

## 3<sup>RD</sup> QUARTER RESULTS 2002

RELENTLESS  
EXECUTION OF  
STRATEGY





## Q3 2002 PRESIDENT'S MESSAGE

### Dear Shareholders,

We are pleased to report record revenue and net income for the three months ended September 30, 2002. We believe Paladin's continued strong performance demonstrates both our effectiveness in executing our business strategy and the resulting value we are creating for our stakeholders.

Revenue for the third quarter increased 25% to \$6.09 million, compared to \$4.86 million in the third quarter a year ago. Net income increased 4% to \$1.53 million compared to \$1.47 million in the same period last year. Diluted earnings per share for the third quarter were \$0.10 per share compared to \$0.12 per share in the same quarter of 2001. For the nine-month period ended September 30, 2002, revenue increased 39% to \$17.81 million compared to \$12.89 million in the first nine months of 2001. Net income for the first nine months of 2002 increased 47% to \$4.37 million from \$2.98 million last year. Diluted earnings per share increased 29% to \$0.31 per share compared to \$0.24 per share in the corresponding period last year.

Our strong growth resulted from the continued market performance of both our established product lines and new brands. Recently launched products in 2002 include: Androderm<sup>®</sup>, Plan B<sup>™</sup>, Tapazole<sup>®</sup>, and Propyl-Thyracil<sup>®</sup>. New products in 2002 include: Locacorten<sup>®</sup>-Vioform<sup>®</sup> line of products and Rogitine<sup>®</sup>, licensed from Novartis Pharmaceuticals Canada Inc. in the fourth quarter of 2001, and the portfolio of products acquired from Pharmacia Canada Inc. in January 2002. We are pleased to report that we continued to make progress in building our product pipeline in the third quarter.

During the quarter, we obtained the Canadian distribution rights to GlucaGen<sup>®</sup> (recombinant glucagon) from Novo Nordisk Canada Inc. GlucaGen<sup>®</sup> is chemically identical to human glucagon, a naturally occurring peptide that is indicated for emergency treatment of hypoglycemia in insulin-dependent diabetics and for relaxation of the gastrointestinal tract during routine radiology procedures. We will work with Novo Nordisk Canada Inc., to file a New Drug Submission for GlucaGen<sup>®</sup> with the Biologics and Gene Therapies Directorate of Health Canada within the coming year.

We also filed a New Drug Submission for the approval of Statex<sup>®</sup> SR (sustained-release morphine sulfate tablets) with the Therapeutic Products Directorate of Health Canada. The submission seeks Health Canada's approval for the use of Statex<sup>®</sup> SR in Canada for the relief of severe pain requiring the prolonged use of an opioid analgesic preparation. Studies performed by the National Cancer Institute of Canada (Clinical Trials Group) have demonstrated that Statex<sup>®</sup> SR is equivalent to Purdue Pharma L.P.'s MS-Contin<sup>®</sup>, a leading controlled release morphine sulfate tablet brand, in terms of average scores in pain, nausea, drowsiness and insomnia.

Paladin received a request from Health Canada in July 2002 for additional information on our application to have Plan B<sup>™</sup> switched to non-prescription status. We completed our response to Health Canada's request within the ninety-day calendar. Health Canada's request for additional information does not jeopardize the priority review status already assigned to this submission. It should be noted that Plan B<sup>™</sup> is already



available across Canada and can be prescribed by pharmacists in Quebec and British Columbia without a prescription.

Subsequent to the end of our third quarter, on October 3, 2002, we announced a licensing agreement with Hydro Med Sciences, Inc., for the Canadian rights to its unique, once yearly implant (Histrelin Hydrogel Implant) indicated for the treatment of advanced prostate cancer. We anticipate that a regulatory submission will be filed in Canada by the end of our first quarter of fiscal 2004. We also recently announced the availability of our new 5.0 mg format for Androderm®. Androderm® is the only transdermal patch for the treatment of male testosterone deficiency available in Canada. This product is competing in a \$23 million market that has grown at a four-year compounded annual growth rate of more than 30%.

In conjunction with reporting our third quarter results, we announced a strategic plan to significantly expand our sales and marketing activities for Androderm®, Estring®, Muse®, Plan B™, and Oesclim®. These key products are at an early stage in their product life cycles and we are extending more sales and marketing support for them in order to fully capitalize on strong growth opportunities in the market. Our increased sales and marketing efforts will boost Paladin's reach from 1,375 physicians to more than 7,500 physicians across Canada. This investment in our future growth demonstrates our commitment to strengthening our leadership position in the Canadian specialty pharmaceutical market.

During the quarter, Paladin was named one of Canada's fastest growing technology companies in the 2002 Deloitte & Touche, Canadian Technology Fast 50. This award recognizes our success at acquiring the rights to innovative pharmaceutical products and marketing them to Canadian specialty physicians. It is this focus that can be credited with the Company's 1,996% revenue growth over the past five years and 19th overall ranking in the Fast 50.

With over \$47 million in cash and temporary investments, we are well capitalized to execute on our strategy of acquiring additional innovative pharmaceuticals for the Canadian market. Our focus remains on acquiring promotion-sensitive products from large pharmaceutical companies and in-licensing innovative products that are in late-stage development within our key therapeutic areas. We will continue to leverage our strong network of specialist physician relationships and distribution channels to cost-effectively drive new product growth, while also benefiting from a strategic investment in our sales and marketing programs to broaden the market reach and growth opportunities for certain key products.

On behalf of our Board of Directors, thank you for your continued support.

Sincerely,

*"Jonathan Ross"*  
*(signed)*

Jonathan Ross Goodman, B.A., LL.B., M.B.A.  
President & CEO



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(All numbers are in thousands of Canadian dollars)

The following analysis explains the variations in the results of operations, financial position and cash flows for Paladin Labs Inc. ("Paladin" or the "Company"). This discussion should be read in conjunction with the information contained in the Company's interim and annual financial statements and the related notes to these financial statements.

### Overview

Paladin is a speciality pharmaceutical company focused on acquiring or in-licensing innovative pharmaceutical products for the Canadian market. Through a national sales force, the Company markets its pharmaceutical products to Canadian specialists in its key therapeutic areas.

#### Third quarter highlights:

- Revenues reached \$6,087 an increase of 25% over the same period last year.
- Net income reached \$1,533, an increase of 4% over the same period last year.
- Therapeutic Products Directorate ("TPD") of Health Canada requested additional information for Plan B™ non-prescription switch submission.
- Filed New Drug Submission for the approval of Statex SR® with TPD.
- Entered into a distribution agreement with Novo Nordisk Canada Inc. for GlucaGen®.
- Named one of Canada's Fastest Growing Technology Companies by Deloitte & Touche.

As is common in the specialty drug industry, Paladin's revenue and profitability growth may vary from one quarter to another. These fluctuations result from, among other things, the timing of TPD approvals, the timing of new product launches and the timing of the listing of the new drugs on Formularies.

### Results of Operations

**Revenues:** Revenues increased \$1,228 or 25% to \$6,087 for the three-month period ended September 30, 2002 from \$4,859 for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, revenues increased \$4,954 or 39% to \$17,812 from \$12,858 for the nine-month period ended September 30, 2001. This increase was due primarily to new and recently launched products. Recently launched products include Androderm®, Plan B™, Tapazole®, and Propyl-Thyracil®. The newly launched products include Locacorten® – Vioform® line of products and Rogitine®, licensed from Novartis Pharmaceuticals Canada Inc. in the fourth quarter of 2001 and the portfolio of products acquired



from Pharmacia Canada Inc. in January 2002. The addition of these products strengthened the Company's product offering in its key therapeutic areas of urology, endocrinology and women's health. The Company has been able to leverage its existing relationships with key physicians in these therapeutic areas to effectively market and promote these products.

During the second quarter, Anthra Pharmaceuticals, Inc. ("Anthra") advised the Company that it was having difficulties manufacturing Valtaxin™, a treatment for BCG-refractory bladder cancer, and is not able to determine when it will resume production. Paladin acquired the exclusive license for Valtaxin™ from Anthra in September 1999 and recorded its first sale in May 2001. Valtaxin™ represented 1.6% of revenues for fiscal 2001 and was expected to grow to 2.1% of revenues for fiscal 2002. The Company now expects that Valtaxin™ will represent 1% of 2002 sales and given the manufacturing issues is not able to forecast at this time when the resumption of sales will begin.

**Gross Profit:** Total gross profit increased \$1,020 or 30% to \$4,472 for the three-month period ended September 30, 2002 from \$3,452 for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, total gross profit increased \$4,302 or 49% to \$13,048 from \$8,746 for the nine-month period ended September 30, 2001. Gross profit, as a percentage of revenues, improved to 73% for the three-month period ended September 30, 2002 from 71% for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, gross profit, as a percentage of revenues, improved to 73% from 68% for the nine-month period ended September 30, 2001.

**Selling and Administrative Expense:** Selling and administrative expense increased \$702 or 41% to \$2,393 for the three-month period ended September 30, 2002 from \$1,691 for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, selling and administrative expense increased \$1,283 or 24% to \$6,546 from \$5,263 for the nine-month period ended September 30, 2001. This increase was primarily due to increased sales and marketing spending associated with new product launches and to higher staffing costs related to expanded infrastructure necessitated by the Company's product line growth during 2001 and 2002.

Selling and administrative expense, as a percentage of revenues, increased to 39% for the three-month period ended September 30, 2002 from 35% for the three-month period ended September 30, 2001. This increase was due to marketing expenses related to new product launch costs. For the nine-month period ended September 30, 2002, selling and administrative expense, as a percentage of revenues, decreased to 37% from 41% for the nine-month period ended September 30, 2001. The decrease in selling and administrative expense, as a percentage of revenues, is a result of



efficiencies realized from in-licensing and launching brands in the Company's key therapeutic areas. This strategy has allowed the Company to leverage its existing sales and marketing infrastructure to launch new products.

**Research and Development Expense:** Research and development expense decreased \$45 or 18% to \$203 for the three-month period ended September 30, 2002 from \$248 for the three-month period ended September 30, 2001. This decrease is primarily a result of timing of research and development projects and their related expenditures. For the nine-month period ended September 30, 2002, research and development expense increased \$299 or 61% to \$791 from \$492 for the nine-month period ended September 30, 2001. This increase was primarily due to higher staffing costs and associated costs required to support DHEA and other products in various stages of development including further Canadian regulatory expenses for currently marketed products.

**Amortization Expense:** Amortization expense increased \$266 or 160% to \$433 for the three-month period ended September 30, 2002 from \$167 for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, amortization expense increased \$813 or 171% to \$1,289 from \$476 for the nine-month period ended September 30, 2001. This increase reflects the impact of amortization expense related to the Company's acquisition of licenses, rights and intellectual property during the year ended December 31, 2001, as well as the impact of amortization expense related to the Company's acquisitions of licenses, rights and intellectual property during fiscal 2002.

**Interest Income:** Interest income increased \$133 or 57% to \$365 for the three-month period ended September 30, 2002 from \$232 for the three-month period ended September 30, 2001. The increase reflects the full effect of investment of the proceeds of the May 2002 equity issue offset by the effect of lower interest rates in the current year. For the nine-month period ended September 30, 2002, interest income decreased \$118 or 14% to \$710 from \$828 for the nine-month period ended September 30, 2001. This decrease reflects the effect of lower interest rates in the current year.

**Gain on Disposal:** During the three and nine-month periods ended September 30, 2001 the Company recorded a gain of \$109 related to the disposition of certain licenses.

**Income Tax Expense:** Income tax expense increased \$61 or 29% to \$275 for the three-month period ended September 30, 2002 from \$214 for the three-month period ended September 30, 2001. For the nine-month period ended September 30, 2002, income tax expense increased \$289 or 62% to \$758 from \$469 for the nine-month period ended September 30, 2001. The effective tax rate was 15% for the three-month period ended September 30, 2002 compared to 14% for the three-month period



ended September 30, 2001. For the nine-month period ended September 30, 2002, the effective tax rate was 15% compared to 14% for the nine-month period ended September 30, 2001.

*Net Income:* As a result of the factors set forth above, net income increased \$59 or 4%, to \$1,533 for the three-month period ended September 30, 2002 from \$1,473 for the three-month period ended September 30, 2001 and increased \$1,391 or 47% to \$4,374 for the nine-month period ended September 30, 2002 from \$2,983 for the nine-month period ended nine 30, 2001.

### Liquidity and Capital Resources

The Company believes that its existing cash and cash equivalents, temporary investments, as well as cash generated from operations are sufficient to finance its current operations, working capital needs and future product acquisitions. At present, the Company is actively pursuing product acquisitions that may require substantial capital resources. There are no present agreements or commitments with respect to any acquisitions.

Cash flows from operating activities were \$3,369 and \$1,198 for the three-month period ended September 30, 2002 and 2001, respectively. Cash flows from operating activities were \$6,959 and \$3,245 for the nine-month period ended September 30, 2002 and 2001, respectively. Cash flows from operating activities represent the cash flows from earnings, excluding revenues and expenses not affecting cash, principally amortization, future income taxes, and imputed interest. The Company believes these cash flows are sufficient to meet existing commitments.

The cash flows from operating activities for the third quarter of 2002 and 2001 was the result of an increase in net income, amortization, future income taxes, and an increase in net change in non-cash balances relating to working capital.

For the nine-month period ended September 30, 2002 the cash flows from operating activities was due to an increase in net income, amortization, future income taxes, and an increase in net change in non-cash balances relating to operations. For the nine-month period ended September 30, 2001, the cash flows from operating activities was mainly due to an increase in net income, amortization and future income taxes offset by a gain on disposal of license and a decrease in net change in non-cash balances relating to operations

The Company's investing activities used cash of \$1,146 and \$9,922 for the three-month period ended September 30, 2002 and 2001, respectively. During the three-month period ended September 30, 2002, the Company invested \$519 in acquisitions of pharmaceutical product licenses and rights and intellectual property and had a \$611 decrease in temporary investments. For the three-month period ended September 30, 2001, the Company invested \$2,311 in pharmaceutical products licenses and rights and had a \$7,400 increase in temporary investments.



Cash used in investing activities was \$21,627 and \$3,722 for the nine-month period ended September 30, 2002 and 2001 respectively. During the nine-month period ended September 30, 2002, the Company invested \$3,270 in acquisitions of pharmaceutical product licenses and rights and intellectual property and had a \$19,503 increase in temporary investments. This was offset by \$1,179 in accounts payable related to the above-mentioned acquisitions. For the nine-month period ended September 30, 2001, the Company invested \$5,338 in pharmaceutical products licenses and rights and intellectual property and had a \$1,627 reduction in temporary investments.

Cash flows from financing activities were \$9 and \$103 for the three-month period ended September 30, 2002 and 2001, respectively, primarily from common stock option exercises and the issuance of shares under the stock purchase plan.

Cash flows from financing activities were \$20,127 and \$236 for the nine-month period ended September 30, 2002 and 2001, respectively. For the nine-month period ended September 30, 2002, \$19,895 was provided from the issuance of special warrants less related issuance costs. In addition, \$232 was provided from common stock option exercises and the issuance of shares under the stock purchase plan. For the nine-month period ended September 30, 2001, \$236 was provided from common stock option exercises and issuance of shares under the stock purchase plan.

### **Event Subsequent to the End of the Quarter**

On October 3, 2002, the Company entered into a 15 year licensing agreement with related investment agreements under which the Company will be required to make payments of \$1,586 (US\$1,000) during 2003, and \$793 if certain milestones are met.

# BALANCE SHEET

[In thousands of Canadian dollars]

	September 30 2002	December 31 2001
	\$	\$
	(unaudited)	
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents <i>[note 4]</i>	7,437	1,978
Temporary investments <i>[note 4]</i>	39,973	20,470
Accounts receivable	1,944	2,067
Inventories	–	50
Income tax credits receivable	579	487
Future income tax assets	2,275	2,275
<b>Total current assets</b>	<b>52,208</b>	<b>27,327</b>
Capital assets	14,545	12,530
Investments, at cost	2,771	2,771
Future income tax credits receivable	1,267	347
Future income tax assets	347	2,216
	<b>71,138</b>	<b>45,191</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	6,277	3,924
Income taxes payable	169	181
Deferred credit	1,638	1,638
<b>Total current liabilities</b>	<b>8,084</b>	<b>5,743</b>
Balance of sale payable	584	544
Deferred credit	–	935
Future income tax liability	133	133
	<b>8,801</b>	<b>7,355</b>
<b>Shareholders' equity <i>[note 5]</i></b>		
Capital stock	57,281	37,154
Contributed surplus	87	87
Other paid-in capital	23	23
Retained earnings	4,946	572
<b>Total shareholders' equity</b>	<b>62,337</b>	<b>37,836</b>
	<b>71,138</b>	<b>45,191</b>

See accompanying notes

## STATEMENTS OF INCOME AND RETAINED EARNINGS

[In thousands of Canadian dollars except for share and per share amounts]

	Three-month period ended September 30		Nine-month period ended September 30	
	2002 \$ (unaudited)	2001 \$ (unaudited)	2002 \$ (unaudited)	2001 \$ (unaudited)
Revenues	6,087	4,859	17,812	12,858
Cost of sales	1,615	1,407	4,764	4,112
<b>Gross profit</b>	<b>4,472</b>	<b>3,452</b>	<b>13,048</b>	<b>8,746</b>
Selling and administrative	2,393	1,691	6,546	5,263
Research and development	203	248	791	492
Amortization	433	167	1,289	476
Interest income, net	(365)	(232)	(710)	(828)
<b>Income before under noted items</b>	<b>1,808</b>	<b>1,578</b>	<b>5,132</b>	<b>3,343</b>
Gain on disposal of license	–	109	–	109
<b>Income before income taxes</b>	<b>1,808</b>	<b>1,687</b>	<b>5,132</b>	<b>3,452</b>
Provision for income taxes				
Current	21	5	81	15
Future	254	209	677	454
	275	214	758	469
<b>Net income</b>	<b>1,533</b>	<b>1,473</b>	<b>4,374</b>	<b>2,983</b>
<b>Retained earnings (deficit), beginning of period</b>	<b>3,413</b>	<b>597</b>	<b>572</b>	<b>(913)</b>
Retained earnings (deficit), end of period	4,946	2,070	4,946	2,070
<b>Earnings per share</b>				
Basic	0.10	0.12	0.32	0.24
Diluted	0.10	0.12	0.31	0.24
<b>Weighted average number of shares outstanding [note 6]</b>				
Basic	14,777,171	12,428,420	13,724,021	12,410,020
Diluted	15,052,244	12,486,145	13,956,901	12,476,703

See accompanying notes

# STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]

	Three-month period ended September 30		Nine-month period ended September 30	
	2002 \$ (unaudited)	2001 \$ (unaudited)	2002 \$ (unaudited)	2001 \$ (unaudited)
<b>Operating activities</b>				
Net income	1,533	1,473	4,374	2,984
Add items not affecting cash				
Amortization	433	167	1,289	476
Future income taxes	227	173	15	371
Imputed interest on balance of sale	13	12	40	37
Gain on disposal of license	–	(109)	–	(109)
	<b>2,206</b>	<b>1,716</b>	<b>5,718</b>	<b>3,759</b>
Net change in non-cash balances relating to operations	1,163	(518)	1,241	(514)
<b>Cash flows from (used in) operating activities</b>	<b>3,369</b>	<b>1,198</b>	<b>6,959</b>	<b>3,245</b>
<b>Investing activities</b>				
Acquisition of capital assets	(16)	–	(33)	(11)
Additions to pharmaceutical product licenses and rights	(519)	(2,311)	(3,270)	(5,126)
Accounts payable related to the acquisition of intellectual property	–	–	1,179	–
Investments	–	(211)	–	(211)
Net decrease (increase) in temporary investments	(611)	(7,400)	(19,503)	1,627
<b>Cash flows (used in) from financing activities</b>	<b>(1,146)</b>	<b>(9,922)</b>	<b>(21,627)</b>	<b>(3,722)</b>
<b>Financing activities</b>				
Issuance of common shares	9	103	232	236
Issuance/conversion of special warrants	–	–	20,952	–
Share issue costs	–	–	(1,057)	–
<b>Cash flows from financing activities</b>	<b>9</b>	<b>103</b>	<b>20,127</b>	<b>236</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>2,232</b>	<b>(8,621)</b>	<b>5,459</b>	<b>(241)</b>
Cash and cash equivalents, beginning of period	5,205	11,238	1,978	2,858
<b>Cash and cash equivalents, end of period</b>	<b>7,437</b>	<b>2,617</b>	<b>7,437</b>	<b>2,617</b>
Cash and cash equivalents	7,437	2,617		
Temporary investments	39,973	19,855		
	<b>47,410</b>	<b>22,472</b>		

See accompanying notes



## NOTES TO FINANCIAL STATEMENTS

[In thousands of Canadian dollars except for share and per share amounts]

### 1. BASIS OF PRESENTATION

Information with respect to the December 31, 2001 balance sheet is derived from the Company's complete audited financial statements. These unaudited interim financial statements should be read in conjunction with the notes appearing in the Company's audited financial statements for the year ended December 31, 2001 and the accompanying notes.

### 2. ACCOUNTING POLICIES

The accounting policies underlying these interim financial statements are those set forth in note 2 of the audited financial statements for the year ended December 31, 2001, except, as outlined below, effective January 1, 2002 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants regarding intangible assets and stock – based compensation plans.

### 3. CHANGES IN ACCOUNTING POLICIES

#### i) Intangible Assets

Effective January 1, 2002, the Company prospectively adopted the new recommendation published by the Canadian Institute of Chartered Accountants relating to the method of valuation and the presentation and disclosure requirements for intangible assets. The new recommendations require recognized intangible assets to be amortized over their useful life to an enterprise, unless the life is determined to be indefinite. When an intangible asset is determined to have an indefinite useful life, it should not be amortized until its life is determined to be no longer indefinite. The amortization method and estimate of the useful life of an intangible asset should be reviewed annually. Intangible assets, which are subject to amortization, are tested for impairment by comparing the net carrying amount with the net recoverable amount whereas for intangible assets not subject to amortization, the net carrying amount is compared to the asset's fair value. The impact of the adoption of the new recommendations will not result in any change to the recognized intangible assets of the Company because its intangible assets are not considered to have an indefinite life. However, the Company will have additional disclosure requirements relating to its intangible assets.

#### ii) Stock Based Compensation

Effective January 1, 2002, the Company prospectively adopted the new recommendation published by the Canadian Institute of Chartered Accountants relating to stock – based compensation and other stock – based payments. The Company has chosen to recognize no compensation when stock options are granted to employees and directors under stock option plan with no cash settlement features. However, direct awards of stock to employees and stock options awards granted to non-employees will continue to be accounted for in accordance with the fair value method of accounting for stock – based compensation.



#### 4. CASH AND TEMPORARY INVESTMENTS

Cash and temporary investments increased by \$2,232 during the three-month period ended September 30, 2002 and increased by \$5,459 during the nine-month period ended September 30, 2002.

#### 5. CAPITAL STOCK

**Authorized:** 100,000,000 common shares without nominal or par value

##### Issued and outstanding:

	Number of shares	Amount
Balance at December 31, 2001	12,539,247	\$37,154
Issued on exercise of stock options	30,041	183
Issued under employee share purchase plan	3,470	29
Issued under exercise of special warrants	2,205,500	19,895
Employee share purchase loan repayment	—	20
Balance at September 30, 2002	14,778,258	\$57,281

On March 20, 2002, the Company signed an agency agreement to issue 2,205,500 special warrants for a cash consideration of \$20,952 less issue costs of \$1,057. On May 3, 2002, Paladin filed a long form prospectus to qualify the common shares, which were to be issued in exchange for the special warrants. On May 10, 2002, each special warrant was exercised without additional consideration into one common share.

##### Stock option plan

On July 31, 2002 the maximum number of common shares to be issued pursuant to the Company's stock option plan was increased to 861,547 from 686,547. The changes to the number of stock options granted by the Company and their weighted average exercise price are as follows:

	2002		2001	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance at December 31	694,833	5.71	484,344	4.90
Granted	89,258	9.85	194,867	5.22
Exercised	(30,041)	6.10	(55,000)	4.50
Expired or forfeited	(25,054)	7.31	(41,158)	5.65
Balance at September 30	728,996	6.15	583,350	4.95
Options exercisable at September 30	289,976	5.43	338,265	4.44



The company applies the intrinsic value based method of accounting for stock-based compensation awards granted to employees. Accordingly, no compensation cost has been recognized for stock options granted to employees and directors. Had compensation cost been determined based on the fair value at the date of grant of options granted, the fair value of the options would have been amortized over the vesting period of the options and the Company's net income and income per common share would have been amended as follows:

	<b>Three-month period ended September 30, 2002</b>	<b>Nine-month period ended September 30, 2002</b>
	\$	\$
<b>Net income as reported</b>	1,533	4,374
Pro-forma	1,501	4,278
<b>Basic Earnings per share</b>		
As reported	0.10	0.32
Pro-forma	0.10	0.31
<b>Diluted Earnings per share</b>		
As reported	0.10	0.31
Pro-forma	0.10	0.31

## 6. EARNINGS PER SHARE

The following summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding used in the diluted earnings per share calculations:

	<b>Three-month period ended September 30</b>		<b>Nine-month period ended September 30</b>	
	2002	2001	2002	2001
Basic weighted average number of shares outstanding	14,777,171	12,428,420	13,724,021	12,410,020
Dilutive effect of options	275,073	57,725	227,806	66,683
Dilutive effect of warrants	-	-	5,074	-
Diluted weighted average number of shares outstanding	15,052,244	12,486,145	13,956,901	12,476,703

There was no adjustment to net income for purposes of calculating diluted earnings per share.



## 7. COMMITMENTS

In the normal course of business, the Company secures Canadian sales and marketing rights to innovative drug products and has entered into various agreements which include contractual obligations extending beyond the current year and which could be broadly classified into three major categories: revenue based; milestone based; and, purchase based commitments.

### Revenue based commitments

The Company has committed under certain pharmaceutical product license agreements to make royalty payments ranging from 2.5% to 15% of sales, or requires payments for products at rates ranging from 26% to 50% of the net selling price, or 60% of the net profit on sales. In addition, the Company will have to pay \$4,837 [US\$3,050] and \$250 if the Company achieves specific sales volumes on specific products in the future.

### Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties of \$396 [US\$250] over the next two years. In addition, specific payments are required under these agreements if milestones are met, such as regulatory approval in Canada. Based on the outcome of these milestones, the Company may have to pay up to \$2,169 [US\$1,368] and \$100.

### Purchase and service based commitments

The Company is committed to making minimum spending relating to inventory purchases, regulatory, sales and marketing expenditures in the amount of \$14,995 in order to retain exclusive distribution agreements for certain products. These commitments end in 2011 and annual amounts are as follows:

	\$
October 1, 2002 to December 31, 2002	710
2003	3,485
2004	3,295
2005	1,786
2006	1,792
2007	851
2008-2011	3,076

## 8. SUBSEQUENT EVENT

On October 3, 2002 the Company entered into a 15 year licensing agreement with related investment agreements under which the Company will be required to make payments of \$1,586 [US\$1,000] during 2003, and \$793 [US\$500] if certain milestones are met.

## **Stock Exchange Listing**

Toronto Stock Exchange

Trading Symbol: PLB

## **Transfer Agent**

Computershare Trust Company of Canada

1500 University St.

Suite 700

Montreal, Quebec

H3A 3S8

## **Investor Relations**

Samira Sakhia

Chief Financial Officer

Tel.: (514) 340-5067

Fax: (514) 344-4675

E-mail: [info@paladin-labs.com](mailto:info@paladin-labs.com)

Bruce Wigle

Investor Relations

Tel.: (416) 815-0700, Ext. 228

Fax: (416) 815-0080

E-mail: [bwigle@equicomgroup.com](mailto:bwigle@equicomgroup.com)

