>56,916</b>	<b>189,902</b>
<b>Capital assets</b>	<b>129,453</b>	<b>170,819</b>	<b>199,582</b>	<b>499,854</b>
<b>Goodwill</b>	<b>3,091</b>	<b>187,787</b>	<b>-</b>	<b>190,878</b>

**Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

	Manufacturing location			
	Six months ended Apr 30, 2007			
	Canada	USA	Europe	Total
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	14,976	349	859	16,184
USA	78,875	110,236	6,759	195,870
Europe	19,063	955	115,380	135,398
Other geographic areas	1,570	139	3,543	5,252
<b>Total revenues</b>	<b>114,484</b>	<b>111,679</b>	<b>126,541</b>	<b>352,704</b>

	Manufacturing location			
	Six months ended Apr 30, 2006			
	Canada	USA	Europe	Total
	\$	\$	\$	\$
<b>Revenues</b>				
Canada	21,056	288	408	21,752
USA	73,595	120,283	3,928	197,806
Europe	25,295	335	97,640	123,270
Other geographic areas	2,503	171	2,344	5,018
<b>Total revenues</b>	<b>122,449</b>	<b>121,077</b>	<b>104,320</b>	<b>347,846</b>

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

Revenue information by service activity is as follows:

**Revenue Information By Service Activity:**

	Three months ended Apr 30,			
	2007		2006	
	\$		\$	
Commercial manufacturing - prescription	133,909	74%	140,160	74%
Commercial manufacturing - over-the-counter	18,594	10%	27,395	14%
Development services	28,506	16%	22,347	12%
	<b>181,009</b>	<b>100%</b>	<b>189,902</b>	<b>100%</b>

	Six months ended Apr 30,			
	2007		2006	
	\$		\$	
Commercial manufacturing - prescription	260,136	74%	252,199	72%
Commercial manufacturing - over-the-counter	37,071	10%	51,290	15%
Development services	55,497	16%	44,357	13%
	<b>352,704</b>	<b>100%</b>	<b>347,846</b>	<b>100%</b>

## Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007

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

### 4. Stock-based compensation

The Company has an incentive stock option plan. Persons eligible to participate in the plan are directors, officers, and key employees of the Company and its subsidiaries or any other person engaged to provide ongoing management or consulting services to Patheon. The plan provides that the maximum number of shares that may be issued under the plan is 7.5% of the issued and outstanding restricted voting shares of the Company at any point in time. As of April 30, 2007, the total number of restricted voting shares listed and reserved at the TSX for issuance under the plan was 6,850,427, of which there are stock options outstanding to purchase 3,912,849 shares under the plan. The exercise price of restricted voting 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 restricted voting shares of Patheon on the Toronto Stock Exchange during the two trading days immediately preceding the grant date. Options generally expire 10 years after the grant date and are also subject to early expiry in the event of death, resignation, dismissal or retirement of an optionee. Options vest over one to three years, with one-third on each of the first, second and third anniversary of the grant date for those vesting over three years.

For the purposes of calculating the stock-based compensation expense, the fair value of stock options is estimated at the date of the grant using the Black-Scholes option pricing model. The weighted average fair value of 100,000 options granted for the three months and six months ended April 30, 2007 was \$1.92. The weighted average fair value for the stock options granted for the three months and six months ended April 30, 2006 was \$2.77 and \$2.30, respectively. The following assumptions were used in arriving at the fair value of options issued during the six months ended April 30, 2007:

Risk free interest rate	4.2%
Expected volatility	42%
Expected weighted average life of options	6 years
Expected dividend yield	0%

Stock-based compensation expense recorded in the three months ended April 30, 2007 was \$49,000 (2006 - \$152,000) for options granted on or after November 1, 2003. Stock-based compensation expense recorded in the six months ended April 30, 2007 was \$94,000 (2006 - \$492,000) for options granted on or after November 1, 2003.

### 5. Repositioning expenses

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

During the first half of 2007 the Company also incurred professional fees and other costs, in connection with its review of strategic and financial alternatives.

## Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007

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

The following is a summary of expenses associated with these initiatives (collectively “repositioning expenses”) for the three months and six months ended April 30, 2007:

	Three months ended April 30, 2007	Six months ended April 30, 2007
	\$	\$
Performance enhancement program:		
-Employee-related expenses	635	1,779
-Consulting and professional fees	882	2,486
Strategic alternatives review	2,435	3,388
	<b>3,952</b>	<b>7,653</b>

As at April 30, 2007, \$5,883,000 of the repositioning expenses are unpaid and are recorded in accounts payable and accrued liabilities. This includes amounts accrued during the 2006 fiscal year. Repositioning expenses paid during the three months and six months ended April 30, 2007 amounted to \$3,242,000 and \$11,614,000, respectively.

### 6. Other information

#### Foreign exchange

During the three months ended April 30, 2007, the foreign exchange loss on operating exposures, net of cash flow hedges, (including the revaluation of all foreign currency denominated assets and liabilities, other than those liabilities designated as a hedge against foreign currency denominated net investments) recorded in operating expenses was \$943,000 (2006 gain - \$441,000). During the six months ended April 30, 2007, the foreign exchange gain on operating exposures, net of cash flow hedges, was \$811,000 (2006 gain - \$189,000).

During the three months ended April 30, 2007 the Company recorded a foreign exchange loss of \$858,000 in connection with a change in the Company’s internal capital structure, which resulted in the recognition of foreign exchange translation losses previously recorded in accumulated other comprehensive income.

#### Employee future benefits

The employee future benefit expense in connection with defined benefit pension plans and other post retirement benefit plans for the three months ended April 30, 2007 was \$1,549,000 (2006 – \$1,811,000). For the six months ended April 30, 2007 the employee future benefit expense was \$3,228,000 (2006 - \$2,220,000).

### 7. Financial instruments

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

## **Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

The Company's Canadian operations have entered into foreign exchange forward contracts to sell an aggregate amount of US\$54,000,000 as at April 30, 2007. These contracts hedge the Company's expected exposure to U.S. dollar denominated cash flows and mature at the latest on October 29, 2007 at exchange rates varying between \$1.0847 and \$1.17031 Canadian. The mark-to-market value on these financial instruments as at April 30, 2007 was an unrealized gain of \$790,000 which has been recorded in accumulated other comprehensive income in shareholders' equity.

As at April 30, 2007 the Company has designated \$133 million of U.S. dollar denominated debt as a hedge against its net investment in its operations in the U.S.A. and Puerto Rico. The exchange gains and losses arising from this debt are recorded in accumulated other comprehensive income in shareholders' equity.

### **8. Refinancing**

#### Convertible Preferred Shares

On April 27, 2007 JLL Partners, through its investment vehicle, JLL Holdings, LLC, purchased 150,000 convertible preferred shares of Patheon for \$150 million. Until October 27, 2009, no cash dividends will be paid on the preferred shares, but the liquidation preference and conversion rate will increase on a quarterly basis by 2.125%. After October 27, 2009, these increases in the liquidation preference and conversion rate will continue until the maturity or prior conversion, unless the Company elects to pay a cash dividend for any applicable quarter, in which case the Company will pay a cash dividend for such quarter based on an annual dividend rate of 8.5% on the aggregate liquidation preference of the convertible preferred shares.

Each convertible preferred share is convertible into 209.7081 restricted voting shares, as adjusted for any non-cash dividends noted above, at any time at the holder's option. The Company is entitled to require the holder to convert into restricted voting shares if, at any time after October 27, 2009, the market price of the restricted voting shares on the Toronto Stock Exchange exceeds a price equivalent to US\$7.87 for a period of at least 60 days.

If not previously converted, the Company is required to redeem the convertible preferred shares for cash on April 27, 2017 at a price equal to the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon. The Company is also required to redeem the convertible preferred shares upon the occurrence of a change of control of Patheon at a price equal to the greater of the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon, or the price per share paid to holders of restricted voting shares in the change of control transaction, multiplied by the number of restricted voting shares into which the convertible preferred shares are then convertible.

On issuance, the fair value of the debt component of the preferred shares was \$132,862,000. The remainder of the proceeds, attributable to shareholders' equity was \$15,925,000, net of apportioned transaction costs of \$1,213,000.

#### Senior Secured Credit Facilities

On April 27, 2007 the Company completed new credit facilities in the aggregate amount of \$225 million, comprising a seven-year \$150 million senior secured term loan and a five-year \$75 million asset based revolving credit facility. The Company is required to make quarterly installment payments of \$375,000 on the term loan facility, along with additional mandatory repayments based on certain excess cash flow

## **Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

measures. Interest on the facilities is at floating rates based on LIBOR, US prime, or the federal funds effective rate, plus applicable margins. The facilities are secured by substantially all of the assets of the Company's operations in Canada, U.S.A., Puerto Rico and the U.K. and the Company's investments in the shares of all other operating subsidiaries.

Net proceeds from the issue of the convertible preferred shares and the senior secured term loan facility were used to repay the Company's obligations under its existing North American and U.K. credit facilities. No amounts are currently drawn on the revolving facility.

### **9. Refinancing expenses and write-off of deferred financing costs**

During the three months ended April 30, 2007 the Company incurred expenses of \$13,471,000 in connection with its refinancing activities. The expenses are made up of transaction costs for the new credit facilities, costs allocated to the debt portion of the convertible preferred shares and prepayment charges in connection with cancellation of certain of the Company's U.K. debt facilities.

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.

### **10. Other comprehensive income**

The amounts disclosed in other comprehensive income are net of income taxes. Foreign currency losses on investments in subsidiaries, net of hedging activities reclassified to the consolidated statement of earnings (loss) are net of an income tax benefit of \$1,935,000 for the three months and six months ended April 30, 2007. The gains on interest rate hedges reclassified to the consolidated statement of earnings (loss) are net of an income tax benefit of \$323,000 and \$343,000 for the three months and six months ended April 30, 2007, respectively.

After taking into account the Company's valuation reserve for future income taxes, the change in foreign currency losses on investments in subsidiaries, net of hedging activities, is net of an income tax expense of \$1,692,000 and \$nil for the three months and six months ended April 30, 2007, respectively. There is no income tax associated with the change in value of derivatives designated as foreign currency cash flow hedges and losses on foreign currency cash flow hedges reclassified to the consolidated statement of earnings (loss).

### **11. Related party transactions**

Revenues from companies controlled by a director and significant shareholder of the Company were in the amount of \$624,000 and \$683,000 for the three and six months ended April 30, 2007, respectively. These transactions were conducted in the normal course of business and are recorded at the exchanged amount which management believes to be at fair value. Accounts receivables at April 30, 2007 include a balance of \$165,000 resulting from these transactions.

At April 30, 2007 the Company has an investment of \$389,000 representing an 18% interest in two Italian companies whose largest investor is an Officer of the Company. These newly formed companies will specialize in the manufacturing of cytotoxic pharmaceutical products.

**Notes to Unaudited Consolidated Financial Statements for the Six Months Ended April 30, 2007**

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

**12. Divestiture of Niagara-Burlington Operations**

On April 17, 2007 the Company announced that it plans to divest its Niagara-Burlington Operations business which is focused on the commercial manufacturing of over-the-counter products. The Niagara-Burlington Operations consist of facilities in Fort Erie and Burlington Gateway and the commercial operations at Burlington Century. The Company plans to retain the Burlington Century facility where its central quality control laboratory is also based. Commercial manufacturing revenues for the three months and six months ended April 30, 2007 were \$8.9 million and \$17.4 million, respectively. Earnings before repositioning expenses, depreciation and amortization, interest, refinancing charges, write-off of deferred financing costs and income taxes for the three months and six months ended April 30, 2007 were \$0.8 million and \$1.1 million respectively.

The results of operations of the Niagara-Burlington Operations business have not been reported as discontinued operations, as progress made under the divestiture plan at April 30, 2007 does not meet all of the criteria required for such disclosure.

**13. Comparative amounts**

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

## **Patheon Inc.**

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

The following management discussion and analysis of financial condition and results of operations ("MD&A") of Patheon Inc. ("Patheon" or "the Company") for the three-month and six-month periods ended April 30, 2007 and 2006 should be read in conjunction with the Company's consolidated financial statements and related notes contained in this interim report. This MD&A is dated as of June 8, 2007.

The purpose of this 2007 second quarter report is to provide an update to the information contained in the Company's Management's Discussion and Analysis section of the Company's 2006 Annual Report, which contains a more comprehensive discussion of the 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 2006 Annual Report. This document and other information can be downloaded in portable document format (PDF) from the Company's web site at [www.patheon.com](http://www.patheon.com) or from the SEDAR web site for Canadian regulatory filings at [www.sedar.com](http://www.sedar.com). To request a printed copy, the reader may also contact Patheon's transfer agent, Computershare Investor Services Inc., at 1-800-564-6253 or via email at [service@computershare.com](mailto:service@computershare.com), or Patheon at [www.patheon.com](http://www.patheon.com).

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

Except as otherwise indicated, references in this MD&A to "EBITDA before repositioning expenses" are to earnings before repositioning expenses, depreciation and amortization, foreign exchange losses, interest, refinancing expenses, write-off of deferred financing costs, and income taxes. "EBITDA margin before repositioning expenses" is EBITDA before repositioning expenses divided by revenues. EBITDA before repositioning expenses and EBITDA margin before repositioning expenses are measures of earnings or earnings margin not recognized by generally accepted accounting principles in Canada ("Canadian GAAP"). Since each of these measures is a non-GAAP measure that does not have a standardized meaning, it may not be comparable to similar measures presented by other issuers. Prospective investors are cautioned that these, and other non-GAAP measures should not be construed as alternatives to net earnings determined in accordance with Canadian GAAP as indicators of performance. The Company has included these measures because it believes that this information is used by certain investors to assess the financial performance of the Company, in particular the operating earnings before non cash charges and large and non-recurring costs.

### **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<sub>x</sub>") and over-the-counter ("OTC") products in solid, semi-solid and liquid dosage forms. Conventional dosage forms include compressed tablets, hard-shell capsules, powders, ointments, creams, gels, syrups, suspensions, solutions and suppositories. Sterile dosage forms include liquids and powders filled in ampoules, vials, bottles or pre-filled syringes. Sterile lyophilized products are also manufactured in both vials and ampoules.

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

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

At April 30, 2007, there were a total of 177 client products in the Patheon's pharmaceutical development services ("PDS") pipeline, including 10 drug candidates at the New Drug Application ("NDA") stage. This compares with a total of 158 client products a year ago. During the second quarter of 2007, two products developed on behalf of clients were 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 focused on providing "best-in-class" manufacturing and development services effectively balancing high product quality and reliability of supply with cost.

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

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

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

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

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

## **Recent Developments**

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

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

The net proceeds from the JLL Partners investment and the seven-year term loan were used to repay the Company’s obligations under its existing North American and U.K. credit facilities. No amounts have been drawn on the revolving facility.

### ***Restructuring the Canadian Site Network***

On April 17, 2007 the Company announced that as part of its strategy to focus on developing and manufacturing Rx pharmaceutical products and to improve the Company’s profitability, it plans to restructure its current network of six pharmaceutical manufacturing facilities in Canada.

The Company plans to divest its Niagara-Burlington Operations business that is focused on the commercial manufacturing of OTC products. The Niagara-Burlington Operations to be divested consist of facilities in Fort Erie and Burlington Gateway and the commercial operations at Burlington Century. The Company plans to retain the Burlington Century facility where its central quality control laboratory is also based.

The Company also plans to close its York Mills, Toronto facility and transfer substantially all commercial production and development services to its site in Whitby and some production to its Mississauga and Cincinnati sites. The Company will also sell the land and buildings. The process of transferring production to other facilities is expected to take up to two years.

## Results of Operations

### Three Months Ended April 30, 2007 Compared with Three Months Ended April 30, 2006

U.S.\$ '000	Three months ended April 30,			Six months ended April 30,		
	2007	2006	% Change	2007	2006	% Change
<b>North America</b>						
<b>Commercial Manufacturing</b>						
Prescription	72,335	88,231	-18%	149,511	157,534	-5%
Over-the-counter	17,857	26,900	-34%	35,061	50,419	-30%
	<b>90,192</b>	115,131	-22%	<b>184,572</b>	207,953	-11%
<b>Development Services</b>	<b>20,797</b>	17,855	16%	<b>41,591</b>	35,573	17%
	<b>110,989</b>	<b>132,986</b>	<b>-17%</b>	<b>226,163</b>	<b>243,526</b>	<b>-7%</b>
<b>Europe</b>						
<b>Commercial Manufacturing</b>						
Prescription	61,574	51,929	19%	110,624	94,665	17%
Over-the-counter	737	495	49%	2,011	871	131%
	<b>62,311</b>	52,424	19%	<b>112,635</b>	95,536	18%
<b>Development Services</b>	<b>7,709</b>	4,492	72%	<b>13,906</b>	8,784	58%
	<b>70,020</b>	<b>56,916</b>	<b>23%</b>	<b>126,541</b>	<b>104,320</b>	<b>21%</b>
<b>TOTAL</b>						
<b>Commercial Manufacturing</b>						
Prescription	133,909	140,160	-4%	260,136	252,199	3%
Over-the-counter	18,594	27,395	-32%	37,071	51,290	-28%
	<b>152,503</b>	167,555	-9%	<b>297,207</b>	303,489	-2%
<b>Development Services</b>	<b>28,506</b>	22,347	28%	<b>55,497</b>	44,357	25%
<b>CONSOLIDATED REVENUES</b>	<b>181,009</b>	<b>189,902</b>	<b>-5%</b>	<b>352,704</b>	<b>347,846</b>	<b>1%</b>

#### Revenues

Consolidated revenues for the three-month period ended April 30, 2007 decreased 5%, or \$8.9 million, to \$181.0 million from \$189.9 million in the same period in 2006. In the second quarter, revenue decreased in both Rx and OTC manufacturing, but increased in PDS. On a consolidated basis, compared with the second quarter of 2006, Rx and OTC revenues declined by 4% and 32%, respectively, and PDS revenues increased by 28%.

Prescription manufacturing and development services represented 90% of revenues, compared with 86% for the comparable period in 2006.

Geographically, in North America, revenues declined in the second quarter by \$22.0 million or 17% over the same period a year ago. The decrease reflects a significant decline in Rx revenues in Caguas, Puerto Rico as a result of volume declines for Zocor® and Levothyroxine sodium. Zocor® lost its patent protection in June 2006 and the Company's client for Levothyroxine sodium has suffered a significant decline in market share. Rx revenues were also lower in Canada principally as a result of lower volumes for a product where in the prior year the Company's client was building trade inventory levels after its commercial launch. OTC revenues were also lower in both Canada and Cincinnati as certain clients have repatriated products back to their own manufacturing networks. The declines in commercial manufacturing were partially offset by a significant increase in PDS business in both Canada and Cincinnati.

In Europe, revenues for the second quarter of 2007 were \$70.0 million or 23% higher than the same period of 2006. The year-over-year increase in revenues reflects higher Rx manufacturing revenues from operations in Italy and France. These gains reflect the continuing benefits from two carve out initiatives where the Company is manufacturing a range of products for two clients that have closed down facilities within their own manufacturing network. PDS operations in Swindon also continued to show further increases in volumes. The Euro strengthened approximately 10% and U.K. sterling strengthened

approximately 12% against the U.S. dollar, increasing reported revenues by approximately \$6.7 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 11% higher than the same period in 2006.

### ***Operating Expenses***

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support, administrative expenses and foreign exchange gains and losses. In the second quarter of 2007, operating expenses were \$157.0 million, being \$8.7 million lower than the same period a year ago. Operating expenses were principally impacted by lower commercial manufacturing volumes and savings from the performance enhancement program, offset in part by the strengthening European currencies relative to the U.S. dollar. Operating expenses as a percentage of revenues were 86.7%, compared with 87.2% in the same period a year ago.

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

On a consolidated basis in the second quarter of 2007, EBITDA before repositioning expenses, representing earnings before repositioning expenses, depreciation and amortization, foreign exchange losses, interest, refinancing expenses, write-off of deferred financing costs, and income taxes was \$24.0 million, compared with \$24.2 million in the same period a year ago. EBITDA margin before repositioning expenses was 13.3% in the three-month period, compared with 12.8% in the same period a year ago.

In Canada, EBITDA before repositioning expenses from the commercial operations was \$8.2 million, being \$1.5 million lower than the same period last year. The decline principally reflects lower Rx and OTC volumes, offset in part by savings from the performance enhancement program, in particular at the Whitby operations. EBITDA before repositioning expenses was not significantly impacted by foreign exchange in the second quarter of 2007, as the Canadian dollar was only approximately 1% weaker than the U.S. dollar, compared with the same period in 2006.

In the U.S.A. (including Puerto Rico) EBITDA before repositioning expenses for the commercial operations was a loss of \$3.2 million, compared with a profit of \$6.8 million in the same period last year. The significant decline reflects the reduction in Rx manufacturing volumes in the Caguas, Puerto Rico facility.

In Europe, EBITDA before repositioning expenses from the commercial operations was \$13.0 million, being \$5.6 million higher than same period a year ago. The improvement reflects the volume gains in Italy and France. The strengthening European currencies relative to the US dollar compared with the same period last year also had the impact of increasing EBITDA before repositioning expense by approximately \$1.2 million.

EBITDA before repositioning expenses from the global PDS operations was \$7.6 million, being \$4.2 million higher than the same period in 2006. The increase reflects revenue growth across all of the operations.

Corporate costs in the second quarter of 2007 were \$1.5 million lower than the same period last year.

### ***Repositioning Expenses***

During the second quarter of 2007 the Company incurred \$4.0 million of expenses in connection with its performance enhancement program and its review of strategic and financial alternatives. The expenses include consulting fees associated with the manufacturing efficiency review, further reductions in the work force, in particular in Puerto Rico, and professional and other costs in connection with the strategic alternatives review.

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

Depreciation and amortization expense was \$10.8 million in the second quarter of 2007, compared with \$9.9 million in the second quarter of 2006, an increase of \$0.9 million, or 9%. The increase principally reflects the effect of the strengthening European currencies relative to the U.S. dollar.

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

Amortization of intangible assets was \$2.2 million in the second quarter of 2007, compared with \$3.5 million for the second quarter of 2006. The amortization of intangible assets relates to the Puerto Rico operations. The charge is lower than for the same period last year due to the impact of the impairment charge of \$51.9 million that was made during the third quarter of 2006.

### ***Foreign Exchange Loss***

During the three months ended April 30, 2007 the Company recorded a net foreign exchange loss of \$0.9 million. This reflects the recognition of net foreign exchange translation losses previously recorded in accumulated other comprehensive income, arising from a change in the Company's internal capital structure.

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

Interest expense for the second quarter of 2007 was \$7.2 million, up from the \$4.8 million charge in the second quarter of 2006. The increase in interest costs principally reflects higher debt levels, along with increased borrowing costs as a result of the amendments to the Company's North American loan facilities that were replaced by the new financing arrangements on April 27, 2007.

Effective November 1, 2006, the Company adopted CICA Accounting Standard Section 3855 for the accounting of financial instruments, including its policy on deferring costs of obtaining bank and other debt financing (see "Critical Accounting Policies and Estimates"). As a result, amounts that in prior periods were recorded as amortization of deferred financing costs are now recorded in interest expense.

### ***Refinancing Expenses***

During the three months ended April 30, 2007 the Company incurred expenses of \$13.5 million in connection with its refinancing activities. The expenses are made up of transaction costs for the new credit facilities, transaction costs allocated to the debt portion of the convertible preferred shares and prepayment charges in connection with cancellation of certain of the Company's U.K. debt facilities.

### ***Loss Before Income Taxes***

The Company reported a loss before income taxes of \$14.5 million, compared with earnings of \$5.9 million in the same period a year ago.

### ***Income Taxes***

The Company recorded an income tax charge of \$7.5 million in the second quarter of 2007 compared with a charge of \$2.9 million in the same period last year. The income tax charge in 2007 principally reflects high tax rates in Italy where the Company reported significant profits, compounded by tax losses in certain entities in Puerto Rico and Canada, where the tax benefit after valuation reserves has not been recognized. The 2007 expense includes a charge of \$2.1 million in connection with an inter-company dividend payment and a charge of \$1.9 million in connection with the transfer of net foreign exchange losses from accumulated other comprehensive income as noted above.

### ***Net Loss and Loss Per Share***

The Company recorded a net loss in the second quarter of 2007 of \$22.0 million, compared with a profit of \$3.0 million in the same period last year. The loss per share was 23.6¢, compared with a profit of 3.2¢ per share a year earlier. The net loss in 2007 included after tax repositioning expenses of \$3.8 million, or 4.1¢ per share and after tax refinancing expenses of \$12.6 million, or 13.5¢ per share. Excluding these items the net loss in the second quarter of 2007 was \$5.6 million, or 6.0¢ per share.

Because the Company reported a loss in the second quarter of 2007, there is no impact of dilution.

### **Six Months Ended April 30, 2007 Compared with Six Months Ended April 30, 2006**

#### ***Revenues***

Consolidated revenues for the six-month period ended April 30, 2007 increased 1% or \$4.9 million to \$352.7 million from \$347.8 million in the same period in 2006. Rx manufacturing and PDS revenues grew by 3% and 25%, respectively, while OTC manufacturing revenues declined by 28%.

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

Geographically, in North America, revenues for the six-months ended April 30, 2007 declined by \$17.4 million or 7% over the same period a year ago. The decline reflects a significant reduction in OTC volumes in the Canadian and Cincinnati operations as certain clients have repatriated products back to their own manufacturing network. Rx volumes in Puerto Rico were lower as declines in production of Zocor® and Levothyroxine sodium in Caguas were offset in part by increased volumes in Carolina during the first quarter of 2007, where in the prior year the facility had been impacted by a temporary shut down in production to resolve issues with regard to a warning letter issued by the U.S. Food and Drug Administration ("FDA"). Rx revenues were also lower in Canada principally as a result of lower volumes for a product where in 2006 the Company was helping its client build trade inventory levels for a newly launched product. The declines in commercial manufacturing revenues were offset in part by a significant increase in PDS revenues in Canada and Cincinnati.

In Europe, revenues for the six-months ended April 30, 2007 were \$22.2 million or 21% higher than the same period of 2006. The year-over-year increase in revenues reflects higher Rx manufacturing revenues from operations in Italy and France arising from the continuing benefits from two carve out initiatives where the Company is manufacturing a range of products for two clients that have closed down facilities within their own manufacturing network. PDS operations in Swindon, U.K. also continued to show further increases in volumes. These gains were offset in part by lower pre-launch commercial revenues for the cephalosporin lyophilization services in Swindon. The Euro strengthened approximately 10% and U.K. sterling strengthened approximately 12% against the U.S. dollar, increasing reported revenues by approximately \$11.7 million. Had European currencies remained constant to the rates of the prior year, European revenues would have been 10% higher than the same period in 2006.

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

Operating expenses comprise processing costs (principally materials, employee and other site-related costs), marketing, sales, service, corporate support, administrative expenses and foreign exchange gains and losses. In the six-month period ended April 30, 2007 operating expenses were \$305.5 million, compared with \$309.6 million in the same period a year ago, a decline of 1%. The decline reflects savings from the performance enhancement program, offset in part by the strengthening European currencies relative to the U.S. dollar.

Operating expenses as a percentage of revenues were 86.6%, compared with 89.0% in the prior year.

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

On a consolidated basis for the six-month period ended April 30, 2007, EBITDA before repositioning expenses, representing earnings before repositioning expenses, depreciation and amortization, foreign exchange losses, interest, refinancing expenses, write-off of deferred financing costs, and income taxes was \$47.2 million, an increase of \$9.0 million, or 24%, from the comparable period in 2006. EBITDA margin before repositioning expenses was 13.4% in the six-month period ended April 30, 2007, compared with 11.0% in the same period a year ago.

The Canadian commercial operations reported EBITDA before repositioning expenses of \$16.7 million, or \$4.5 million higher than the same period last year. The improvement reflects savings from the performance enhancement program, in particular at the Whitby operations, offset in part by lower Rx and OTC volumes. EBITDA before repositioning expenses was not significantly impacted by foreign exchange, as the average Canadian dollar exchange rate relative to the U.S. dollar was virtually unchanged, compared with the same period in 2006.

EBITDA before repositioning expenses from the U.S.A. commercial operations (including Puerto Rico) was \$1.6 million, being \$7.9 million lower than the same period last year. The decline principally reflects a reduction in Rx manufacturing volumes in the Caguas facility, offset in part by higher profitability in Carolina, which in the first quarter of 2006 was impacted by a temporary shut down in production.

In Europe, EBITDA before repositioning expenses from commercial operations was \$18.4 million being \$4.1 million higher than the same period last year. The improvement reflects increased volumes in the operations in Italy and France, offset in part by the impact of lower pre-launch revenues for the cephalosporin lyophilization services in Swindon. The strengthening European currencies against the US dollar compared with the same period last year also had the impact of increasing EBITDA before repositioning expense by approximately \$1.6 million.

EBITDA before repositioning expenses from the global PDS operations was \$15.0 million, being \$7.0 million higher than the same period in 2006. This reflects improved profitability across all regions.

Corporate costs for the six-month period ended April 30, 2007 were \$1.3 million lower than the same period last year.

### ***Repositioning Expenses***

During the six-month period ended April 30, 2007 the Company incurred \$7.7 million of expenses in connection with its performance enhancement program and its review of strategic and financial alternatives. The expenses include consulting fees associated with the manufacturing efficiency review, further reductions in the work force, in particular in Puerto Rico, and professional and other costs in connection with the strategic alternatives review.

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

Depreciation and amortization expense was \$21.2 million for the six months ended April 30, 2007, compared with \$19.7 million in the same period of 2006, an increase of \$1.5 million, or 8%. The increase principally reflects the effect of the strengthening European currencies relative to the U.S. dollar.

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

The amortization of intangible assets was \$4.4 million in the six months ended April 30, 2007, compared with \$6.9 million in the same period of 2006. The amortization of intangible assets relates to the Puerto Rico operations. The charge is lower than for the same period last year due to the impact of the impairment charge of \$51.9 million that was made during the third quarter of 2006.

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

Interest expense for the six months ended April 30, 2007 was \$14.3 million, compared with \$9.9 million in the same period a year ago. The increase in interest costs reflects higher debt levels, along with increased borrowing costs as a result of the amendments to the Company's North American loan facilities that were replaced by the new financing arrangements on April 27, 2007.

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

### ***Refinancing Expenses and Write-off of Deferred Financing Costs***

All refinancing expenses of \$13.5 million for the six months ended April 30, 2007 were incurred in the second quarter. During the first quarter of 2006, the Company incurred charges of \$1.6 million in connection with the cancellation and prepayment of certain of its North American credit facilities. The Company also wrote off \$6.3 million in related deferred financing costs.

### ***Loss Before Income Taxes***

The Company reported a loss before income taxes of \$14.7 million in the six months ended April 30, 2007, compared with a loss of \$6.7 million in the same period a year ago.

### ***Income Taxes***

The income tax expense for the six months ended April 30, 2007 was \$9.3 million, compared with an expense of \$1.8 million for the same period last year. The income tax charge in 2007 principally reflects high tax rates in Italy where the Company reported significant profits, compounded by tax losses in certain entities in Puerto Rico and Canada, where the tax benefit after valuation reserves has not been recognized. The 2007 expense includes a charge of \$2.1 million in connection with an inter-company dividend payment and a charge of \$1.9 million in connection with the transfer of net foreign exchange losses from accumulated other comprehensive income.

### ***Net Loss and Loss Per Share***

The Company recorded a net loss for the six months ended April 30, 2007 of \$24.0 million, compared with a loss of \$8.5 million in the same period a year ago. The loss per share was 25.8¢ compared with 9.2¢ a year earlier. The net loss for the six months ended April 30, 2007 included after-tax repositioning expenses of \$6.6 million, or 7.1¢ per share and after-tax refinancing expenses of \$12.6 million, or 13.5¢ per share. The net loss for the six months ended April 30, 2006 included after-tax costs for debt prepayment charges and the write-off of deferred financing costs of \$6.2 million, or 6.6¢ per share. Excluding these items the net loss for the six months ended April 30, 2007 was \$4.8 million, or 5.2¢ per share, compared with a loss of \$2.3 million, or 2.6¢ per share for the comparable period last year.

Because the Company reported a loss in the six months ended April 30, 2007 and 2006 there is no impact of dilution.

### **Seasonal Variability of Results**

Historically, the Company's manufacturing and PDS revenues are lower in the first fiscal quarter. The Company attributes this to several factors, including: (i) many clients reassess their need for additional product in the last quarter of the calendar year in order to use existing inventories of products; (ii) the lower production of seasonal cough and cold remedies; (iii) many small pharmaceutical and small biotechnology clients involved in PDS projects limit their project activity toward the end of the calendar

year in order to reassess progress on their projects and manage cash resources; and (iv) the Patheon-wide plant shut-down during a portion of the traditional holiday period in December and January.

## Liquidity and Capital Resources

### Summary of Cash Flows

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

	Three months ended April 30,		Six months ended April 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Net earnings (loss)	(21,986)	2,989	(24,010)	(8,521)
Depreciation and amortization	12,961	13,392	25,612	26,626
Write-off of deferred financing costs	-	-	-	6,332
Foreign exchange loss	858	-	858	-
Amortization of deferred financing costs	1,311	137	1,380	462
Employee future benefits	164	860	635	74
Future income taxes	292	459	68	2,774
Amortization of deferred revenues	(483)	(498)	(969)	(995)
Other	(925)	373	(649)	871
Working capital	2,069	(15,387)	(4,183)	(17,534)
Increase in deferred revenues	-	-	-	9,614
Cash provided by (used in) operating activities	(5,739)	2,325	(1,258)	19,703
Cash used in investing activities	(5,449)	(13,564)	(14,462)	(28,002)
Cash provided by (used in) financing activities	18,540	4,450	10,382	(7,878)
Other	2,360	(225)	1,153	(103)
Net increase (decrease) in cash and cash equivalents	9,712	(7,014)	(4,185)	(16,280)

### Cash Provided by (Used in) Operating Activities

Cash used in operating activities was \$5.7 million in the second quarter of 2007 compared with a cash inflow of \$2.3 million for the comparable period in 2006. On a year-to-date basis, cash used in operating activities was \$1.3 million, compared with a cash inflow of \$19.7 million in the same period last year. The year to date decline principally reflects an increase in net losses offset in part by a reduction in cash invested in working capital. In addition, in 2006, \$9.6 million of cash was received from a client for the reimbursement of costs the Company incurred in connection with the sterile cephalosporin lyophilization capacity that has been installed in Swindon, U.K. This amount was recorded as an increase in deferred revenues and will be recognized as income over the life of the commercial manufacturing contract.

### Cash Used in Investing Activities

Cash used in investing activities in the second quarter of 2007 was \$5.4 million, compared with \$13.6 million in the same period a year ago. On a year-to-date basis, cash used in investing activities was \$14.5 million, compared with \$28.0 million in the same period last year. The decrease for the second quarter and year-to-date principally reflects lower project related capital expenditures on the cephalosporin lyophilization capacity in the Swindon, U.K. facility. The major expenditures for this expansion were incurred in 2006.

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

	Three months ended April 30,		Six months ended April 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Additions to capital assets-sustaining	(2,535)	(3,597)	(5,652)	(6,337)
-project-related	(2,268)	(10,028)	(7,215)	(21,208)
Decrease in investments	-	-	116	-
Increase in deferred pre-operating costs	(646)	61	(1,711)	(457)
Cash used in investing activities	<u>(5,449)</u>	<u>(13,564)</u>	<u>(14,462)</u>	<u>(28,002)</u>

### ***Cash Provided by (Used in) Financing Activities***

The principal financing activity for the six-months ended April 30, 2007 was the issue, through a private placement, of \$150 million of convertible preferred shares of the Company to JLL Partners and the completion of new credit facilities in the aggregate amount of \$225 million, comprising a seven-year \$150 million term loan and a five-year \$75 million revolving facility. The net proceeds from the JLL Partners investment and the seven-year term loan were used to repay the Company's obligations under its existing North American and U.K. credit facilities. No amounts were drawn on the revolving facility.

The principal financing activity during the six-months ended April 30, 2006 was the completion of new credit facilities in North America in the aggregate amount of \$290.0 million to refinance existing debt of the Company and its U.S. subsidiaries. The Company was able to release \$7.8 million of restricted cash that had previously been held as security for certain of the cancelled facilities. During the first quarter of 2006 the Company's Italian subsidiary also entered into a new long-term debt facility in the amount of 28.5 million euros (\$33.9 million) to replace existing loans.

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

	Three months ended April 30,		Six months ended April 30,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Increase (decrease) in bank indebtedness	(8,258)	905	(1,316)	(12,691)
Increase in long-term debt	166,470	27,563	175,840	311,143
Repayment of long-term debt	(288,483)	(23,993)	(312,953)	(311,345)
Issue of convertible preferred shares	150,000	-	150,000	-
Convertible preferred share issue costs - equity component	(1,213)	-	(1,213)	-
Issue of restricted voting shares	24	-	24	-
Decrease in restricted cash	-	-	-	7,805
Increase in deferred financing costs	-	(25)	-	(2,790)
Cash provided by (used in) financing activities	<u>18,540</u>	<u>4,450</u>	<u>10,382</u>	<u>(7,878)</u>

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

#### **Convertible Preferred Shares**

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

Until October 27, 2009, no cash dividends will be paid, but the liquidation preference and conversion rate will increase on a quarterly basis by 2.125%. After October 27, 2009, these increases in the liquidation preference and conversion rate will continue until the maturity or prior conversion of the convertible preferred shares, unless the Company elects to pay a cash dividend for any applicable quarter, in which case the Company will pay a cash dividend for such quarter based on an annual dividend rate of 8.5% on the aggregate liquidation preference of the convertible preferred shares.

Each convertible preferred share is convertible into 209.7081 Patheon restricted voting shares, as adjusted for any non-cash dividends noted above, at any time at the holder's option. The Company will be entitled to require the holder to convert into restricted voting shares if, at any time after October 27, 2009, the market price of the restricted voting shares on the Toronto Stock Exchange exceeds a price equivalent to US\$7.87 for a period of at least 60 days.

If not previously converted, the Company is required to redeem the convertible preferred shares for cash on April 27, 2017 at a price equal to the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon. The Company is also required to redeem the convertible preferred shares upon the occurrence of a change of control of Patheon at a price equal to the greater of the aggregate liquidation preference of the convertible preferred shares, plus accrued and unpaid dividends thereon, or the price per share paid to holders of restricted voting shares in the change of control transaction, multiplied by the number of restricted voting shares into which the convertible preferred shares are then convertible.

The convertible preferred shares have the right to vote, together with the holders of the restricted voting shares, on an as-if converted basis, in respect of all matters other than the election of directors. These voting rights represent approximately 25% of the voting rights of Patheon. The special voting preferred shares have the right to appoint up to three directors.

The convertible preferred shares are considered to be a compound financial instrument with both a debt and equity component. On issuance, the fair value of the debt component was \$132.9 million. The remainder of the proceeds, attributable to shareholders' equity was \$15.9 million, net of apportioned transaction costs of \$1.2 million. See Convertible Preferred Shares in "Critical Accounting Policies and Estimates" below with regard to how the Convertible Preferred Shares have been accounted for.

#### \$225 Million Credit Facilities

On April 27, 2007 the Company completed new credit facilities in the aggregate amount of \$225 million, comprising a seven-year \$150 million senior secured term loan and a five-year \$75 million asset based revolving credit facility. The Company is required to make quarterly installment payments of \$375,000 on the term loan facility, along with additional mandatory repayments based on certain excess cash flow measures. Interest on the facilities is at floating rates based on LIBOR, US prime, or the federal funds effective rate, plus applicable margins. The facilities are secured by substantially all of the assets of the Company's operations in Canada, U.S.A., Puerto Rico and the U.K and the Company's investments in the shares of all other operating subsidiaries.

#### Financial Ratios

Total interest bearing debt, including the debt component of the convertible preferred shares, at April 30, 2007 was \$350.3 million, being \$0.7 million higher than at October 31, 2006. At April 30, 2007, the Company's consolidated ratio of interest-bearing debt to shareholders' equity was 139.2%, compared with 139.4% at October 31, 2006.

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

With the completion of the new financing arrangements on April 27, 2007, the Company believes that its financial resources are sufficient to fund projected capital expenditures, debt service requirements and employee future benefit obligations in the normal course of business. The risks associated with going concern uncertainty reported in the Company's 2006 Annual Report and MD&A for the period ended January 31, 2007 have now been eliminated.

## **Critical Accounting Policies and Estimates**

### ***Changes in and Significant New Accounting Policies***

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

In the second quarter of 2007 the Company changed its accounting policy relating to costs of obtaining bank and other debt financing. Under the new policy all transaction costs, including fees paid to advisors and other related costs, are expensed as incurred. Financing costs, including underwriting and arrangement fees paid to lenders are deferred and netted against the carrying value of the related debt and amortized into interest expense using the effective interest rate method. The Company previously deferred all transaction and financing costs associated with obtaining bank and other debt financing. Under the new requirements of CICA Handbook Section 3855, all deferred costs are netted off against the fair value of the debt. The Company believes that the new policy is reliable and more relevant as it results in a more transparent treatment of transaction costs that the Company has incurred in its recent refinancing activities and in the carrying value of debt. The change in policy has been made retrospectively effective November 1, 2006 and had the effect of increasing the retained deficit at November 1, 2006 by \$1.7 million and reducing the interest expense and net loss for the three months ended January 31, 2007 by \$0.6 million.

As a result of the issuance of the convertible preferred shares on April, 27 2007, the Company has also added a new accounting policy for convertible preferred shares as detailed below.

### ***General***

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

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

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

### ***Revenue Recognition***

The Company recognizes revenue for its commercial manufacturing and pharmaceutical development services when services are completed in accordance with specific agreements with its clients and when all costs connected with providing these services have been incurred, the price is fixed or determinable

and collectibility is reasonably assured. Client deposits on pharmaceutical development services in progress are included in accounts payable and accrued liabilities.

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

### ***Deferred Revenues***

The costs of certain capital assets are reimbursed to the Company by the pharmaceutical companies that are to benefit from the improvements in connection with the manufacturing and packaging agreements in force. These reimbursements are recorded as deferred revenues and are recognized as income over the remaining minimum term of the agreements. During the second quarter of 2007, \$0.5 million was recognized as earnings. During the six months ended April 30, 2007, \$1.0 million was recognized as earnings.

### ***Intangible Assets***

Intangible assets represent the values assigned to acquired client contracts and relationships. They are amortized on a straight-line basis over their estimated economic life. During the second quarter of 2007, \$2.2 million was charged to earnings. During the six months ended April 30, 2007, \$4.4 million was charged to earnings.

### ***Impairment of Long Lived Depreciable Assets***

On an ongoing basis, the Company reviews whether there are any indicators of impairment of its capital assets and identifiable intangible assets ("long lived depreciable assets"). If such indicators are present, the Company assesses the recoverability of the assets or group of assets by determining whether the carrying value of such assets can be recovered through undiscounted future cash flows. If the sum of undiscounted future cash flows is less than the carrying amount, the excess of the carrying amount over the estimated fair value, based on discounted future cash flows, is recorded as a charge to net earnings. No amounts in connection with impairment were charged to the net loss in the three months and six months ended April 30, 2007.

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

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

The goodwill shown on the financial statements for the period ended April 30, 2007 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 \$26.1 million have been recorded at April 30, 2007. The future tax assets are primarily composed of accounting provisions related to pension and post-retirement benefits not currently deductible for tax purposes, the tax benefit of net operating loss carry forwards related to the U.K., unclaimed R&D expenditures and deferred financing and share issue costs. The Company evaluates quarterly the ability to realize its future tax assets. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets.

Future tax liabilities of \$35.8 million have been recorded at April 30, 2007. This liability has arisen primarily on tax depreciation in excess of book depreciation.

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

### ***Convertible Preferred Shares***

On April 27, 2007 the Company issued \$150 million of convertible preferred shares. The shares are considered to be a compound financial instrument that contains both a debt component and an equity component.

On issuance of the convertible preferred shares, the fair value of the debt component is determined by discounting the expected future cash flows using a market interest rate for a non-convertible debt instrument with similar terms. The resulting value is carried as debt on an amortized cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated as a separate component of shareholders' equity, net of transaction costs. Transaction costs are apportioned between the debt and equity components based on their respective carrying amounts when the instrument was issued.

On conversion, the carrying amount of the debt component and the equity component are transferred to share capital and no gain or loss is recognized.

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

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

## **Risk Management**

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

### ***Foreign Currency***

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

Since the European and U.S. operations conduct business principally in their respective local currencies, the exposure to foreign currency gains and losses is not significant. However, the Company's Canadian operations negotiate sales contracts for payment in both U.S. and Canadian dollars, and materials and equipment are purchased in both U.S. and Canadian dollars. The majority of its non-material costs (including payroll, facilities' costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars. Approximately 60% to 70% of revenues of the Canadian operations and approximately 10% to 20% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience trading and translation gains or losses because of volatility in the exchange rate between the Canadian dollar and the U.S. dollar. Based on the Company's current U.S. denominated net inflows, for each one-cent change in the Canadian-U.S. rate, the impact on annual pretax earnings, excluding any hedging activities, is approximately \$1.1 million.

The Company mitigates its foreign exchange risk by engaging in foreign currency hedging activities using derivative financial instruments. At April 30, 2007 the Company had outstanding foreign exchange forward contracts to sell US\$54.0 million. The contracts mature at the latest on October 29, 2007 and cover approximately 90% of the Company's expected foreign exchange exposure for the balance of the 2007 fiscal year. The mark-to-market value at April 30, 2007 that is recorded in accumulated other comprehensive income is a gain of \$0.8 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 currency denominated debt held by the Company designated as a hedge against the carrying value of certain foreign operations, are included in accumulated other comprehensive income in shareholders' equity. At April 30, 2007, the Company had designated \$133 million of US dollar denominated debt as a hedge against its investment in its U.S.A. and Puerto Rico subsidiaries.

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

The Company has exposure to movements in interest rates. On May 25, 2007 the Company entered into an interest rate swap to convert the interest expense on the \$150 million senior secured term loan from a floating interest rate to a fixed interest rate. Taking this interest rate swap into account, at April 30, 2007, 18% of the Company's total debt portfolio, including the debt component of the convertible preferred shares, was subject to movements in floating interest rates. Assuming no change to the structure of the debt portfolio, a 1% change in floating interest rates has an impact on annual pre-tax earnings of approximately \$0.6 million.

### **Effectiveness of Disclosure Controls and Internal Controls**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), on a timely basis so that appropriate decisions can be made regarding public disclosure. An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of October 31, 2006 by and under the supervision of the Company's management, including the CEO and the CFO. Based on this evaluation, the CEO and the CFO have concluded that the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings of the Canadian Securities Administrators) are effective to ensure that the information required to be disclosed in reports that the Company files or submits under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in such legislation. There have been no changes, since this last formal assessment, that have materially affected, or are reasonably likely to materially affect the Company's disclosure controls and procedures.

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

## Selected Quarterly Financial Information

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

QUARTER ENDED	EBITDA BEFORE REPOSITIONING		NET EARNINGS (LOSS)	EARNINGS (LOSS) PER SHARE	
	REVENUES	EXPENSES		Basic	Diluted
<i>(In thousands of U.S. dollars, except per share amounts)</i>	\$	\$	\$	\$	\$
<b>2007</b>					
<b>April 30</b>	<b>181,009</b>	<b>24,007</b>	<b>(21,986)</b>	<b>(\$0.24)</b>	<b>(\$0.24)</b>
<b>January 31</b>	<b>171,695</b>	<b>23,234</b>	<b>(2,024)</b>	<b>(\$0.02)</b>	<b>(\$0.02)</b>
2006					
October 31	175,115	19,565	(22,416)	(\$0.24)	(\$0.24)
July 31	189,191	15,999	(257,213)	(\$2.77)	(\$2.77)
April 30	189,902	24,213	2,989	\$0.03	\$0.03
January 31	157,944	14,012	(11,510)	(\$0.12)	(\$0.12)
2005					
October 31	181,893	26,203	8,379	\$0.09	\$0.09
July 31	178,390	25,826	3,455	\$0.04	\$0.04

## Additional Information

### Share Capital

As of April 30, 2007, the Company had 92,958,688 restricted voting shares (previously common shares) outstanding and 150,000 each of Class I Preferred Shares, Series C and Series D.

The Company's articles were amended on April 26, 2007 to redesignate the common shares as restricted voting shares. This occurred in connection with the issuance of the convertible preferred shares. The holders of the convertible preferred shares have the right to elect up to three of nine members of the Board of Directors. The holders of Patheon's common shares have the right to elect the remaining members of the Board of Directors. Under the rules of the Toronto Stock Exchange, voting equity securities are not to be designated, or called, common shares unless they have a right to vote in all circumstances that is not less, on a per share basis, than the voting rights of each other class of voting securities. Accordingly, the Company has amended its articles to redesignate the common shares as restricted voting shares. This redesignation involves only a change in the name of the securities; the number of shares outstanding and the terms and conditions of the outstanding shares are not affected by the change.

### Public Securities Filings

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

## **Outlook**

Revenues for the third quarter of 2007 are expected to be approximately the same as the second quarter of 2007. Revenues are expected to be slightly higher across the network with the exception of the U.S. operations, where the Company expects to experience lower client demand for products currently being manufactured at those operations. The Company continues to expect that revenues from current operations for 2007 will be comparable to 2006.

### **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; credit and client concentration; the ability to identify and secure new contracts; regulatory matters, including compliance with pharmaceutical regulations; management of expanded operations; international operations risks; currency; competition; product liability claims; intellectual property; environmental; interest rates; and conditions of MOVA's tax exemptions. Although the Company has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date of this news release and MD&A and, except as required by law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.