

PALADIN LABS INC.
FINANCIAL STATEMENTS

June 30, 2005



Management Discussion And Analysis:

All numbers are in thousands of Canadian dollars except for share and per share amounts

The following analysis explains the variations in the results of operations, financial position and cash flows for Paladin Labs Inc. ("Paladin" or the "Company") and is current as at July 27, 2005. 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. As at July 27, 2005, 14,756,711 shares were issued and outstanding.

Forward-Looking Statements

This document contains forward-looking statements, which reflect the Company's current expectations regarding future events. The forward-looking statements involve risk and uncertainties, including the difficulty in predicting product approvals, acceptance and demand for new pharmaceutical products, the impact of competitive products and pricing, new product development and launch, availability of raw materials, the regulatory environment, fluctuations in operating results and other risks. Many risks are inherent in the pharmaceutical industry; others are more specific to Paladin. For additional information on risks and uncertainties relating to these forward-looking statements, investors should consult the Company's ongoing quarterly filings, annual reports, Annual Information Form and other filings found on SEDAR at www.sedar.com.

Overview

Paladin is a specialty pharmaceutical company focused on selling and marketing innovative pharmaceutical products for the Canadian market. Through a national sales force, the Company markets its pharmaceutical products to Canadian physicians in its key therapeutic areas.

Paladin's strategy is to acquire promotion-sensitive products with existing sales and to increase sales of these products through focused marketing and promotion. The Company also in-licenses late-stage development products, obtains regulatory approval for them and then launches them in the Canadian market.

Second quarter highlights:

- Revenues reached \$7,862, an increase of 23% over the same period last year
- Net income was \$585, a decrease of 14% over the same period last year
- Cash flows from operations reached \$1,980, a 259% increase over the same period last year
- Launched national direct-to-consumer marketing campaign launched to support Plan B[®] as a non-prescription product
- Received Notice of Non-Compliance from Health Canada on Vantas[®] new drug submission
- Entered into a marketing and supply agreement with Watson Pharmaceuticals, Inc. for Trelstar[®] in Canada

Paladin's annual and quarterly operating results are primarily affected by the following factors: the level of acceptance of Paladin's products by physicians and their patients and wholesaler buying patterns. The level of patient and physician acceptance of Paladin's products, as well as the availability of similar therapies, impact Paladin's revenues by driving the level and timing of prescriptions for its products. Wholesaler buying patterns, including a tendency to increase inventory levels prior to anticipated or announced price increases, affect the Company's operating results by shifting revenue between quarters.

Critical Accounting Estimates

Paladin's financial statements are prepared in accordance with Canadian generally accepted accounting principles, applied in a consistent basis. Paladin's critical accounting estimates include revenue recognition, the recording of research and development expenses, the useful lives and fair value of intangible assets and stock based compensation expense. For a more detailed discussion of the Company's critical accounting, please refer to the Management Discussion & Analysis included in the Company's 2004 Annual Report. There have been no material changes to accounting estimates since December 31, 2004.

Results of Operations

Three-month period ended June 30, 2005 compared to three-month period ended June 30, 2004, and six-month period ended June 30, 2005 compared to six-month period ended June 30, 2004.

Revenues

Revenues increased \$1,465 or 23% to \$7,862 for the three-month period ended June 30, 2005 from \$6,397 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005, revenues increased \$2,380 or 20% to \$14,374 from \$11,994 for the six-month period ended June 30, 2004. These increases are due primarily to strong performance from the Company's key promoted products, including Dostinex[®], Estrinex[®], Oxytrol[®] and Plan B[®], which increased by 60% and 50% for the three and six-month periods ended June 30, 2005, respectively, compared to the three and six-month periods ended June 30, 2004.

Gross Profit

Total gross profit increased \$946 or 20% to \$5,709 for the three-month period ended June 30, 2005 from \$4,763 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005, gross profit increased \$1,530 or 17% to \$10,572 from \$9,042 for the six-month period ended June 30, 2004. Gross profit, as a percentage of revenues, declined to 73% for the three-month period ended June 30, 2005 from 74% for the three-month period ended June 30, 2004. Gross profit, as a percentage of revenues, declined to 74% for the six-month period ended June 30, 2005 from 75% for the six-month period ended June 30, 2004.

Selling and Marketing Expense

Selling and marketing expense increased \$1,274 or 71% to \$3,058 for the three-month period ended June 30, 2005 from \$1,784 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005 selling and marketing expense increased \$1,968 or 61% to \$5,185 from \$3,217 for the six-month period ended June 30, 2004. Selling and marketing expense, as percentage of revenues, increased to 39% for the three-month period ended June 30, 2005 from 28% for the three-month period ended June 30, 2004. Selling and marketing expense, as percentage of revenues, increased to 36% for the six-month period ended June 30, 2005 from 27% for the six-month period ended June 30, 2004. These increases were primarily attributed to increased promotion activities relating to the re-launch of Plan B[®] as a non-prescription product and the launch of Oxytrol[®]. It is expected that selling and marketing expense, as a percentage of revenues, will remain between 35% and 40% for the year ended December 31, 2005.

General and Administrative Expense

General and administrative expense increased \$56 or 7% to \$820 for the three-month period ended June 30, 2005 from \$764 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005 general and administrative expense increased \$192 or 13% to \$1,661 from \$1,469 for the six-month period ended June 30, 2004. General and administrative expense, as percentage of revenues, declined to 10% for the three-month period ended June 30, 2005 from 12% for the three-month period ended June 30, 2004. General and administrative expense, as percentage of revenues, remained steady at 12% for the six-month period ended June 30, 2005 and the six-month period ended June 30, 2004.

Research and Development Expense

Research and development expense decreased \$218 or 44% to \$282 for the three-month period ended June 30, 2005 from \$500 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005 research and development expense decreased \$1,065 or 63% to \$613 from \$1,678 for the six-month period ended June 30, 2004. During the first half of 2005, Paladin's research and development efforts have been to search and explore potential product opportunities for internal development. Research and development expense for the three-month period ended June 30, 2004 included development expenses for PAL#1, Paladin's internally developed women's health pharmaceutical; expenses related to the preparation of New Drug Submissions for Vantas[™] and Glucagen[®]; and, \$353 related to certain license payments for unapproved products.

Amortization of Intangible Assets and Deferred Charges Expense

Amortization expense decreased \$14 or 1% to \$1,096 for the three-month period ended June 30, 2005 from \$1,110 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005, amortization expense increased \$281 or 15% to \$2,182 from \$1,901 for the six-month period ended June 30, 2004. The decrease in amortization expense for the three-month period ended June 30, 2005 relates to certain assets having been fully amortized in comparison to the preceding period. The increase in amortization expense for the six month period ended June 30, 2005 is a result of the Company's decision to reduce the estimated useful life of the carrying value of the intellectual property associated with products which may be genericized.

Interest Income

Interest income increased \$55 or 20% to \$325 for the three-month period ended June 30, 2005 from \$270 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005, interest income increased \$28 or 5% to \$627 from \$599 for the six-month period ended June 30, 2004. This increase reflects the higher average cash and marketable securities balances over the three and six-month periods ended June 30, 2005 compared to the three and six-month periods ended June 30, 2004.

Other Income

Other income was \$110 for the three and six-month periods ended June 30, 2005. Other income relates to certain product marketing agreements under which the Company earns a service fee for marketing activities performed by the Company.

Income Tax Expense

Income tax expense increased \$109 or 56% to \$303 for the three-month period ended June 30, 2005 from \$194 for the three-month period ended June 30, 2004. For the six-month period ended June 30, 2005, income tax expense increased \$233 or 66% to \$584 from \$351 for the six-month period ended June 30, 2004. For the three and six-month periods ended June 30, 2005 the effective tax rate was 34% and 35%, respectively, compared to 22% and 26% for the three and six-month periods ended June 30, 2004.

Net Income

Due to the factors set forth above, net income decreased \$96 to \$585 for the three-month period ended June 30, 2005 compared to net income of \$681 for the three-month period ended June 30, 2004 and increased \$59 to \$1,084 for the six-month period ended June 30, 2005 from \$1,025 for the six-month period ended June 30, 2004.

Liquidity and Capital Resources

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

Paladin's cash, cash equivalents, and short-term and long-term marketable securities increased \$2,002 to \$44,126 at June 30, 2005 from \$42,124 at December 31, 2004. Working capital increased \$4,053 to \$45,846 at June 30, 2005 from \$39,709 at December 31, 2004. This increase is primarily due to an increased cash, cash equivalents, and short-term and long-term marketable securities position generated from operations as well as a decrease in long-term marketable securities.

Cash flows from operating activities increased to \$1,980 and \$552 for the three -month periods ended June 30, 2005 and 2004, respectively. Cash flows for the six-month period ended June 30, 2005 were \$4,070. For the six-month period ended June 30, 2004 cash flows used in operating activities were \$1,896. Cash flows from operating activities represent the cash flows from net earnings, excluding revenues and expenses not affecting cash, principally amortization, future income taxes, and option compensation expense.

Cash flows from investing activities were \$88 and \$4,734 for the three-month periods ended June 30, 2005 and 2004, respectively. During the three month period ended June 30, 2005, the Company invested \$807 in

acquisitions of pharmaceutical product licenses, rights and intellectual property offset by cash flows generated from maturing marketable securities. For the three-month period ended June 30, 2004, the Company had invested \$519 in acquisitions of pharmaceutical product licenses, rights and intellectual property offset by cash flows generated from maturing marketable securities.

Cash flows from investing activities were \$1,455 and \$7,194 for the six-month periods ended June 30, 2005 and 2004, respectively. During the six month period ended June 30, 2005, the Company invested \$1,009 in acquisitions of pharmaceutical product licenses, rights and intellectual property offset by cash flows generated from maturing marketable securities. For the six-month period ended June 30, 2004, the Company had invested \$1,942 in acquisitions of pharmaceutical product licenses, rights and intellectual property offset by cash flows generated from maturing marketable securities.

Cash flows used in financing activities were \$684 and \$802 for the three-month periods ended June 30, 2005 and 2004, respectively. During the three-month period ended June 30, 2005, under the terms of the normal course issuer bid, the Company repurchased 107,500 of its own shares for \$482. In addition, accounts payable related to pharmaceutical product licenses decreased by \$234, offset by \$32 generated by the issuance of common shares for cash and a repayment of a share purchase loan. For the three month period ended June 30, 2004, \$217 was provided from common stock option exercises and the issuance of common shares under the stock option plan. In addition, the Company had a decrease of \$1,039 in accounts payable related to pharmaceutical product licenses.

Cash flows used in financing activities were \$1,035 and \$2,209 for the six-month periods ended June 30, 2005 and 2004, respectively. During the six-month period ended June 30, 2005, under the terms of the normal course issuer bid, the Company repurchased 107,500 of its own shares for \$482. In addition, accounts payable related to pharmaceutical product licenses decreased by \$598, offset by \$45 generated by the issuance of common shares for cash and a repayment of a share purchase loan. For the six-month period ended June 30, 2004, \$254 was provided from common stock option exercises and the issuance of shares under the stock purchase plan. In addition, the Company had a decrease of \$2,483 in accounts payable related to pharmaceutical product licenses.

Related Party Transactions

JODDES Limited ("JODDES"), a private Canadian corporation, is a significant shareholder, holding approximately 45% of the outstanding shares of the Company, and one director of the Company, the Company's President and CEO, is related to JODDES.

Effective February 1, 2004, Paladin amended the distribution agreement with this affiliate. As a result of this amendment, Paladin has begun to invoice customers and collect accounts receivables and has taken title to the inventory and accounts receivables related to the products distributed by Paladin. Consequently, on February 1, 2004, Paladin purchased \$4.1 million of accounts receivables and \$2.9 million of inventory from this affiliate. The related party will continue to provide logistics services, including customer service, warehousing and shipping, invoicing and collection services.

The Company also engages this affiliate to perform certain research and development services. These service contracts are on a pay-for-use basis. The Company also leases its office facilities from another wholly owned subsidiary of JODDES. This lease is for a period of 2 years and includes minimum payments of \$133.

All transactions with affiliated companies are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount.

The table below reflects all transactions and services with affiliates, including those referred to in the agreements described above:

	Three-month period ended June 30		Six-month period ended June 30	
	2005	2004	2005	2004
	\$	\$	\$	\$
Revenues	174	14	375	503
Purchases	2,024	2,232	3,166	5,713
Research and development expenses	65	118	113	222
Sales and marketing expenses	449	379	820	679
General and administrative expenses	73	86	143	148

Risk Factors

For a more detailed discussion of the risk factors that could materially affect the results of operations and the financial condition of the Company, please refer to the Company's Annual Information Form.

Contractual Obligations and Commitments

In the normal course of business, Paladin secures Canadian development, sales, marketing and distribution rights to innovative drug products and has entered into various agreements which include contractual obligations extending beyond the current year. In addition, under certain agreements, Paladin may have to pay additional consideration should the Company achieve certain sales volumes or if certain milestones are met, such as regulatory approval in Canada. The Company has the following contractual obligations and commitments related to product license, trademark and distribution agreements:

	Contractual Obligations	Commitments	
	Purchase and service based commitments	Milestone based commitments	Revenue based commitments
	\$	\$	\$
July 1, 2005 – December 31, 2005	820	-	243
Fiscal 2006 – fiscal 2007	5,392	1,226	889
Fiscal 2008 – fiscal 2009	1,717	-	306
After fiscal 2010	1,360	2,373	9,537
Total	9,289	3,599	10,975

NOTICE TO READER OF THE INTERIM FINANCIAL STATEMENTS

The financial statements of Paladin Labs Inc. (the “**Company**”) and the accompanying interim balance sheet as at June 30, 2005 and the interim statements of income, retained earnings and cash flows for the three month period then ended are the responsibility of the Company’s management. These financial statements have not been audited or reviewed on behalf of the shareholders by the independent external auditors, Ernst & Young LLP.

The interim financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles. Readers are cautioned that these interim statements may not be appropriate for their purposes.

(signed) Jonathan Ross Goodman _____
Jonathan Ross Goodman, B.A., LL.B, M.B.A.
President and Chief Executive Officer
Montreal, Canada
July 27, 2005

(signed) Samira Sakhia _____
Samira Sakhia C.A., M.B.A.
Chief Financial Officer
Montreal, Canada
July 27, 2005

BALANCE SHEET

[In thousands of Canadian dollars]

	June 30 2005 \$	December 31 2004 \$
(unaudited)		
ASSETS		
Current		
Cash and cash equivalents	5,992	1,507
Short-term marketable securities	36,651	36,039
Accounts receivable	5,796	5,878
Inventories	2,347	2,718
Other current assets	442	735
Future income tax assets	1,054	600
Total current assets	52,282	47,477
Long-term marketable securities	1,483	4,578
Property, plant and equipment	65	77
Intangible assets	9,961	11,065
Deferred charges	4,107	4,176
Investments	1,433	1,433
Future income tax credits recoverable	450	439
Future income tax assets	682	1,715
	70,463	70,960
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	4,870	4,723
Accounts payable to related parties	717	1,754
Income taxes payable	386	229
Balance of license agreements payable	464	1,062
Total current liabilities	6,437	7,768
Shareholders' equity [note 3]		
Capital stock	57,464	57,837
Other paid-in capital	741	554
Retained earnings	5,821	4,801
Total shareholders' equity	64,026	63,192
	70,463	70,960

See accompanying notes

STATEMENTS OF INCOME AND RETAINED EARNINGS

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

[unaudited]

	Three-month period ended		Six-month period ended	
	2005	June 30 2004	2005	June 30 2004
	\$	\$	\$	\$
Revenues	7,862	6,397	14,374	11,994
Cost of sales	2,153	1,634	3,802	2,952
Gross profit	5,709	4,763	10,572	9,042
Selling and marketing	3,058	1,784	5,185	3,217
General and administrative	820	764	1,661	1,469
Research and development	282	500	613	1,678
Amortization of intangible assets and deferred charges	1,096	1,110	2,182	1,901
Interest income, net	(325)	(270)	(627)	(599)
Other Income	(110)	—	(110)	—
Income before income taxes	888	875	1,668	1,376
Provision for income taxes				
Current	—	25	—	50
Future	303	169	584	301
	303	194	584	351
Net income	585	681	1,084	1,025
Retained earnings, beginning of period	5,300	1,906	4,801	1,562
Purchase of common shares	(64)	—	(64)	—
Retained earnings, end of period	5,821	2,587	5,821	2,587
Earnings per share				
Basic	0.04	0.05	0.07	0.07
Diluted	0.04	0.05	0.07	0.07
Weighted average number of shares outstanding				
[note 4]				
Basic	14,846,483	14,829,954	14,852,728	14,916,400
Diluted	14,856,774	14,935,709	14,862,999	14,908,438

See accompanying notes

STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]

[unaudited]

	Three-month period ended		Six-month period ended	
	2005	June 30 2004	2005	June 30 2004
	\$	\$		
Operating activities				
Net income	585	681	1,084	1,025
Add items not affecting cash				
Amortization	1,111	1,125	2,212	1,933
Stock based compensation expense [note 3]	125	82	192	218
Future income taxes	302	75	567	150
Unrealized foreign exchange (gain) loss	(1)	—	(18)	—
	2,122	1,963	4,037	3,326
Net change in non-cash balances relating to operations	(142)	(1,411)	33	(5,222)
Cash flows from (used in) operating activities	1,980	552	4,070	(1,896)
Investing activities				
Additions to pharmaceutical product licenses, rights, intellectual property and deferred charges	(807)	(519)	(1,009)	(1,942)
Acquisition of property, plant and equipment	(12)	(2)	(19)	(2)
Purchases of short-term marketable securities	(18,722)	(14,016)	(19,918)	(16,769)
Maturities of short-term marketable securities	21,112	21,173	24,384	29,605
Purchases of long-term marketable securities	(1,483)	(1,902)	(1,983)	(3,698)
Cash flows from investing activities	88	4,734	1,455	7,194
Financing activities				
Common shares issued for cash	12	217	25	254
Accounts payable related to the acquisition of intellectual property and deferred charges	(234)	(1,039)	(598)	(2,483)
Repurchase of shares	(482)	—	(482)	—
Repayment of share purchase loan	20	20	20	20
Cash flows used in financing activities	(684)	(802)	(1,035)	(2,209)
Effect of exchange rate change on cash and cash equivalents	3	—	(5)	—
Net change in cash and cash equivalents during the period	1,387	4,484	4,485	3,089
Cash and cash equivalents, beginning of period	4,605	596	1,507	1,991
Cash and cash equivalents, end of period	5,992	5,080	5,992	5,080
Cash and cash equivalents	5,992	5,080		
Short-term marketable securities	36,651	30,801		
Long-term marketable securities	1,483	2,617		
	44,126	38,498		

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, 2004 balance sheet is derived from the Company's complete audited financial statements. These unaudited interim financial statements should be read in conjunction with the audited financial statements and the notes thereto in the Company's Annual Report for the year ended December 31, 2004.

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, 2004.

3. Capital Stock

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

Issued and outstanding:

	Number of shares	Amount
Balance at beginning of year	14,858,469	\$57,837
Issued on exercise of stock options	—	—
Issued under employee share purchase plan	5,742	25
Purchase of shares	(107,500)	(418)
Employee share purchase loan	—	20
Balance at June 30, 2005	14,756,711	\$57,464

During the three-month period ended June 30, 2005, under the terms of the normal course issuer bid, the Company repurchased 107,500 shares. As at June 30, 2005, 6,200 shares had been cancelled, the remainder are in the process of being cancelled.

Stock option plan

The changes to the number of stock options granted by the Company and their weighted average exercise price are as follows:

	2005		2004	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance at beginning of year	789,321	5.53	873,984	5.57
Granted	130,250	4.35	98,369	4.21
Exercised	—	—	(47,590)	4.84
Expired or forfeited	(66,078)	5.77	(64,186)	6.28
Balance at June 30	853,493	5.33	860,577	5.51
Options exercisable at June 30	551,492	5.52	439,140	5.62

During 2003, the Company adopted the fair value based method of accounting for employee stock compensation on a prospective basis for options awarded since January 1, 2003. Consequently, the Company records a charge against income with a corresponding credit against paid-in-capital. For options, which were granted or modified during fiscal 2002, the Company will continue to present pro forma net income as if the fair value had been applied to those awards.

The Company recorded option compensation expense with a corresponding credit against paid-in-capital and determined the fair value of stock using the Black-Scholes option-pricing model as follows:

	Three-month period ended June 30		Six-month period ended June 30	
	2005	2004	2005	2004
Option compensation expense	123	80	187	216
Weighted average fair value of stock options	\$2.70	\$3.90	\$2.80	\$3.47
Weighted average risk-free interest rate	3.83%	4.15%	3.86%	3.94%
Dividend yield	nil	nil	nil	nil
Weighted average volatility factor	61%	66%	62%	66%
Weighted average expected life	7 years	7 years	7 years	7 years

For purposes of pro forma disclosures, the estimated fair value of the options granted prior to 2003 will continue to be disclosed as an expense on a straight-line basis over the option's vesting period. The fair value of option grants during 2002 was estimated at the date of grant using the following assumptions: weighted-average risk-free interest rate of 5.02%; dividend yield of nil; weighted-average volatility factor of the expected market price of the Company's common shares of 76%; and a weighted-average expected life of the options of 7 years. The weighted average fair value of stock options granted during 2002, under the Black-Scholes option-pricing model, and above assumptions was \$6.05.

For options for which the option term was amended from five years to seven years, the fair value was estimated at the date of amendment using the following assumptions: weighted-average risk-free interest rate of 4.06%; dividend yield of nil; weighted-average volatility factor of the expected market price of the Company's common shares of 72%; and a weighted-average expected life of the options of 3.5 years. The weighted average fair value of stock options amended on December 4, 2002, under the Black-Scholes option-pricing model, and above assumptions was \$4.06.

	Three-month period ended		Six-month period ended	
	2005	June 30 2004	2005	June 30 2004
	\$	\$	\$	\$
Net income as reported	585	681	1,084	1,025
Less: Amortization of fair value related to option grants	(10)	(19)	(21)	(38)
Amortization of fair value related to option life amendment in fiscal 2002	(4)	(11)	(11)	(37)
Pro-forma net income	571	651	1,052	950
Basic Earnings per share				
As reported	0.04	0.05	0.07	0.07
Pro-forma	0.04	0.04	0.07	0.06
Diluted Earnings per share				
As reported	0.04	0.05	0.07	0.07
Pro-forma	0.04	0.04	0.07	0.06

4. 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:

Earnings per share	Three-month period ended		Six-month period ended	
	2005	June 30 2004	2005	June 30 2004
Basic weighted average number of shares outstanding	14,846,483	14,829,954	14,852,728	14,816,400
Dilutive effect of options	10,291	105,755	10,271	92,038
Diluted weighted average number of shares outstanding	14,856,774	14,935,709	14,862,999	14,908,438

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

5. Related party transactions

JODDES Limited (“JODDES”), a private Canadian corporation, is a significant shareholder holding approximately 45% of the outstanding shares of the Company, and one director of the Company, the Company’s President and CEO, is related to JODDES.

Effective February 1, 2004, Paladin amended the distribution agreement with this affiliate. As a result of this amendment, Paladin has begun to invoice customers and collect accounts receivable and has taken title to the inventory and accounts receivables related to the products distributed by Paladin. Consequently, on February 1, 2004, Paladin purchased \$4.1 million of account receivable and \$2.9 million of inventory from this affiliate. The related party will continue to provide logistics services, including customer service, warehousing and shipping, invoicing and collection services.

The Company also engages this affiliate to perform certain research and development services. These service contracts are on a pay-for-use basis. The Company also leases its office facilities from another wholly owned subsidiary of JODDES. This lease is for a period of 2 years and includes minimum payments of \$133.

All transactions with affiliated companies are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount.

The table below reflects all transactions and services with affiliates, including those referred to in the agreements described above:

	Three-month period ended		Six-month period ended	
	2005	June 30 2004	2005	June 30 2004
	\$	\$	\$	\$
Revenues	174	14	375	503
Purchases	1,188	1,907	2,330	5,387
Research and development expenses	65	118	113	222
Sales and marketing expenses	449	379	820	679
General and administrative expenses	73	86	143	148

6. Commitments

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

Revenue based commitments

Most pharmaceutical product license agreements require that the Company make royalty payments; ranging from 2.5% to 20% of sales, or require 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 may have to pay up to \$10,875 [US\$8,873] and \$100 if the Company achieves specific sales volumes on specific products in the future. Payments related to sales volume may be due over the next 10 years.

Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties for \$919 [US\$750] over the next five years. In addition, additional payments maybe 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 \$2,680, including US\$2,118, over a maximum period of 15 years.

Purchase and service based commitments

The Company is committed to making minimum spending related to inventory purchases, regulatory, sales and marketing expenditures in the amount of \$9,289 including US\$125 in order to retain exclusive distribution agreements for certain products. These commitments end in 2011 and annual amounts are as follows:

	\$
July 1, 2005 - December 31, 2005	820
2006	3,291
2007	2,101
2008	856
2009	861
2010-2011	1,360

7. Comparative figures

Certain of the comparative figures have been reclassified to conform to the presentation adopted in the current year.

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