PALADIN LABS INC.

CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

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, 2009 and compares these unaudited quarterly results to those of the quarter ended March 31, 2008. 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 6, 2009 and as at this date 14,941,615 shares and 1,385,445 options were issued and outstanding. Reference to "Paladin" or the "Company" includes Paladin Labs Inc. and all its subsidiaries, including the acquisition of Virexx Medical Corp. as of December 23, 2008, the effective date of the acquisition, further described in note 4 to these unaudited interim consolidated financial statements.

Forward-Looking Statements

This document contains forward-looking statements for the Company and its subsidiaries. These forward looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. The Company considers the assumptions on which these forward-looking statements are based to be reasonable at the time they were prepared, but cautions the reader that these assumptions regarding future events, many of which are beyond the control of the Company and its subsidiaries, may ultimately prove to be incorrect. Factors and risks, which could cause actual results to differ materially from current expectations, are discussed in the Company's Annual Report as well as in the Company's Annual Information Form for the year ended December 31, 2008. The Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events, except as required by law. For additional information on risks and uncertainties relating to these forward-looking statements, investors should consult the Company's ongoing quarterly filings, Annual Report and Annual Information Form and other filings found on SEDAR at www.sedar.com.

Overview

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

First quarter highlights:

- Revenues reached $25,815, an increase of 53% over the same period last year
- Net income was $3,052, an increase of 107% over the same period last year
- Cash flows from operations reached $8,266, a 12% increase over the same period last year
- EBITDA[1] was $10,955, an increase of 103% over the same period last year
- Entered into a distribution agreement with Mission Pharmacal Company granting Paladin the exclusive Canadian rights to market and sell Urocit-K®, indicated for the treatment of calcium and uric acid kidney stones
- Received approval from the Toronto Stock Exchange ("TSX") on February 27, 2009 to make a normal course issuer bid to purchase up to 811,548 common shares.
- Filed a new drug submission for Trelstar® 22.5 mg (triptorelin pamoate for injectable suspension). Trelstar® 22.5 mg is a 6-month slow release, injectable, luteinizing hormone-releasing hormone (LHRH) agonist indicated for the palliative treatment of advanced prostate cancer.
- On May 6, 2009, the Company entered into a Plan of Arrangement Agreement with Isotechnika Inc. ("Isotechnika") (TSX:ISA) to acquire 100% of the common shares of Isotechnika including the intellectual property relating to Canada and certain other strategic markets of interest to the Company for $7,000 at closing and up to $4,350 over a subsequent twelve-month period post closing. These agreements are subject to court, regulatory and Isotechnika shareholder approval.

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, income taxes and the determination of fair value of financial instruments. For a more detailed discussion of the Company's critical accounting estimates, please refer to the management's discussion & analysis included in the Company's 2008 Annual Report. There have been no material changes to accounting estimates since December 31, 2008.

New Accounting Standards and Disclosure Changes

Effective January 1, 2009, the Company has adopted the following recently introduced Canadian Institute of Chartered Accountants ("CICA") Handbook Sections:

Section 3064 – *Goodwill and Intangible Assets*, reinforces the approach under which assets are recorded only if they meet the definition and the recognition criteria of an asset. It also clarifies the application of the concept of matching costs with revenues. These changes, including the related disclosure requirements, did not have a significant effect on the Company's consolidated financial statements.

Section 1400 – *General Standards of Financial Statement Presentation*. This section includes requirements to assess and disclose the Company's ability to continue as a going concern. These changes did not have a significant impact on the Company's consolidated financial statements.

IFRS Changeover Plan

In February 2008 the Canadian Accounting Standards Board (AcSB) confirmed that the use of International Financial Reporting Standards ("IFRS") would be required for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. The Company will implement these standards as at January 1, 2011. The AcSB also stated that, during the transition period, enterprises will be required to provide comparative figures in accordance with IFRS. Under IFRS, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy that must be addressed. The Company is currently evaluating the impact of adopting IFRS on the consolidated financial statements. While the Company has put in place an implementation program and has begun training and analyzing the possible impact of this change on the Company's consolidated financial statements, the final impact of the transition to IFRS cannot be reasonably estimated at this time.

Results of Operations

Three-month period ended March 31, 2009 compared to three-month period ended March 31, 2008.

Revenues

Revenues increased $8,981 or 53% to $25,815 for the three-month period ended March 31, 2009 from $16,834 for the three-month period ended March 31, 2008. The Company's acquisition of Dexedrine®, effective December 24, 2008, contributed $3,606 to revenues for the quarter ended March 31, 2009. Furthermore, an amount of $1,693 previously recorded in deferred revenue was recognized into revenue during the quarter in accordance with the Company's revenue recognition policy.

In addition, the increase in revenues for the quarter ended March 31, 2009 is primarily attributable to the sales growth of certain significant promoted products, including Tridural™, Twinject®, Seasonale™, Plan B®, Pennsaid®, Metadol®, Testim® and Trelstar® which combined increased by 11% compared to the quarter ended March 31, 2008.

Product revenues highlights for the Company's most significant promoted products using IMS Canada data[2] for the quarter ended March 31, 2009 compared to the quarter ended March 31, 2008 are as follows:

	Three-month period ended March 31, 2009	
Promoted Products	**Revenue per IMS Canada**	**% change vs. 2008**
	$	
Plan B®	1,943	12%
Twinject®	1,100	3%
Pennsaid®	2,772	7%
Metadol®	1,851	27%
Trelstar®	513	80%
Seasonale™	697	254%
Testim®	439	41%
Tridural™	2,012	272%
Total	**11,327**	**38%**

Gross Profit

Total gross profit increased $6,555 or 51% to $19,445 for the three-month period ended March 31, 2009 from $12,890 for the three-month period ended March 31, 2008. Gross profit, as a percentage of revenues, decreased to 75% from 77% for the quarter ended March 31, 2009 compared to the quarter ended March 31, 2008. The decrease in gross profit as a percentage of revenues for the quarter ended March 31, 2009 is mainly a result of the impact of lower margins from the BioEnvelop™ edible film business and reduced margins on certain newly launched products.

Selling and Marketing Expense

Selling and marketing expense essentially remained steady, decreasing only slightly by $21 or nil% to $5,512 for the three-month period ended March 31, 2009 from $5,533 for the three-month period ended March 31, 2008. Selling and marketing expense, as percentage of revenues, decreased to 21% for the quarter ended March 31, 2009 from 33% 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 Company's growth in non-promoted product revenue during the first quarter of 2009, driving selling and marketing expense as a percentage of revenues downward for the quarter. Furthermore, during the first

[2] The Company has chosen not to disclose detailed product revenues 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 note that IMS Canada sales data may not necessarily correspond to the Company's recording of revenues in accordance with GAAP.

quarter of 2008, the Company was in the first year of promotional market launch activities for Tridural™ and Seasonale™, requiring significant marketing expense outlays. The promotional activities driving selling and marketing costs primarily relate to Paladin's continued promotional activities for Tridural™, Trelstar®, Twinject®, Plan B®, Metadol® and Testim®.

General and Administrative Expense

General and administrative expense increased $473 or 33% to $1,915 for the three-month period ended March 31, 2009 from $1,442 for the three-month period ended March 31, 2008. General and administrative expense, as percentage of revenues, decreased to 7% for the quarter ended March 31, 2009, from 9% for the same period last year, as a result of the Company's growth in non-promoted product revenue during the first quarter of 2009. The increase in the current's year first quarter general and administrative expenses in dollar terms is the result of an increase in headcount, an increase in stock-based compensation expense and business development activities supporting the Company's growth.

Research and Development Expense

Research and development expense increased $219 or 21% to $1,262 for the three-month period ended March 31, 2009 from $1,043 for the three-month period ended March 31, 2008. Research and development expense, as percentage of revenues, decreased to 5% for the quarter ended March 31, 2009 compared to 6% for the quarter ended March 31, 2008, as a result of the Company's growth in non-promoted product revenue during the first quarter of 2009. The increase in dollar terms for the quarter ended March 31, 2009 primarily relates to on-going research and development efforts at Virexx® (see note 4 to the unaudited interim consolidated financial statements), research activities related to BioEnvelop™ and the Impavido® business. During the quarters ended March 31, 2009 and 2008, 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.

Net Interest Income

Net interest income decreased $320 or 62% to $199 for the three-month period ended March 31, 2009 from $519 for the three-month period ended March 31, 2008. This decrease is primarily the result of lower interest rates along with lower average cash and marketable securities balances over the quarter ended March 31, 2009 compared to the quarter ended March 31, 2008.

Amortization of Pharmaceutical Product Licenses, Rights and Deferred Charges

Amortization expense increased $3,159 or 108% to $6,096 for the three-month period ended March 31, 2009 from $2,937 for the three-month period ended March 31, 2008. This increase in amortization expense is the result of the amortization related to the Company's recently acquired pharmaceutical product licenses and rights, including: Dexedrine®, Antizol®, Impavido®, Unisom® and Kaopectate®.

Unrealized (Gain) Loss on Derivative Financial 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 gain on the conversion option in the amount of $344 for the quarter ended March 31, 2009 [2008 - $2 loss] and an unrealized gain on warrants in a portfolio company in the amount of $15 [2008 – nil].

Loss on Disposal of Investment

During the three month period ended March 31, 2009, the Company disposed of certain shares held in a portfolio company for proceeds of $568, representing a gain of $62. In addition, during the quarter ended March 31, 2009, Endo Pharmaceuticals Inc. ("Endo") acquired Indevus Pharmaceuticals Inc. ("Indevus") for US$4.50 per Indevus share in cash and up to an additional US$3.00 per share in cash upon achievement of certain regulatory and sales milestones. The Company received proceeds in the amount of $2,167 (US$1,720) for the investment it held in 382,253 common shares of Indevus, resulting in a realized loss on disposal in the amount of $414. Furthermore, the Company recorded $416 representing the estimated fair value of a contingent right to cash receivable in relation to the achievement of certain regulatory and sales milestones, determined to represent the fair value upon receipt and measured based upon the average incremental Indevus common stock trading price over the US$4.50 cash payment received over a 31 day trading period on NASDAQ. For the quarter ended March 31, 2008, the Company did not dispose of any investments.

Foreign Exchange Loss (Gain)
During the three month period ended March 31, 2009, the Company recorded a foreign exchange loss of $22, compared to a gain of $28 for the same period last year, mainly as a result of the weakening of the Canadian dollar relative to the US dollar.

Other Income
Other income was $nil for the three-month period ended March 31, 2009, compared to $3 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 $786 or 78% to $1,792 for the three-month period ended March 31, 2009 from $1,006 for the three-month period ended March 31, 2008. For the quarter ended March 31, 2009, the effective tax rate was 37% compared to 41%, for the quarter ended March 31, 2008. The decrease in effective tax rates in the current year is due to decreases in permanent differences mainly; 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	22,736	15,936	2013-2027
	Provincial	12,941	7,108	2026-2027
Scientific Research and Experimental Development expenditures				
	Federal	21,152	10,056	N/A
	Provincial	12,065	7,320	N/A
Investment tax credits				
	Federal	3,134	74	2013-2029

The amount of the tax benefit claimed in the current and prior years, is subject to audit by the taxation authorities and could be reduced by a material amount in the future.

Net Income
Due to the factors set forth above, net income increased $1,575 or 107% to $3,052 for the three-month period ended March 31, 2009 compared to net income of $1,477 for the same period ended last year.

Liquidity and Capital Resources

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, 2009, 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 6 to the unaudited interim consolidated financial statements.

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. There are no present agreements or commitments with respect to any such acquisitions, other than those disclosed in Note 10 to the unaudited interim consolidated financial statements.

	Three-month period ended March 31	
	2009	2008
	$	$
Cash flows from operating activities	**8,266**	7,374
Cash flows used in investing activities	**(661)**	(6,365)
Cash flows from (used) in financing activities	**188**	(1,336)
Increase (decrease) in cash position	**7,793**	(327)
Cash and cash equivalents, beginning of period	**4,646**	6,074
Cash and cash equivalents, end of period	**12,439**	5,747
Short and long-term marketable securities, end of period	**20,052**	27,533
Cash, cash equivalents and marketable securities, end of period	**32,491**	33,280

Paladin's cash, cash equivalents and marketable securities increased $11,149 to $32,491 at March 31, 2009 from $21,342 at December 31, 2008. This increase is primarily a result of the Company's cash flows generated from operating activities in the amount of $8,266, proceeds from disposal of investments in the amount of $2,735, and common shares issued for cash in the amount of $188, partially offset by purchases of short-term and long-term marketable securities net of cash flows generated by maturing market securities in the amount of $3,367. Working capital (current assets less current liabilities) increased $12,652 to $38,071 at March 31, 2009 from $25,419 at December 31, 2008 primarily due to the increase in the cash, cash equivalents and marketable securities described above.

Cash flows from operating activities increased 12% or $892 to $8,266 for the three-month period ended March 31, 2009 from $7,374 for the three-month period ended March 31, 2008. 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 $661 compared to $6,365 for the three-month period ended March 31, 2009 and 2008, respectively. During the three-month period ended March 31, 2009, the Company invested $3,367 towards the acquisition of short-term and long-term marketable securities net of cash flows generated by maturing marketable securities, $29 for the acquisition of capital assets, partially offset by proceeds from disposal of investments in the amount of $2,735. 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 capital assets, partially offset by cash generated by maturing marketable securities in the amount of $2,757.

Cash flows from financing activities were $188 compared to cash flows used in financing activities in the amount of $1,336 for the three-month periods ended March 31, 2009 and 2008, respectively. During the three-month period ended March 31, 2009, $188 was 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, 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.

Acquisition of Virexx Medical Corp.

On December 23, 2008, the Company acquired all the issued and outstanding shares of Virexx Medical Corp. ("Virexx")(TSX:VIR) (AMEX:REX) in accordance with an Order for Reorganization led by Virexx's appointed Trustee, whereby the Company paid $1,446 in cash. In addition, the Company has agreed to a contractual right of payment of an amount of up to $2,500 in the aggregate to former Virexx shareholders, if certain conditions are met, including the Company receiving at least $4,000 in connection with certain Virexx assets, prior to December 31, 2009. As at March 31, 2009, the Company has not received any funds with respect to this contractual right and as such has not recorded any contractual amounts payable. The Company has also incurred transaction costs in the amount of $196, included in the cash payment above, in connection with the acquisition. Virexx, a Canadian-based biotech company focused on developing innovative-targeted therapeutic products, was subsequently wound-up into Paladin Labs Inc. The results of Virexx operations have been included in the Company's results since December 23, 2008, the date of acquisition. The Company refers the reader to note 4 of the unaudited interim consolidated financial statements, for further details regarding the acquisition.

Related Party Transactions

Joddes Limited ["Joddes"], a private Canadian corporation, is a significant shareholder holding approximately 42% 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 and selling 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 for a total remaining committed amount of $832 as at March 31, 2009 and is included in the purchase and service based commitments amount in Contractual Obligations and Commitments below.

The Company also holds contractual royalty agreements with a wholly-owned subsidiary of Joddes for certain legacy and over-the-counter products. The terms of these arrangements vary whereby the Company may earn a royalty fee based on certain established terms relating to the net sales of the respective products such as through a percentage of net sales, certain guaranteed minimum annual payments, or as a percentage of a defined product contribution.

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, 2009, the Company has not received or earned any reimbursement. The acquisition of the Canadian distribution rights to Metadol® was not in the normal course of operations and was recorded at an agreed upon exchange amount in accordance with the requirements of accounting standard CICA 3840.

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 March 31	
	2009	2008
	$	$
Revenues	**889**	733
Purchases	**1,570**	2,849
Sales and marketing	**1,239**	913
Research and development	**133**	122
General and administrative	**121**	91

Quarterly Information (unaudited)

(In thousands of Canadian dollars except per share information)

	Q1 F2009	Q4 F2008	Q3 F2008	Q2 F2008	Q1 F2008	Q4 F2007	Q3 F2007	Q2 F2007
Revenues	**25,815**	23,051	22,191	20,668	16,834	17,697	16,915	15,436
EBITDA[1]	**10,955**	7,415	9,189	6,997	5,419	4,925	5,074	5,094
Earnings before income taxes	**4,844**	3,512	5,975	4,067	2,483	2,500	1,606	1,786
Net Income before extraordinary gain	**3,052**	2,044	3,617	2,588	1,477	1,030	828	1,037
Net Income	**3,052**	6,116	3,617	2,588	1,477	1,030	828	5,911
Earnings per share before extraordinary gain	**$0.20**	$0.14	$0.24	$0.17	$0.10	$0.07	$0.06	$0.07
Earnings per share	**$0.20**	$0.41	$0.24	$0.17	$0.10	$0.07	$0.06	$0.39
Diluted earnings per share before extraordinary gain	**$0.20**	$0.14	$0.24	$0.17	$0.10	$0.07	$0.05	$0.07
Diluted earnings per share	**$0.20**	$0.41	$0.24	$0.17	$0.10	$0.07	$0.05	$0.38

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.

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. 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 6 of the Company's unaudited 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.

Concentration of Credit Risk and Major Customers

The Company's cash and cash equivalents, short-term and long-term investments are held through various institutions. 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 four months to eighteen months from the date of purchase. Marketable securities are all invested with large Canadian financial institutions.

The Company is exposed to credit risk from its 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, 2009, two customers, a major wholesale distributor and a major retail chain, represented 28% and 16% of revenues, respectively [2008 – 28% and 15%]. As at March 31, 2009, two customers, a major wholesale distributor and a major retail chain, represented 32% and 13% of trade accounts receivable, respectively [2008 – 45% and 13%]. For a more detailed analysis and disclosure of credit risk please refer to note 7 to the quarterly unaudited consolidated financial statements.

Liquidity risk

The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. The Company has sufficient funds available through its cash and marketable securities, should its cash requirements exceed cash generated from operations to cover all financial liability obligations. As at March 31, 2009, 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 the "Contractual Obligations and Commitments" section below and note 9 to the unaudited interim consolidated financial statements.

Foreign exchange risk

The Company principally operates within Canada, however, a portion of the Company's revenues, expenses, and current assets and liabilities, are denominated in United States dollars ("USD") and EURO. This results in financial risk due to fluctuations in the value of the USD and EURO relative to the Canadian dollar ("CAD"). The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Based on the net exposure described in note 7 to the unaudited interim consolidated financial statements, and assuming that all other variables remain constant, a ten-point increase or decrease in the CAD/USD and CAD/EURO exchange rates would have an effect of $261 on net earnings.

Interest rate risk

The Company is subject to interest rate risk on its cash 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.

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.

Internal Control Over Financial Reporting

No changes were made in our internal control over financial reporting during the quarter ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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. The Company is committed to making minimum purchases of inventory, and minimum expenditures for regulatory, selling and marketing services in the amount of $39,115, including US$4,526 and €4,645, to retain exclusive distribution agreements for certain products. These commitments end in 2015 and annual commitments are as follows:

Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Purchase and service based commitments	**39,115**	10,113	23,636	4,235	1,131

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 may have to pay up to $32,088 including US$19,133, €1,208 and GBP£500 over a maximum period of 15 years if it achieves certain product, regulatory or sales milestones on specific products in the future. The Company has the following commitments related to product license, trademark and distribution agreements:

Commitments	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Milestone based commitments	**10,070**	5,129	3,220	1,094	627
Revenues based commitments	**22,018**	107	1,415	165	20,331

Contingencies

On July 25, 2008, the Company received notices of re-assessment from the Canada Revenue Agency ("CRA") relating to the taxation years ending August 16, 2005 and July 31, 2006 containing adjustments relating to the use of certain non-capital losses acquired as part of the Dimethaid Health Care Ltd. (subsequently renamed Squire Pharmaceuticals Inc. "Squire") acquisition from Nuvo Research Inc. ("Nuvo"). In addition, on August 11, 2008, the Company received a notice of assessment from CRA for the taxation year ending July 31, 2007. The notices of assessment and re-assessment, if they stood, amount to additional Canadian federal tax due of approximately $5,558 plus interest and penalties of approximately $1,733. On October 30, 2008, the Company received a Notice of Reassessment from the Ontario Minister of Finance for the taxation year ended August 16, 2005 for additional taxes , due of $747 plus interest and penalties of $378. It is likely that the Quebec provincial tax authorities will propose similar adjustments as a result of the CRA re-assessments. As such the Company estimates the total tax liability exposure to the federal and relevant provincial governments as a result of the CRA's position to be approximately $11,157 including interest and penalties. The Company disagrees with the position taken by the CRA and believes it is without merit. On October 23, 2008, the Company filed a Notice of Objection through the CRA appeals process and intends to pursue further through the courts, if necessary. The Ontario Minister of Finance has agreed to be bound by the decision of the CRA appeals process.

Under the terms of the Share Purchase Agreement ("SPA") for Squire, Nuvo provided representations and warranties with respect to the status of the Squire tax accounts and certain tax asset values whereby, if the amounts represented are incorrect then Nuvo is required to indemnify the Company. The Company also holds indemnities from Nuvo relating to all costs relating to reassessment including advisory fees, interest and penalties, as applicable. In the event of an unfavorable ruling, the Company intends to claim at least $9,242 from Nuvo under the SPA. Nuvo has issued a Letter Agreement providing security over the indemnity obligations by entitling the Company to the benefit of security over certain assets and product revenue streams of Nuvo and certain of its subsidiaries.

Although the final resolution of the proposed adjustments is uncertain, based on currently available information, the Company has not provided for any amounts relating to this reassessment.

In connection with the appeals process, in the notice of re-assessment, the Company is required to post a deposit of up to one half of the tax and interest assessed. To that effect the Company deposited $3,755 to the CRA and $500 to the Ontario Minister of Finance during the year ended December 31, 2008, and may make a claim from Nuvo under the SPA.

If the Company is successful in its appeal of the re-assessment these amounts will be refunded to the Company with accrued interest.

Management currently believes that the resolution of this matter will not have a material effect on the Company's results of operations, financial position or liquidity. However, an unfavourable resolution with the CRA and the relevant provincial authorities combined with a failure of Nuvo to satisfy their obligations under the SPA, could have a material impact on the Company's results of operations, financial position and cash flows in the year in which an adjustment is recorded or the tax is due or paid.

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, 2009 and the interim consolidated statements of income, cash flows, comprehensive income, accumulated other comprehensive income (loss) and retained earnings 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. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly in all material respects. The Company's accounting procedures and related systems of internal controls are designed to provide a reasonable assurance that its assets are safeguarded and its financial records are reliable. Readers are cautioned that these interim consolidated 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
May 6, 2009

(signed) Samira Sakhia
Samira Sakhia C.A., M.B.A.
Chief Financial Officer

Montreal, Canada
May 6, 2009

CONSOLIDATED BALANCE SHEETS

[In thousands of Canadian dollars]

	March 31 2009 $	December 31 2008 $
	(unaudited)	(audited[3])
ASSETS		
Current		
Cash and cash equivalents	**12,439**	4,646
Marketable securities	**18,093**	14,753
Accounts receivable *[note 7]*	**17,751**	17,889
Inventory	**8,592**	8,643
Other current assets	**1,897**	2,531
Income taxes receivable *[note 9]*	**4,255**	4,209
Investment tax credits receivable	**36**	36
Investment tax credits recoverable	**74**	43
Future income tax assets	**7,905**	9,120
Total current assets	**71,042**	61,870
Long-term marketable securities	**1,959**	1,943
Capital assets	**566**	594
Pharmaceutical product licences and rights	**52,062**	58,152
Investments	**4,024**	4,792
Future income tax assets	**3,960**	4,789
Total assets	**133,613**	132,140
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**15,074**	16,464
Accounts payable to related parties	**1,025**	1,384
Deferred revenue	**—**	1,693
Income taxes payable	**6,252**	6,391
Balance of sale payable	**10,526**	10,429
Future income tax liabilities	**94**	90
Total current liabilities	**32,971**	36,451
Long-term		
Future income tax liabilities	**64**	341
Total liabilities	**33,035**	36,792
Shareholders' equity		
Capital stock *[note 3]*	**60,866**	60,664
Other paid-in capital	**3,547**	3,155
Accumulated other comprehensive income (loss)	**164**	(1,420)
Retained earnings	**36,001**	32,949
Total shareholders' equity	**100,578**	95,348
Total liabilities and shareholders' equity	**133,613**	132,140

See accompanying notes

[3] Derived from the audited annual financial statements filed on SEDAR at www.sedar.com

CONSOLIDATED STATEMENTS OF INCOME

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

	Three-month period ended March 31	
	2009	2008
	$	$
Revenues	**25,815**	16,834
Cost of sales	**6,370**	3,944
Gross profit	**19,445**	12,890
Expenses (income)		
Selling and marketing	**5,512**	5,533
General and administrative	**1,915**	1,442
Research and development	**1,262**	1,043
Interest income, net	**(199)**	(519)
Earnings before under-noted items	**10,955**	5,391
Amortization of pharmaceutical product licenses, rights and deferred charges	**6,096**	2,937
Unrealized (gain) loss on derivative financial instruments	**(359)**	2
Net loss on disposal of investment	**352**	—
Foreign exchange loss (gain)	**22**	(28)
Other income	**—**	(3)
Income before income taxes	**4,844**	2,483
Provision for income taxes		
Current	**194**	849
Future	**1,598**	157
	1,792	1,006
Net income for the period	**3,052**	1,477
Earnings per share		
Basic	**0.20**	0.10
Diluted	**0.20**	0.10
Weighted average number of shares outstanding		
Basic	**14,929,672**	14,830,560
Diluted	**15,212,910**	15,083,608

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]
[unaudited]

	Three-month period ended March 31	
	2009	2008
	$	$
Operating activities		
Net income	**3,052**	1,477
Add items not affecting cash		
Amortization	**6,148**	2,982
Future income taxes	**1,598**	157
Stock based compensation expense *[note 3]*	**402**	238
Unrealized (gain) loss on derivative financial instruments	**(359)**	2
Net accreted interest	**(25)**	(18)
Net loss on disposal of investments	**352**	—
	11,168	4,838
Net change in non-cash balances relating to operations	**(2,902)**	2,536
Cash flows from operating activities	**8,266**	7,374
Investing activities		
Additions to pharmaceutical product licenses and rights, and deferred charges	—	(8,867)
Acquisition of capital assets	**(29)**	(255)
Purchases of short-term marketable securities	**(10,362)**	(11,765)
Maturities of short-term marketable securities	**8,964**	14,522
Purchases of long-term marketable securities	**(1,969)**	—
Proceeds from disposal of investments	**2,735**	—
Cash flows used in investing activities	**(661)**	(6,365)
Financing activities		
Repurchase of shares	**—**	(1,806)
Common shares issued for cash	**188**	470
Cash flows from (used in) financing activities	**188**	(1,336)
Net change in cash and cash equivalents during the period	**7,793**	(327)
Cash and cash equivalents, beginning of period	**4,646**	6,074
Cash and cash equivalents, end of period	**12,439**	5,747
Cash and cash equivalents	**12,439**	5,747
Short-term marketable securities	**18,093**	27,533
Long-term marketable securities	**1,959**	—
	32,491	33,280

See accompanying notes

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME, ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), AND RETAINED EARNINGS

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

	Three-month period ended March 31	
	2009	2008
	$	$
Net income for the period	**3,052**	1,477
Other comprehensive income (loss):		
Change in fair value of available-for-sale financial instruments [net of ($29) taxes [2008 – $115]]	**185**	(466)
Reclassification adjustment for losses (gains) on available-for-sale financial instruments included in net income in the current period [net of ($219) taxes [2008 – ($2)]]	**1,399**	(11)
Other comprehensive income (loss) for the period	**1,584**	(477)
Comprehensive income for the period	**4,636**	1,000
Accumulated other comprehensive (loss), beginning of period	**(1,420)**	(324)
Other comprehensive income (loss) for the period	**1,584**	(477)
Accumulated other comprehensive income (loss), end of period	**164**	(801)
Retained earnings, beginning of period	**32,949**	20,508
Net income for the period	**3,052**	1,477
Excess of purchase price over stated capital of common shares cancelled	**—**	(1,072)
Retained earnings, end of period	**36,001**	20,913
Retained earnings and accumulated other comprehensive income (loss), end of period	**36,165**	20,112

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, 2008.

Information with respect to the December 31, 2008 balance sheet is derived from the Company's complete audited consolidated financial statements. The accounting policies underlying these unaudited interim financial statements are those set forth in note 2 of the audited consolidated financial statements for the year ended December 31, 2008.

Changes in accounting policies

Effective January 1, 2009, the Company has adopted the following recently introduced Canadian Institute of Chartered Accountants ("CICA") Handbook Sections:

Section 3064 – Goodwill and Intangible Assets, reinforces the approach under which assets are recorded only if they meet the definition and the recognition criteria of an asset. It also clarifies the application of the concept of matching costs with revenues. These changes, including the related disclosure requirements, did not have a significant effect on the Company's consolidated financial statements.

Section 1400 – General Standards of Financial Statement Presentation. This section includes requirements to assess and disclose the Company's ability to continue as a going concern. These changes did not have a significant impact on the Company's consolidated financial statements.

3. Capital Stock

Authorized

100,000,000 common shares without nominal or par value.

3. Capital Stock (cont'd)

Issued and outstanding

	Number of shares	Amount
Balance at beginning of year	**14,921,446**	**$60,664**
Issued upon exercise of stock options	15,453	151
Issued under employee share purchase plan	4,341	51
Balance at March 31, 2009	**14,941,240**	**$60,866**

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

	2009		2008	
	#	**Weighted average exercise price $**	#	Weighted average exercise price $
Balance at beginning of year	**1,067,948**	**9.03**	1,002,844	7.73
Granted	**342,750**	**12.19**	259,185	10.80
Exercised	**(15,453)**	**9.12**	(82,736)	5.41
Expired or forfeited	**(1,925)**	**10.58**	(30,875)	9.51
Balance at March 31	**1,393,320**	**9.81**	1,148,418	8.54
Options exercisable at March 31	**438,661**	**6.86**	483,218	6.29

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

	Three-month period ended March 31	
	2009	2008
Stock-based compensation expense	**$402**	$227
Weighted average fair value of options	**$5.74**	$5.77
Weighted average risk-free interest rate	**2.44%**	3.31%
Dividend yield	**Nil**	Nil
Weighted average volatility factor	**42%**	48%
Weighted average expected life	**7 years**	7 years

4. Business acquisition

On December 23, 2008, the Company acquired all the issued and outstanding shares of Virexx Medical Corp. ("Virexx")(TSX:VIR) (AMEX:REX) in accordance with an Order for Reorganization led by Virexx's appointed Trustee, whereby the Company paid $1,446 in cash. In addition, the Company has agreed to a contractual right of payment of an amount up to $2,500 in the aggregate to former Virexx shareholders, if certain conditions are met, including the Company receiving at least $4,000 in connection with certain Virexx assets, prior to December 31, 2009. As at March 31, 2009, the Company has not received any funds with respect to this contractual right and as such has not recorded any contractual amounts payable.

4. Business acquisition (cont'd)

The Company has also incurred transaction costs in the amount of $196, included in the cash payment above, in connection with the acquisition. Virexx is a Canadian-based biotech company focused on developing innovative-targeted therapeutic products and was subsequently wound up into the Company on December 23, 2008.

The acquisition was accounted for using the purchase method. The results of Virexx operations have been included in the Company's results since December 23, 2008, the date of acquisition.

The Company, using information currently available estimates the fair value of the contingent consideration described above to be $nil. The total purchase price of $1,446 was allocated to the fair value of the net assets acquired in the amount of $7,951, representing negative goodwill in the amount of the excess of $6,505. The Company, as per applicable accounting standards, eliminated the value previously assigned to certain prescribed assets in the amount of $2,433 against the excess of the amounts assigned to assets acquired and liabilities assumed over the cost of the purchase above. The remaining excess is presented as an extraordinary gain in the amount of $4,072. The purchase price was preliminarily allocated as follows:

Purchase price allocation	$
Cash	27
Future income tax asset	6,056
Current liabilities	(565)
	5,518
Consideration represented by:	
Cash paid	1,446
Extraordinary gain (net of $nil taxes)	**4,072**

The Company is in the process of finalizing the purchase price allocation and will be completed during 2009.

5. Related party transactions

Joddes Limited ["Joddes"], a private Canadian corporation, is a significant shareholder holding approximately 42% 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 and selling 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 for a total remaining committed amount of $832 as at March 31, 2009 and is included in the purchase and service based commitments in Note 6.

The Company also holds contractual royalty agreements with a wholly-owned subsidiary of Joddes for certain legacy and over-the-counter products. The terms of these arrangements vary whereby the Company may earn a royalty fee based on certain established terms relating to the

5. Related party transactions (cont'd)

net sales of the respective products such as through a percentage of net sales, certain guaranteed minimum annual payments, or as a percentage of a defined product contribution.

Effective November 1, 2006, the Company acquired the Canadian distribution rights to Metadol® from a wholly-owned subsidiary of Joddes for cash consideration of $15,000. 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, 2009, the Company has not received or earned any reimbursement. The acquisition of the Canadian distribution rights to Metadol® was not in the normal course of operations and was recorded at an agreed upon exchange amount in accordance with the requirements of accounting standard CICA 3840.

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 March 31	
	2009	2008
	$	$
Revenues	**889**	733
Purchases	**1,570**	2,849
Selling and marketing	**1,239**	913
Research and development	**133**	122
General and administrative	**121**	91

6. 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 10% to 20% of sales, or generally require payments for products at rates ranging from 20% to 40% of the net selling price and in certain cases require revenue sharing at various rates over and above a pre-established net sales threshold.

In addition, the Company may have to pay up to $22,018 including US$17,472 if it achieves specific sales volumes on specific products in the future, over a maximum of nine years.

6. Commitments (cont'd)

Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties in the amount of $4,764 including US$150 and €1,208 over the next five 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 $5,306, including US$1,511 and GB£500, over a maximum period of 15 years.

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 $39,115, including US$4,526 and €4,645, to retain exclusive distribution agreements for certain products. These commitments end in 2015 and annual commitments are as follows:

	$
2009	10,113
2010	14,583
2011	6,837
2012	2,216
2013	2,204
2014 – 2015	3,162

7. Financial Instruments

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.

The classification of financial instruments and their respective carrying values and fair values were as follows:

7. Financial Instruments (cont'd)

March 31, 2009	Available-for-sale	Held-to-maturity	Loans and receivables	Other financial liabilities	Derivatives	**Carrying value**	**Fair value**
	$	**$**	**$**	**$**	**$**	**$**	**$**
Financial assets							
Cash	12,439					**12,439**	**12,439**
Marketable securities	18,093					**18,093**	**18,093**
Accounts receivable			17,751			**17,751**	**17,751**
Other current assets			161			**161**	**161**
Long-term marketable securities	1,959					**1,959**	**1,959**
Investments	1,886		1,185		953	**4,024**[4]	**4,462**
Total financial assets	**34,377**	**—**	**19,097**	**—**	**953**	**54,427**	**54,865**
Financial liabilities							
Accounts payable and accrued liabilities				15,074		**15,074**	**15,074**
Accounts payable to related parties				1,025		**1,025**	**1,025**
Balance of sale payable				10,526		**10,256**	**10,526**
Total financial liabilities	**—**	**—**	**—**	**26,625**	**—**	**26,625**	**26,625**

December 31, 2008	Available-for-sale	Held-to-maturity	Loans and receivables	Other financial liabilities	Derivatives	**Carrying value**	**Fair value**
	$	**$**	**$**	**$**	**$**	**$**	**$**
Financial assets							
Cash	4,646					**4,646**	**4,646**
Marketable securities	14,753					**14,753**	**14,753**
Accounts receivable			17,889			**17,889**	**17,889**
Other current assets			158			**158**	**158**
Long-term marketable securities	1,943					**1,943**	**1,943**
Investments	3,131		1,067		594	**4,792**[4]	**5,144**
Total financial assets	**24,473**	**—**	**19,114**	**—**	**594**	**44,181**	**44,533**
Financial liabilities							
Accounts payable and accrued liabilities				16,464		**16,464**	**16,464**
Accounts payable to related parties				1,384		**1,384**	**1,384**
Balance of sale payable				10,429		**10,429**	**10,429**
Total financial liabilities	**—**	**—**	**—**	**28,277**	**—**	**28,277**	**28,277**

[4] In accordance with Section 3855, certain Company investments in private companies included in the balance above, 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.

7. Financial Instruments (cont'd)

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. Fair values for marketable securities and investments classified "Available for sale" are obtained using quoted active market prices as such securities. In accordance with CICA 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 recoverable amount.

The carrying values of all financial instruments approximate their fair values, except for the fair values for the bifurcated conversion option of a secured convertible term note in a portfolio company classified as a derivative and certain warrants in a portfolio company that were 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.

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.

Concentration of credit risk and major customers

The Company's cash and cash equivalents, short-term and long-term investments are held through various institutions. 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 four months to eighteen months from the date of purchase. Marketable securities are all invested with large Canadian financial institutions.

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, 2009, two customers, a major wholesale distributor and a major retail chain, represented 28% and 16% of revenues, respectively [2008 – 28% and 15%]. As at March 31, 2009, two customers, a major wholesale distributor and a major retail chain, represented 32% and 13% of trade accounts receivable, respectively [2008 – 45% and 13%].

The following table provides further details on the Company's accounts receivable balances:

	March 31, 2009	December 31, 2008
	$	$
Accounts receivables	**21,741**	21,869
Allowance for product returns	**(3,820)**	(3,783)
Allowance for doubtful accounts	**(170)**	(197)
Total accounts receivable	**17,751**	17,889

7. Financial Instruments (cont'd)

The following table provides the change in the allowance for doubtful accounts and product returns for trade accounts receivable:

	$
Balance at December 31, 2008	**3,980**
Change in provision for doubtful accounts	(27)
Change in provision for product returns	37
Balance at March 31, 2009	**3,990**

The following table provides further details on trade accounts receivable past due but not provisioned:

	March 31, 2009	December 31, 2008
	$	$
Trade accounts receivables not passed due	**17,255**	15,132
Trade accounts receivables passed due and not provisioned		
Under 30 days	**3,856**	4,573
31 to 60 days	**460**	1,967
Over 60 days	**—**	—
Allowance for product returns	**(3,820)**	(3,783)
Total accounts receivable, net of allowance for doubtful accounts and product returns	**17,751**	17,889

Liquidity risk

The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. The Company has sufficient funds available through its cash and marketable securities, should its cash requirements exceed cash generated from operations to cover all financial liability obligations. As at March 31, 2009, 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 6, 9 and 10.

All financial liabilities are short term in nature.

Foreign exchange risk

The Company principally operates within Canada, however, a portion of the Company's revenues, expenses, and current assets and liabilities, are denominated in United States (US) dollars and EURO. This results in financial risk due to fluctuations in the value of the US dollar and EURO 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 significant balances in foreign currencies as at March 31, 2009 are as follows:

	U.S. dollars	EURO
	$	€
Cash	3,357	**—**
Accounts receivable	350	85
Accounts payable and accrued liabilities	(1,181)	**—**
Net Exposure	**2,526**	**85**

7. Financial Instruments (cont'd)

Based on the aforementioned net exposure as at March 31, 2009, and assuming that all other variables remain constant, a ten-point increase or decrease in the CAD/USD and CAD/EURO exchange rates would have an effect of $261 on net earnings.

Interest rate risk

The Company is subject to interest rate risk on its cash 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.

8. Comparative figures

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

9. Contingencies

On July 25, 2008, the Company received notices of re-assessment from the Canada Revenue Agency ("CRA") relating to the taxation years ending August 16, 2005 and July 31, 2006 containing adjustments relating to the use of certain non-capital losses acquired as part of the Dimethaid Health Care Ltd. (subsequently renamed Squire Pharmaceuticals Inc. "Squire") acquisition from Nuvo Research Inc. ("Nuvo"). In addition, on August 11, 2008, the Company received a notice of assessment from CRA for the taxation year ending July 31, 2007. The notices of assessment and re-assessment, if they stood, amount to additional Canadian federal tax due of approximately $5,558 plus interest and penalties of approximately $1,733. On October 30, 2008, the Company received a Notice of Reassessment from the Ontario Minister of Finance for the taxation year ended August 16, 2005 for additional taxes, due of $747 plus interest and penalties of $378. It is likely that the Quebec provincial tax authorities will propose similar adjustments as a result of the CRA re-assessments. As such the Company estimates the total tax liability exposure to the federal and relevant provincial governments as a result of the CRA's position to be approximately $11,157 including interest and penalties. The Company disagrees with the position taken by the CRA and believes it is without merit. On October 23, 2008, the Company filed a Notice of Objection through the CRA appeals process and intends to pursue further through the courts, if necessary. The Ontario Minister of Finance has agreed to be bound by the decision of the CRA appeals process.

Under the terms of the Share Purchase Agreement ("SPA") for Squire, Nuvo provided representations and warranties with respect to the status of the Squire tax accounts and certain tax asset values whereby, if the amounts represented are incorrect then Nuvo is required to indemnify the Company. The Company also holds indemnities from Nuvo relating to all costs relating to reassessment including advisory fees, interest and penalties, as applicable. In the event of an unfavorable ruling, the Company intends to claim at least $9,242 from Nuvo under the SPA. Nuvo has issued a Letter Agreement providing security over the indemnity obligations by entitling the Company to the benefit of security over certain assets and product revenue streams of Nuvo and certain of its subsidiaries.

9. Contingencies (cont'd)

Although the final resolution of the proposed adjustments is uncertain, based on currently available information, the Company has not provided for any amounts relating to this reassessment.

In connection with the appeals process, in the notice of re-assessment, the Company is required to post a deposit of up to one half of the tax and interest assessed. To that effect the Company deposited \$3,755 to the CRA and \$500 to the Ontario Minister of Finance during the year ended December 31, 2008, and may make a claim from Nuvo under the SPA.

If the Company is successful in its appeal of the re-assessment these amounts will be refunded to the Company with accrued interest.

Management currently believes that the resolution of this matter will not have a material effect on the Company's results of operations, financial position or liquidity. However, an unfavourable resolution with the CRA and the relevant provincial authorities combined with a failure of Nuvo to satisfy their obligations under the SPA, could have a material impact on the Company's results of operations, financial position and cash flows in the year in which an adjustment is recorded or the tax is due or paid.

10. Subsequent Event

On May 6, 2009, the Company entered into a Plan of Arrangement Agreement with Isotechnika Inc. ("Isotechnika") (TSX:ISA) to acquire 100% of the common shares of Isotechnika including the intellectual property relating to Canada and certain other strategic markets of interest to the Company for \$7,000 at closing and up to \$4,350 over a subsequent twelve-month period post closing. These agreements are subject to court, regulatory and Isotechnika shareholder approval.

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