

PALADIN LABS INC.
CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008



Management Discussion and Analysis:

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

This management's discussion and analysis provides our overview of the Company's operations, performance and financial condition for the quarter ended March 31, 2008 and compares these unaudited quarterly results to those of the quarter ended March 31, 2007. It is intended to complement and supplement financial information included in the interim and annual consolidated financial statements, related notes, other financial information found elsewhere in our annual report and in our annual information form or other documents filed on SEDAR at www.sedar.com. As a result, it should be read in conjunction with such financial information. This management's discussion and analysis is current as at May 14, 2008 and 14,810,279 shares and 1,132,368 options were issued and outstanding as at this date. Reference to "Paladin" or the "Company" includes Paladin Labs Inc. and all its subsidiaries.

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 and annual information form and other filings found on SEDAR.

Overview

Paladin is a specialty pharmaceutical company focused on developing, acquiring, in-licensing, marketing, and distributing innovative pharmaceutical products.

First quarter highlights:

- Revenues reached \$16,834, an increase of 31% over the same period last year
- Net income was \$1,477, an increase of 17% over the same period last year
- Cash flows from operations reached \$7,374, a 73% increase over the same period last year
- EBITDA¹ was \$5,419, an increase of 12% over the same period last year
- Announced the Canadian launch of Seasonale™, the first and only extended-cycle oral contraceptive available in Canada
- Entered into a definitive purchase and sale agreement and completed the transaction under these agreements with AEterna Zentaris Inc. (TSX:AEZ)(NASDAQ:AEZS) with respect to all rights related to the manufacture, production, distribution, marketing, sale and/or use of miltefosine.
- Filed new drug submission to obtain regulatory approval for Seasonique™.
- Announced a normal course issuer bid effective February 28, 2008.
- Entered in to an exclusive Canadian distribution agreement with the KV Pharmaceutical Company (NYSE:KV) for Micro-K® Extencaps® Capsules.
- Entered into a Canadian co-promotion agreement for Tridural™ once-daily tramadol with Nycomed Canada Inc., a subsidiary of Nycomed, sharing brand responsibilities and expenses with Paladin and deploying a national primary care sales force to promote Tridural™. Paladin will continue to handle distribution and will also continue to promote Tridural™ using its primary care sales force.
- Subsequent to quarter end, Paladin announced that the National Drug Scheduling Advisory Committee (NDSAC) has recommended to move Plan B® from Behind-the-Counter status to full Over-the-Counter (OTC) status to the National Association of Pharmacy Regulatory Authorities (NAPRA).

Paladin's annual and quarterly operating results are primarily affected by the level of acceptance of Paladin's products by physicians and their patients, and the timing and number of product launches. The level of patient and physician acceptance of Paladin's products, the acceptance of provincial government reimbursement on such products, market access, as well as the availability of similar therapies, impact Paladin's revenues by driving the level and timing of prescriptions for its products. Each new product launch requires significant promotional investment during the first three to five years from launch.

¹ EBITDA – Non-GAAP financial measures

The term EBITDA (earnings before interest, taxes, depreciation and amortization) does not have any standardized meaning under Canadian Generally Accepted Accounting Principles ("GAAP") and therefore may not be comparable to similar measures presented by other companies. The Company defines EBITDA as earnings before interest expense, taxes, amortization, and unusual items; such as write-downs and gains (losses) on intellectual property and investments. EBITDA is calculated and presented consistently from period to period and agrees, on a consolidated basis, with the amount disclosed as "*Earnings before under-noted items*" on the consolidated statement of income. The Company believes EBITDA to be an important measurement that allows it to assess the operating performance of its ongoing business on a consistent basis without the impact of amortization expenses. The Company excludes amortization expenses because their level depends substantially on non-operating factors such as the historical cost of intangible and capital assets. The Company's method for calculating EBITDA may differ from that used by other issuers and, accordingly, this measure may not be comparable to EBITDA used by other issuers.

Critical Accounting Estimates

Paladin's consolidated financial statements are prepared in accordance with Canadian GAAP, applied in a consistent basis. Paladin's critical accounting estimates include revenue recognition, inventory valuation, the recording of research and development expenses and related tax credits, the useful lives and fair value of intangible assets, stock based compensation expense and income taxes. For a more detailed discussion of the Company's critical accounting, please refer to the management's discussion & analysis included in the Company's 2007 Annual Report. There have been no material changes to accounting estimates since December 31, 2007.

Results of Operations

Three-month period ended March 31, 2008 compared to three-month period ended March 31, 2007.

Revenues

Revenues increased \$3,941 or 31% to \$16,834 for the three-month period ended March 31, 2008 from \$12,893 for the three-month period ended March 31, 2007. Revenue from products acquired during 2008 contributed \$135 to the quarter ended March 31, 2008.

The increase in revenues for the three-month period ended March 31, 2008 is primarily attributable to the sales growth of certain significant promoted products, including TriduralTM, Twinject[®], SeasonaleTM, Plan B[®], Pennsaid[®], Metadol[®], Trelstar[®], and Testim[®] which combined increased by 31% compared to the three-month period ended March 31, 2007.

Product revenue highlights for the Company's most significant promoted products using IMS Canada data² for the quarter ended March 31, 2008 compared to the quarter ended March 31, 2007 are as follows: Plan B[®] sales grew \$364 to \$1,726 from \$1,362, Twinject[®] sales grew \$9 to \$1,072 from \$1,063, Pennsaid[®] sales grew \$152 to \$2,594 from \$2,442, Metadol[®] sales grew \$334 to \$1,464 from \$1,130, Trelstar[®] sales grew \$225 to \$285 from \$60 and SeasonaleTM, Tridural[®] and Testim[®], having been launched post the prior year comparative, collectively contributed \$951 in sales growth.

² The Company has chosen not to disclose detailed product revenue information for competitive reasons, however, does include detailed IMS Canada sales data, essentially end-user pharmacy purchase volume data, to allow the reader to better understand revenue changes from period to period on certain significant products. It is important that readers of this sales data note that IMS Canada sales data may not necessarily correspond to the Company's recording of revenue in accordance with GAAP.

Gross Profit

Total gross profit increased \$2,469 or 24% to \$12,890 for the three-month period ended March 31, 2008 from \$10,421 for the three-month period ended March 31, 2007. Gross profit, as a percentage of revenues, decreased to 77% from 81% for the three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007. The decrease in gross profit as a percentage of revenues for the three-month period ended March 31, 2008 is mainly a result of the impact of lower margins from the BioEnvelop™ edible film business and reduced margins on certain newly launched products. It is expected that gross profit, as a percentage of revenues, will approximate 75% to 77% for the year ending December 31, 2008.

Selling and Marketing Expense

Selling and marketing expense increased \$1,112 or 25% to \$5,533 for the three-month period ended March 31, 2008 from \$4,421 for the three-month period ended March 31, 2007. Selling and marketing expense, as percentage of revenues, decreased to 33% for the three-month period ended March 31, 2008 from 34% for the same period last year. The decrease in the current year's first quarter selling and marketing expenses as a percentage of revenues is primarily the result of the timing of certain promotional efforts. The promotional activities driving selling and marketing costs primarily relate to Paladin's launch of Seasonale™, Tridural™, Testim® and Trelstar® as well as the continued promotional activities for Twinject®, Plan B®, Pennsaid® and Metadol®. It is expected that selling and marketing expense, as a percentage of revenues, will approximate 30% to 40% for the year ending December 31, 2008.

General and Administrative Expense

General and administrative expense increased \$396 or 39% to \$1,414 for the three-month period ended March 31, 2008 from \$1,018 for the three-month period ended March 31, 2007. General and administrative expense, as percentage of revenues, remained consistent at 8% for the three-month period ended March 31, 2008 and 2007. General and administrative expense, as a percentage of revenues, is expected to approximate 8% to 10% for the year ending December 31, 2008.

Research and Development Expense

Research and development expense increased \$498 or 91% to \$1,043 for the three-month period ended March 31, 2008 from \$545 for the three-month period ended March 31, 2007. Research and development expense, as percentage of revenues, increased to 6% for the quarter ended March 31, 2008 compared to 4% for the quarter ended March 31, 2007. The increase for the three-month period ended March 31, 2008 primarily relates to certain contractual payments for clinical studies and product submission fees as well as increased head-count. During the three-month periods ended March 31, 2008 and 2007, Paladin's research and development efforts have been to manage development projects with licensors and preparing new drug submissions to strengthen the Company's pipeline as well as to search and explore potential product opportunities for internal development. It is expected that research and development expense, as a percentage of revenues, will approximate 5% to 7% for the year ending December 31, 2008 primarily as a result of BioEnvelop's advancement in its research and development activities.

Amortization

Amortization expense increased \$319 or 12% to \$2,937 for the three-month period ended March 31, 2008 from \$2,618 for the three-month period ended March 31, 2007. This increase in amortization expense is the result of the amortization related to the Company's newly acquired pharmaceutical product licenses and rights.

Net Interest Income

Net interest income increased \$136 or 36% to \$519 for the three-month period ended March 31, 2008 from \$383 for the three-month period ended March 31, 2007. This increase is primarily the result of higher average cash and marketable securities balances partially offset by lower interest rates over the three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007. In addition, upon adoption of Section 3855 - *Financial Instruments, Recognition and Measurement*, the Company has accreted interest income on the allocated loan portion of a secured convertible term note investment in a portfolio company, in the amount of \$24 for the three-month period ended March 31, 2008 [2007 - \$17].

Unrealized Loss on Derivative Instruments

In accordance with Section 3855, the Company used the Black-Scholes option pricing model to re-measure the fair value of a conversion option on a secured convertible term note investment in a portfolio company recognizing an unrealized loss in the amount of \$2 and \$210 for the three-month periods ended March 31, 2008 and 2007, respectively.

Gain on Disposal of Investment

During the three month period ended March 31, 2008, the Company did not dispose of any investments. For the same period ended March 31, 2007, the Company exercised its right to convert \$158 of a secured convertible term note in one of the Company's portfolio investments into common shares and subsequently sold such shares in the public market for \$232, representing a gain of \$74.

Other Income

Other income was \$3 for the three-month period ended March 31, 2008, compared to \$nil for the same period last year. During the three month period ended March 31, 2008, the Company received \$75 as a termination payment for certain costs disbursed as part of a previously licensed pharmaceutical product and paid \$72 to settle a disputed client relationship.

Income Tax Expense

Income tax expense increased \$204 or 25% to \$1,006 for the three-month period ended March 31, 2008 from \$802 for the three-month period ended March 31, 2007. For the three-month period ended March 31, 2008, the effective tax rate was 41% compared to 39%, for the three-month period ended March 31, 2007. The increase in effective rates in the current year is due to increases in permanent differences including; amortization of eligible capital property and stock option compensation expense. The Company has the following tax pools detailed below which may be applied against taxable income:

| | Available \$ | Recognized \$ | Expires in |
|--------------------------------------------------------------------------|-----------------|------------------|------------|
| Non-capital tax losses | | | |
| Federal | 13,708 | 12,913 | 2024-2028 |
| Provincial | 10,677 | 9,881 | 2024-2028 |
| Scientific Research and Experimental Development expenditures | | | |
| Federal | 11,831 | 3,555 | N/A |
| Provincial | 11,028 | 2,636 | N/A |
| Investment tax credits | | | |
| Federal | 2,422 | 773 | 2010-2027 |

Net Income

Due to the factors set forth above, net income increased \$213 or 17% to \$1,477 for the three-month period ended March 31, 2008 compared to net income of \$1,264 for the same period ended last year.

Liquidity and Capital Resources

The Company believes that its existing cash, cash equivalents and short-term marketable securities, 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 the use of substantial capital resources.

Paladin's cash, cash equivalents and marketable securities decreased \$2,936 to \$33,280 at March 31, 2008 from \$36,216 at December 31, 2007. This decrease is primarily as a result of the Company's acquisition of pharmaceutical product licenses and rights, and deferred charges in the amount of \$8,867, the purchase of 182,725 of the Company's shares pursuant to the terms of the normal course issuer bid in the amount of \$1,806, offset by cash flows generated from operating activities in the amount of \$7,374 and common shares issued for cash in the amount of \$470. Working capital (current assets less current liabilities) decreased \$1,917 to \$40,048 at March 31, 2008 from \$41,965 at December 31, 2007 primarily due the use of short-term marketable securities maturities and cash from operations to finance the acquisition of pharmaceutical product licenses and rights in the amount of \$8,867 and the investing and financing activities further described below.

The Company's Investment Policy regulates the investment activities relating to cash resources. An Investment Committee composed of representatives from management and the Board of Directors monitors compliance with said policy. The Company invests strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates. As at March 31, 2008, there were no restrictions on the flow of these funds nor have any of these funds been committed in any way, except as set out in Note 7.

Cash flows from operating activities increased 73% or \$3,102 to \$7,374 for the three-month period ended March 31, 2008 from \$4,272 for the three-month period ended March 31, 2007. Cash flows from operating activities represent the cash flows from net earnings, excluding revenues and expenses not affecting cash, principally amortization, future income taxes, stock based compensation expense, gains (losses) on investments and derivative instruments, and accreted interest.

Cash flows used in investing activities were \$6,365 compared to cash flows used of \$4,401 for the three-month period ended March 31, 2008 and 2007, respectively. During the three-month period ended March 31, 2008, the Company invested \$8,867 towards the acquisition of pharmaceutical product licenses and rights, \$255 for the acquisition of property, plant and equipment, partially offset by cash generated by maturing marketable securities in the amount of \$2,757. During the three-month period ended March 31, 2007, the Company invested \$4,594 towards short and long-term marketable securities and \$39 for the acquisition of property, plant and equipment partially offset by proceeds from the partial sale of the Company's investment in a portfolio company in the amount of \$232.

Cash flows used in financing activities were \$1,336 compared to \$45 for the three-month periods ended March 31, 2008 and 2007, respectively. During the three-month period ended March 31, 2008, \$1,806 was used by the Company to repurchase 182,725 of its own common shares under the terms of the normal course issuer bid, offset by \$470 received from common stock option exercises and the issuance of common shares under the stock purchase plan for cash. During the three-month period ended March 31, 2007, \$373 was used by the Company to repurchase 37,800 of its own common shares under the terms of the normal course issuer bid offset by \$328 generated from common stock option exercises and the issuance of common shares under the stock purchase plan for cash.

Related Party Transactions

Joddes Limited ["Joddes"], a private Canadian corporation, is a significant shareholder holding approximately 43% of the outstanding shares of the Company, and one director of the Company, the Company's President and CEO, is related to Joddes.

The Company engages a wholly-owned subsidiary of Joddes to provide logistics services including: customer service, warehousing, shipping, invoicing, collection services and certain manufacturing services on behalf of the Company. The Company also engages this affiliate to perform certain research and development services on a contractual 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 10 years, ending in 2013 and includes minimum annual payments of \$136 for a total remaining committed amount of \$895 as at March 31, 2008 and is included in the purchase and service based commitments in note 7.

During 2006, the Company acquired the Canadian distribution rights to Metadol[®] from a wholly-owned subsidiary of Joddes. Under the terms of the agreement, the Company can purchase the Canadian license for Metadol[®] on the fourth anniversary of the agreement for \$1 and can receive a reimbursement of up to \$3,750 subject to certain acquisition related conditions. As at March 31, 2008, the Company has not received or earned any reimbursement.

All transactions with related parties except for the Metadol[®] transaction described above, are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount. The accounts payable to related parties is on normal commercial terms and conditions and is non-interest bearing.

The table below reflects all transactions and services with related parties which include those referred to in the agreements described above as well as revenues from a wholly-owned subsidiary of Joddes:

| | Three-month period ended | |
|-------------------------------------|--------------------------|------------------|
| | 2008 | March 31 2007 |
| | \$ | \$ |
| Revenues | 733 | 139 |
| Purchases | 2,849 | 1,927 |
| Research and development expenses | 122 | 65 |
| Sales and marketing expenses | 913 | 787 |
| General and administrative expenses | 91 | 66 |

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.

Off-Balance Sheet Arrangements

The Company's off balance sheet arrangements consist of contractual obligations and agreements for development, sales, marketing and distribution rights to innovative drug products for the Canadian market. The effect of terminating these arrangements under normal operating circumstances consists of an effective transition of the remaining responsibilities and obligations to the licensor under agreed upon time frames and conditions. Please refer to this section below or note 7 of the Company's interim consolidated financial statements for additional details. Other than these contractual obligations and commitments, the Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, changes in revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

The Company does not issue guarantees contemplated by the applicable CICA Guidelines.

Contractual Obligations and Commitments

In the normal course of business, Paladin secures 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 |
| | \$ | \$ | \$ |
| Fiscal 2008 | 9,410 | 455 | 614 |
| Fiscal 2009 – fiscal 2011 | 29,038 | 2,034 | 1,288 |
| Fiscal 2012 – fiscal 2013 | 1,794 | 1,575 | 173 |
| After fiscal 2014 | 735 | 514 | 13,696 |
| Total | 40,977 | 4,578 | 15,771 |

Quarterly Information (unaudited)

(In thousands of Canadian dollars except per share information)

| | Q1 F2008 | Q4 F2007 | Q3 F2007 | Q2 F2007 | Q1 F2007 | Q4 F2006 | Q3 F2006 | Q2 F2006 |
|------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Revenues | 16,834 | 17,697 | 16,915 | 15,436 | 12,893 | 14,282 | 12,702 | 11,241 |
| EBITDA ¹ | 5,419 | 4,925 | 5,074 | 5,094 | 4,820 | 4,271 | 4,742 | 3,570 |
| Earnings before income taxes | 2,483 | 2,500 | 1,606 | 1,786 | 2,066 | 2,365 | 3,139 | 1,836 |
| Net Income before extraordinary gain | 1,477 | 1,030 | 828 | 1,037 | 1,264 | 1,534 | 1,908 | 1,214 |
| Net Income | 1,477 | 1,030 | 828 | 5,911 | 1,264 | 1,534 | 1,908 | 1,214 |
| Earnings per share before extraordinary gain | \$0.10 | \$0.07 | \$0.06 | \$0.07 | \$0.08 | \$0.10 | \$0.13 | \$0.08 |
| Earnings per share | \$0.10 | \$0.07 | \$0.06 | \$0.39 | \$0.08 | \$0.10 | \$0.13 | \$0.08 |
| Diluted earnings per share before extraordinary gain | \$0.10 | \$0.07 | \$0.05 | \$0.07 | \$0.08 | \$0.10 | \$0.13 | \$0.08 |
| Diluted earnings per share | \$0.10 | \$0.07 | \$0.05 | \$0.38 | \$0.08 | \$0.10 | \$0.13 | \$0.08 |

Paladin's annual and quarterly operating results are primarily affected by the level of acceptance of Paladin's products by physicians and their patients, and the timing and number of product launches. The level of patient and physician acceptance of Paladin's products, the acceptance of provincial government reimbursement on such products, market access, as well as the availability of similar therapies, impact Paladin's revenues by driving the level and timing of prescriptions for its products. Each new product launch requires significant promotional investment during the first three to five years from launch.

New Accounting Standards and Disclosure Changes

Effective January 1, 2008, the Company adopted the following recently introduced Canadian Institute of Chartered Accountants ("CICA") Handbook Sections:

Section 1535, "Capital Disclosures", establishes standards for disclosing information about an entity's capital and how it is managed. These standards require an entity to disclose the following:

- its objectives, policies and processes for managing capital;
- summary quantitative data about what the Company views as capital
- whether during the period, it complied with any externally imposed capital requirements to which it is subject;
- when the entity has not complied with such requirements, the consequences of such non-compliance.

Section 3862, "Financial Instruments – Disclosures", modifies the disclosures requirements for financial instruments that were included in Section 3861 "Financial Instruments – Disclosure and Presentation". The new standard requires entities to provide disclosures in their financial statements that enable users to evaluate:

- the significance of financial instruments for the entity's financial position and performance;
- the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863, "Financial Instruments – Presentation", carries forward unchanged the presentation requirements of the old Section 3861 "Financial Instruments – Disclosure and Presentation".

The impact of these changes is outlined in notes 8 and 9 to these interim financial statements.

Controls and procedures

In compliance with the Canadian Securities Administrators Multilateral Instrument 52-109, the Company has filed certificates signed by the President and Chief Executive Officer and the Chief Financial Officer that, among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting.

Internal control over financial reporting (“ICFR”) is designed to provide reasonable assurance regarding the reliability of the Company’s financial reporting and its compliance with Canadian Generally Accepted Accounting Principles in its financial statements. The President and Chief Executive Officer and the Chief Financial Officer of the Company have evaluated whether there were changes to its ICFR during the three-month period ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, the ICFR. No such significant changes were identified through their evaluation.

**NOTICE TO READER OF THE INTERIM
CONSOLIDATED FINANCIAL STATEMENTS**

The consolidated financial statements of Paladin Labs Inc. (the “**Company**”) and the accompanying interim consolidated balance sheet as at March 31, 2008 and the interim consolidated statements of income, other comprehensive income, retained earnings and cash flows for the three-month period then ended are the responsibility of the Company’s management. These consolidated financial statements have not been audited or reviewed on behalf of the shareholders by the independent external auditors, Ernst & Young LLP.

The interim consolidated 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 consolidated statements may not be appropriate for their purposes.

Jonathan Ross Goodman, B.A., LL.B, M.B.A.
President and Chief Executive Officer
Montreal, Canada
May 14, 2008

Samira Sakhia C.A., M.B.A.
Chief Financial Officer
Montreal, Canada
May 14, 2008

CONSOLIDATED BALANCE SHEETS

[In thousands of Canadian dollars]

| | March 31 2008 \$ | December 31 2007 \$ |
|---------------------------------------------------|------------------------|---------------------------|
| | (unaudited) | |
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | 5,747 | 6,074 |
| Marketable securities | 27,533 | 26,041 |
| Accounts receivable | 10,761 | 11,920 |
| Inventory | 7,247 | 6,781 |
| Other current assets | 1,102 | 2,943 |
| Investment tax credits receivable | 36 | 244 |
| Future income tax asset | 2,453 | 2,992 |
| Total current assets | 54,879 | 56,995 |
| Long-term marketable securities | — | 4,101 |
| Investment tax credits recoverable | 776 | 773 |
| Capital assets | 519 | 300 |
| Pharmaceutical product licences and rights | 30,716 | 24,366 |
| Deferred charges | 1,026 | 1,455 |
| Investments | 3,320 | 4,041 |
| Future income tax assets | 7,138 | 6,874 |
| Total assets | 98,374 | 98,905 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 9,491 | 11,582 |
| Accounts payable to related parties | 2,182 | 1,032 |
| Deferred revenue | 15 | 271 |
| Balance of sale payable <i>[note 5]</i> | 89 | 89 |
| Income taxes payable | 3,054 | 2,056 |
| Total current liabilities | 14,831 | 15,030 |
| Long-term | | |
| Balance of sale payable | 525 | 518 |
| Future income tax liability | 1,112 | 1,357 |
| Total liabilities | 16,468 | 16,905 |
| Shareholders' equity | | |
| Capital stock <i>[note 3]</i> | 59,557 | 59,797 |
| Other paid-in capital | 2,237 | 2,019 |
| Retained earnings | 20,913 | 20,508 |
| Accumulated other comprehensive income | (801) | (324) |
| Total shareholders' equity | 81,906 | 82,000 |
| Total liabilities and shareholders' equity | 98,374 | 98,905 |

See accompanying notes

CONSOLIDATED STATEMENTS OF INCOME

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

[unaudited]

| | Three-month period ended March 31 | |
|---------------------------------------------------------------|--------------------------------------|---------------|
| | 2008 | 2007 |
| | \$ | \$ |
| Revenues | 16,834 | 12,893 |
| Cost of sales | 3,944 | 2,472 |
| Gross profit | 12,890 | 10,421 |
| Expenses (income) | | |
| Selling and marketing | 5,533 | 4,421 |
| General and administrative | 1,414 | 1,018 |
| Research and development | 1,043 | 545 |
| Interest income, net | (519) | (383) |
| Earnings before under-noted items | 5,419 | 4,820 |
| Amortization of intangible assets and deferred charges | 2,937 | 2,618 |
| Unrealized loss on derivative instruments | 2 | 210 |
| Gain on disposal of investment | — | (74) |
| Other income | (3) | — |
| Income before income taxes | 2,483 | 2,066 |
| Provision for income taxes | | |
| Current | 849 | 154 |
| Future | 157 | 648 |
| | 1,006 | 802 |
| Net income for the period | 1,477 | 1,264 |
| Earnings per share before extraordinary gain | | |
| Basic | 0.10 | 0.08 |
| Diluted | 0.10 | 0.08 |
| Earnings per share | | |
| Basic | 0.10 | 0.08 |
| Diluted | 0.10 | 0.08 |
| Weighted average number of shares outstanding [note 6] | | |
| Basic | 14,830,560 | 15,000,000 |
| Diluted | 15,083,608 | 15,300,000 |

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]

[unaudited]

| | Three-month period ended March 31 | |
|-------------------------------------------------------------------------------|--------------------------------------|----------------|
| | 2008 | 2007 |
| | \$ | \$ |
| Operating activities | | |
| Net income | 1,477 | 1,264 |
| Add items not affecting cash | | |
| Amortization | 2,982 | 2,638 |
| Future income taxes | 157 | 648 |
| Stock based compensation expense <i>[note 3]</i> | 238 | 129 |
| Net unrealized loss on derivative instruments | 2 | 210 |
| Accreted interest | (24) | (17) |
| Gain on disposal of investment | — | (74) |
| Imputed interest on balance of sale | 6 | 6 |
| | 4,838 | 4,804 |
| Net change in non-cash balances relating to operations | 2,536 | (532) |
| Cash flows from operating activities | 7,374 | 4,272 |
| Investing activities | | |
| Additions to pharmaceutical product licenses and rights, and deferred charges | (8,867) | — |
| Acquisition of property, plant and equipment | (255) | (39) |
| Purchases of short-term marketable securities | (11,765) | (25,986) |
| Maturities of short-term marketable securities | 14,522 | 31,770 |
| Purchases of long-term marketable securities | — | (10,378) |
| Proceeds from disposal of investment | — | 232 |
| Cash flows (used in) investing activities | (6,365) | (4,401) |
| Financing activities | | |
| Repurchase of shares | (1,806) | (373) |
| Common shares issued for cash | 470 | 328 |
| Cash flows (used in) financing activities | (1,336) | (45) |
| Net change in cash and cash equivalents during the period | (327) | (174) |
| Cash and cash equivalents, beginning of period | 6,074 | 2,769 |
| Cash and cash equivalents, end of period | 5,747 | 2,595 |
| Cash and cash equivalents | 5,747 | 2,595 |
| Short-term marketable securities | 27,533 | 35,772 |
| Long-term marketable securities | — | 2,166 |
| | 33,280 | 40,533 |

See accompanying notes

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME, ACCUMULATED OTHER COMPREHENSIVE INCOME, AND RETAINED EARNINGS

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

| | Three-month period ended March 31 | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|--------|
| | 2008 | 2007 |
| | \$ | \$ |
| Net income for the period | 1,477 | 1,264 |
| Other comprehensive (loss) income: | | |
| Change in fair value of available-for-sale financial instruments [net of (\$115) taxes [2007 – \$14]] | (466) | 72 |
| Reclassification adjustment for gains on available-for-sale financial instruments included in net income in the current period [net of (\$2) taxes [2007 – (\$26)]] | (11) | (138) |
| Other comprehensive loss for the period | (477) | (66) |
| Comprehensive income for the period | 1,000 | 1,198 |
| | | |
| Accumulated other comprehensive loss, beginning of period | (324) | — |
| Cumulative impact of accounting changes upon adoption of new financial instruments accounting standards on January 1, 2007 | — | 692 |
| Adjusted balance, beginning of period | (324) | 692 |
| Other comprehensive loss for the period | (477) | (66) |
| Accumulated other comprehensive (loss) income, end of period | (801) | 626 |
| | | |
| Retained earnings, beginning of period | 20,508 | 13,711 |
| Net income for the period | 1,477 | 1,264 |
| Adjustment to retained earnings upon adoption of new financial instruments accounting standards on January 1, 2007 (net of \$3 taxes) | — | 19 |
| Excess of purchase price over stated capital of common shares cancelled | (1,072) | (227) |
| Retained earnings, end of period | 20,913 | 14,767 |

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1. Governing Statute and Nature of Operations

Paladin Labs Inc. is a specialty pharmaceutical public company continued under the Canada Business Corporations Act, focusing on developing, acquiring, marketing and distributing innovative pharmaceutical products. Paladin Labs Inc., together with its subsidiaries, is hereinafter referred to as the “Company”.

2. Basis of Presentation and Accounting policies

The unaudited interim consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“GAAP”) applicable to interim financial statements and include the accounts of all its subsidiaries. Accordingly, they do not include all the information and disclosures required according to GAAP for annual financial statements and should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto in the Company’s Annual Report for the year ended December 31, 2007.

Information with respect to the December 31, 2007 balance sheet is derived from the Company’s complete audited consolidated financial statements. 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, 2007.

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 | 14,902,784 | \$59,797 |
| Issued upon exercise of stock options | 82,736 | 468 |
| Issued under employee share purchase plan | 2,484 | 26 |
| Purchase of shares | (182,725) | (734) |
| Balance at March 31, 2008 | 14,805,279 | \$59,557 |

3. Capital Stock (cont'd)

Stock option plan

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

| | 2008 | | 2007 | |
|----------------------------------------|------------------|------------------------------------|-----------|------------------------------------|
| | # | Weighted average exercise price \$ | # | Weighted average exercise price \$ |
| Balance at beginning of year | 1,002,844 | 7.73 | 819,915 | 6.07 |
| Granted | 259,185 | 10.80 | 330,822 | 11.19 |
| Exercised | (82,736) | 5.41 | (134,695) | 6.39 |
| Expired or forfeited | (30,875) | 9.51 | (39,764) | 9.15 |
| Balance at March 31 | 1,148,418 | 8.54 | 976,278 | 7.64 |
| Options exercisable at March 31 | 483,218 | 6.29 | 449,814 | 5.83 |

The Company recorded option compensation expense with a corresponding credit to other paid-in-capital and determined the fair value of stock under the Black-Scholes option-pricing model using the following assumptions:

| | Three-month period ended March 31 | |
|------------------------------------------|-----------------------------------|---------|
| | 2008 | 2007 |
| Option compensation expense | \$227 | \$228 |
| Weighted average fair value of options | \$5.77 | \$6.79 |
| Weighted average risk-free interest rate | 3.31% | 4.49% |
| Dividend yield | Nil | Nil |
| Weighted average volatility factor | 48% | 53% |
| Weighted average expected life | 7 years | 7 years |

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:

| | Three-month period ended March 31 | |
|-------------------------------------------------------|-----------------------------------|------------|
| | 2008 | 2007 |
| Basic weighted average number of shares outstanding | 14,830,560 | 15,003,709 |
| Dilutive effect of options | 253,048 | 343,716 |
| Diluted weighted average number of shares outstanding | 15,083,608 | 15,347,425 |

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

5. Business acquisition

On April 30, 2007, the Company acquired all of the issued and outstanding shares of BioEnvelop Inc. ("BioEnvelop"), a subsidiary of BioEnvelop Technologies Inc. (TSX VENTURE: BIE), for a total consideration of \$1,993 consisting of the assumption of a note payable in BioEnvelop which was immediately repaid. The consideration was paid as follows: \$650 in cash, \$1,029 in common stock issued on the closing of the transaction representing 98,455 common shares and a \$314 non-interest bearing balance of sale payable 180 days after the closing date, subject to certain acquisition related conditions. The non-interest bearing balance of sale payable consists of a short term balance of sale payable in the amount of \$148 and \$166 payable in a pre-determined number of common shares to be issued using a value of \$10.45 per share, determined based on the weighted average trading price of the Company's common shares on the TSX for the ten trading days immediately prior to the closing date. As at March 31, 2008, the remaining portion of the non-interest bearing balance of sale payable is \$89.

6. Related party transactions

Joddes Limited ["Joddes"], a private Canadian corporation, is a significant shareholder holding approximately 43% of the outstanding shares of the Company, and one director of the Company, the Company's President and CEO, is related to Joddes.

The Company engages a wholly-owned subsidiary of Joddes to provide logistics services including: customer service, warehousing, shipping, invoicing, collection services and certain manufacturing services on behalf of the Company. The Company also engages this affiliate to perform certain research and development services on a contractual 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 10 years, ending in 2013 and includes minimum annual payments of \$136 for a total remaining committed amount of \$895 as at March 31, 2008 and is included in the purchase and service based commitments in note 7.

Effective November 1, 2006, the Company acquired the Canadian distribution rights to Metadol[®] from a wholly-owned subsidiary of Joddes. Under the terms of the agreement, the Company can purchase the Canadian license for Metadol[®] on the fourth anniversary of the agreement for \$1 and can receive a reimbursement of up to \$3,750 subject to certain acquisition related conditions. As at March 31, 2008, the Company has not received or earned any reimbursement.

All transactions with related parties, except for the Metadol[®] transaction described above, are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount. The accounts payable to related parties is on normal commercial terms and conditions and is non-interest bearing.

6. Related party transactions (cont'd)

The table below reflects all transactions and services with related parties which include those referred to in the agreements described above as well as revenues from a wholly-owned subsidiary of Joddes:

| | Three-month period ended March 31 | |
|-------------------------------------|--------------------------------------|-------|
| | 2008 | 2007 |
| | \$ | \$ |
| Revenues | 733 | 139 |
| Purchases | 2,849 | 1,927 |
| Research and development expenses | 122 | 65 |
| Sales and marketing expenses | 913 | 787 |
| General and administrative expenses | 91 | 66 |

7. Commitments

In the normal course of business, the Company secures 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 and services based commitments.

Revenue based commitments

Most pharmaceutical product license agreements require that the Company make royalty payments; ranging from 5% to 20% of sales, or require payments for products at rates ranging from 20% to 40% of the net selling price.

A certain pharmaceutical product license agreement requires that the Company make royalty payments ranging from 75% to 90% of the excess of a defined contribution amount above certain established minimums and requires payments of 50% of the excess of certain established internal rates of return for a product.

In addition, the Company may have to pay up to \$15,770, including US\$14,728 if it achieves specific sales volumes on certain products in the future, over a maximum of 10 years.

Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties for \$3,085, including US\$150 and €1,500 over the next six years. In addition, certain additional payments may be 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 \$1,444, including US\$411 and GBP£500, over a maximum period of 15 years.

7. Commitments (cont'd)

Purchase and service based commitments

The Company is committed to making minimum purchases of inventory, and minimum expenditures for regulatory, selling and marketing services in the amount of \$40,977, including US\$5,731, to retain exclusive distribution agreements for certain products. These commitments end in 2015 and annual commitments remaining are as follows:

| | \$ |
|-----------|--------|
| 2008 | 9,410 |
| 2009 | 10,971 |
| 2010 | 12,634 |
| 2011 | 5,433 |
| 2012 | 896 |
| 2013-2015 | 1,633 |

8. Financial Instruments

The classification of financial instruments under the new accounting standards as of March 31, 2008 and December 31, 2007 and their respective carrying values and fair values were as follows:

| As at March 31, 2008 | Available -for-sale | Held-to- maturity | Loans and receivables | Other financial liabilities | Derivatives | Carrying value | Fair value |
|------------------------------------------|------------------------|----------------------|--------------------------|-----------------------------------|-------------|--------------------|---------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Cash and cash equivalents | 5,747 | | | | | 5,747 | 5,747 |
| Marketable securities | 22,867 | 4,666 | | | | 27,533 | 27,581 |
| Accounts receivable | | | 10,761 | | | 10,761 | 10,761 |
| Other current assets | | | 1,102 | | | 1,102 | 1,102 |
| Investment tax credits receivable | | | 36 | | | 36 | 36 |
| Long-term marketable securities | — | | | | | — | — |
| Investments | 3,066 | | 244 | | 10 | 3,320 ³ | 3,439 |
| Accounts payable and accrued liabilities | | | | 9,491 | | 9,491 | 9,491 |
| Accounts payable to related parties | | | | 2,182 | | 2,182 | 2,182 |
| Income taxes payable | | | | 3,054 | | 3,054 | 3,054 |
| Balance of sale payable | | | | 614 | | 614 | 614 |
| Total | 28,614 | 4,666 | 12,143 | 15,341 | 10 | 63,840 | 64,007 |

³ In accordance with Section 3855, the Company's investments in Verus, and Glide both of which are private companies, are carried at cost as there are no quoted market prices in an active market for such equity instruments. Fair value has not been disclosed because fair value cannot be measured reliably.

8. Financial Instruments (cont'd)

| As at December 31, 2007 | Available -for-sale | Held-to- maturity | Loans and receivables | Other financial liabilities | Derivatives | Carrying value | Fair value |
|------------------------------------------|------------------------|----------------------|--------------------------|-----------------------------------|-------------|-------------------|---------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Cash and cash equivalents | 6,074 | | | | | 6,0 | 6,074 |
| Marketable securities | 16,375 | 9,666 | | | | 26,04 | 26,019 |
| Accounts receivable | | | 11,920 | | | 11,92 | 11,920 |
| Other current assets | | | 2,943 | | | 2,9 | 2,943 |
| Investment tax credits receivable | | | 244 | | | 244 | 244 |
| Long-term marketable securities | 4,101 | | | | | 4,1 | 4,101 |
| Investments | 3,809 | | 220 | | 12 | 4,0 | 4,176 |
| Accounts payable and accrued liabilities | | | | 11,582 | | 11,58 | 11,582 |
| Accounts payable to related parties | | | | 1,032 | | 1,0 | 1,032 |
| Income taxes payable | | | | 2,056 | | 2,0 | 2,056 |
| Balance of sale payable | | | | 607 | | 607 | 607 |
| Total | 30,359 | 9,666 | 15,327 | 15,277 | 12 | 70,64 | 70,754 |

Fair Value

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The Company uses the following methods and assumptions to establish the fair value for each class of financial instruments for which their carrying amounts are included in the interim balance sheet as follows:

- Cash & cash equivalents are classified as "Available-for-sale" due to their short-term nature and the fact that they must be readily available to finance the Company's operations;
- Marketable securities are classified as "Held to maturity" and "Available for sale". The marketable securities classified as "Held to maturity" are initially recognized at their fair values, with any resulting premium or discount from the face value being amortized to income or expense using the effective interest method. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. The marketable securities classified as "Available for sale" are initially recognized at their fair values, with any resulting changes in the fair value being charged or credited to other comprehensive income and when ultimately sold to net income. Fair values for marketable securities are obtained using quoted active market prices for such securities;
- Accounts receivable and other current assets and investment tax credits receivable are classified as "Loans and receivables". They are recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amount is a reasonable approximation of fair value due to the short-term nature of the accounts;

8. Financial Instruments (cont'd)

- Investments in other companies are classified as “Available for sale” except for the bifurcated conversion option of a secured convertible term note in a portfolio company, which is classified as a “Derivative” and the allocated loan portion on the same convertible term note which is classified as “Loans and receivables”. Derivatives are carried at fair value with changes in the fair value being charged or credited to the statement of income for the relevant period. Investments in other companies consist of strategic investments. The investments classified as “Available for sale” are carried at fair value with changes in the fair value being charged or credited to other comprehensive income. In accordance with Section 3855, investments in private companies are carried at cost unless evidence of an other than temporary impairment exists in which case they are written down to their net recoverable amount. Fair values for investments in other companies classified as “Available for sale” are obtained using quoted prices in active markets for public companies, if such are available. Fair value for the bifurcated conversion option of a secured convertible term note in a portfolio company classified as a derivative was obtained using the Black-Scholes option pricing valuation model. The allocated loan portion described above classified as “Loans and receivables” is being discounted using an 11% discount rate, such approximating market value; and,
- Accounts payable and accrued liabilities, accounts payable to related parties, income taxes payable, and balance of sale payable are classified as “Other financial liabilities”. They are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts included on the balance sheet are measured at amortized cost which approximates fair value due to the short-term nature of these financial liabilities. The long-term balance of sale payable has been recorded at its discounted value, using a discount rate of 5%, and approximates its market value.

These estimates are affected by assumptions the Company makes about the amount and timing of estimated future cash flows and discount rates, all of which reflect varying degrees of risk. Income taxes and other expenses that would be incurred on disposition of these financial instruments are not reflected in the fair values. As a result, the fair values are not necessarily the net amounts that would be realized if these instruments were settled.

Risk arising from financial instruments

The Company does not use derivative financial instruments for speculative or trading purposes. Since the Company does not trade actively in derivative instruments it is not exposed to any significant liquidity risks relating to them.

Credit risk

Our cash equivalents and short-term investments are held through various institutions. Cash equivalents are mainly investments in Canadian banker’s acceptances that are readily convertible into a known amount of cash, they are subject to minimal risk of changes in value and have an original maturity of three months or less from the date of purchase. Marketable securities are mainly investments in liquid, high-grade investment securities, they are subject to minimal risk of changes in value and have an original maturity from three months to a eighteen months from the date of purchase. Marketable securities are all invested with large Canadian financial institutions.

8. Financial Instruments (cont'd)

The Company is exposed to credit risk from our customers and continually monitors its customers' credit. It establishes the provision for doubtful accounts based upon the credit risk applicable to each customer. For the three-month period ended March 31, 2008, two customers, a major wholesale distributor and a major retail chain, represented 28% and 15% of revenues, respectively [2007 - 32% and 17%]. As at March 31, 2008, two customers, a major wholesale distributor and a major retail chain, represented 78% and 22% of trade accounts receivable, respectively [2007 - 80% and 20%].

Liquidity risk and market risk

The Company's Investment Policy regulates the investment activities relating to cash resources. An Investment Committee composed of representatives from management and the Board of Directors monitors compliance with said policy. The Company invests in strategic investments in the form of equity or strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates. As at March 31, 2008, there were no restrictions on the flow of these funds nor have any of these funds been committed in any way, except as set out in note 7.

The Company operates nationally, however, a portion of the Company's expenses, mainly inventory purchases, are incurred in United States (US) dollars. This results in financial risk due to fluctuations in the value of the US dollar relative to the Canadian dollar. The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results, financial position or cash flows.

The Company is subject to interest rate risk on its cash, cash equivalents and marketable securities. The Company does not believe that the results of operations or cash flows would be materially affected to any significant degree by a sudden change in market interest rates relative to interest rates on the investments, owing to the relative short-term nature of the marketable securities.

9. Management of Capital

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders;
- to maintain a flexible capital structure which optimizes the cost of capital at acceptable risk.

In the management of capital, the Company includes shareholders' equity alone in the definition of capital. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and short-term investments balances.

The Company expects that its current capital resources will be sufficient to carry on its operations for the foreseeable future and is not subject to any capital requirements imposed by a regulator or third parties.

10. Comparative figures

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

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Toronto Stock Exchange: PLB

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