

PALADIN LABS INC.
CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010



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 June 30, 2010 and compares these unaudited quarterly results to those of the quarter ended June 30, 2009. 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 August 4, 2010 and as at this date 18,729,999 shares and 1,363,714 options were issued and outstanding. Reference to "Paladin" or the "Company" includes Paladin Labs Inc. and all its subsidiaries including the acquisition of Isotechnika Inc. ("Isotechnika") as of June 18, 2009, the effective date of the acquisition, further described in note 6 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, 2009. 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.

Second quarter highlights:

- Revenues reached \$32,936, an increase of 26% over the same period last year
- Net income before extraordinary gain was \$4,685, an increase of 165% over the same period last year
- Cash flows from operations reached \$15,111, a 34% increase over the same period last year
- EBITDA¹ was \$13,656, an increase of 62% over the same period last year
- Obtained approval from Health Canada for Seasonique[®], a next generation extended-cycle oral contraceptive for the prevention of pregnancy

Paladin's revenues are principally derived from sales of pharmaceutical products to large pharmaceutical wholesalers and chain pharmacies. The Company's expenses have been comprised primarily of cost of goods sold (including royalty payments to those companies from whom Paladin licenses its products), selling, marketing and administrative expenses and research and development expenses. In addition, a substantial portion of the Company's expenses are related to amortization of the pharmaceutical product licenses and rights the Company acquires.

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 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, foreign exchange gains (losses), share of net income in companies subject to significant influence 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 statements 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 on 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 pharmaceutical product licenses and rights, 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 2009 Annual Report. There have been no material changes to accounting estimates since December 31, 2009.

New Accounting Standards and Disclosure Changes

Effective January 1, 2010, the Company adopted the following recently introduced Canadian Institute of Chartered Accountants (“CICA”) Handbook Sections:

Section 1582, *Business Combinations*. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. The initial application of this standard did not have a significant impact on the Company's consolidated financial statements.

Section 1601, *Consolidated Financial Statements*. This section establishes the standards for preparing consolidated financial statements. The initial application of this standard did not have a significant impact on the Company's consolidated financial statements.

Section 1602, *Non-controlling Interests*, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. These changes did not have any impact on the Company's consolidated financial statements as the Company owns 100% of its current subsidiaries.

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 interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011. The Company will implement these standards on January 1, 2011. The AcSB also stated that, during the transition period, companies will be required to provide comparative figures in accordance with IFRS. For the year ended December 31, 2010, the Company will be providing readers a reconciliation of current CICA GAAP to IFRS accounting standards. It is important to note that under IFRS there is

significantly more disclosure required. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy that must be addressed.

The Company's IFRS changeover plan is progressing according to expectations. The Company continues to monitor standards to be issued by the IASB but it is difficult to predict the IFRS that will be in effect at the end of the Company's first IFRS reporting period as the IASB work plan anticipates the completion of several projects in calendar years 2010 and 2011. The Company will provide updates as further progress is achieved and conclusions are reached.

IFRS 1 "First time adoption of international financial reporting standards" requires that first-time adopters select accounting policies that comply with each IFRS effective at the end of its first IFRS reporting period, December 31, 2011 for the Company, and apply those policies to all periods presented in its first IFRS financial statements. IFRS 1 also provides certain optional exemptions to the full retrospective application. The following are the Company's conclusions with respect to the key IFRS 1 optional exemptions:

- Business combinations – the Company will apply the new standard only to business combinations that have occurred after the transition date, without restatement of prior business combinations.
- Property, plant and equipment and pharmaceutical product licenses and rights – the Company will use the historical cost method for capital assets and pharmaceutical product licenses and rights.
- Share-based payments - the Company will not restate any of its existing stock options which have been fully vested before January 1, 2010.

Based on the Company's assessment of current IFRS, the Company has not identified any significant balance sheet items or any significant differences in the recording of the Company's revenues and expenses that would be materially impacted by the application of IFRS standards. Continued progress is necessary before we can increase the specificity of the disclosure of the impacts of IFRS.

Pursuant to the Canadian Securities Administrators Staff Notice 52-320, Disclosure of Expected Changes in Accounting Policies Relating to Changeover to IFRS, the Company is presenting below the progress towards the completion to our changeover plan.

	KEY ACTIVITIES	MILESTONES / DEADLINES	PROGRESS TO DATE
Accounting policies and financial statement preparation	Identify relevant differences between IFRS and the Company's accounting policies and practices and design and implement solutions; Evaluate and select one-time and ongoing accounting policy alternatives; Benchmark findings with peer companies; Prepare financial statements and related note disclosures to comply with IFRS; Quantify the effects of changeover to IFRS;	Assessment and quantification of the significant effects of the changeover to be completed during 2010; Final selection of accounting policy alternatives by the changeover date;	Identification of IFRS differences completed by management and reviewed by third-party experts under way; Evaluation and selection of accounting policy alternatives is ongoing; Third-party experts are assisting in the transition; Analysis, subject to the impact of the proposed IFRS standards, is underway; Impact quantification is underway;
Information technology and data systems	Identify and address IFRS differences that require changes to financial systems; Evaluate and select methods to address need for dual record-keeping during 2010 (i.e. IFRS and Canadian GAAP) for comparatives, budget and planning purposes in 2011;	Changes to significant systems and dual record-keeping process completed in time for the first quarter of 2010;	No IFRS differences with significant system impacts have been identified to date; Dual record-keeping solution design and tracking is in progress;
Internal control over financial reporting (ICFR)	Revise existing internal control processes and procedures to address significant changes to existing accounting policies and practices, including the need for dual record-keeping in 2010; Design and implement internal controls with respect to one-time changeover adjustments and related communications;	Changes completed by the first quarter of 2010. Conduct management evaluation of new or revised controls throughout 2010; Update the Chief Executive Officer/Chief Financial Officer certification process by fourth quarter of 2010;	Monitoring design of solutions to address IFRS differences to permit concurrent design or revision and implementation of necessary internal controls;
Disclosure controls and procedures (DC&P)	For changes to accounting policies and practices identified, assess the DC&P design and effective implementation;	See ICFR deadlines above;	MD&A disclosures are ongoing;
Training and communication	Provide training to employees and management; Communicate progress of changeover plan to internal and external stakeholders;	Timely training provided to align with work under changeover – to be completed during 2010; Communicate effects of changeover for 2011 financial planning process, by the third quarter of 2010;	Selected training for employees directly engaged in the changeover and general awareness to broader group of finance employees; Periodic internal and external communications about our progress are ongoing;
Business activities	Identify impact of changeover on contractual arrangements, including customer and supplier agreements and employee compensation plans; Make any required changes to arrangements and plans;	Changes to be completed by third quarter of 2010;	No potential impact identified to date;

Results of Operations

Three-month period ended June 30, 2010 compared to three-month period ended June 30, 2009, and six-month period ended June 30, 2010 compared to six-month period ended June 30, 2009.

Revenues

Revenues increased \$6,711 or 26% to \$32,936 for the three-month period ended June 30, 2010 from \$26,225 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, revenues increased \$11,733 or 23% to \$63,773 from \$52,040 for the six-month period ended June 30, 2009. Incremental revenues from products acquired in 2009 contributed \$1,518 for the quarter ended June 30, 2010 and \$3,078 for the six-month period ended June 30, 2010. Furthermore, during the six-month period ended June 30, 2010, an amount of \$1,668 (2009 - \$1,693) previously recorded in deferred revenue was recognized into revenue in accordance with the Company's revenue recognition policy.

The increase in revenues for the three and six-month periods ended June 30, 2010 is also attributable to the sales growth of certain significant promoted products, including Tridural[®], Trelstar[®], Testim[®], Metadol[®] and Plan B[®], which combined increased by 29% and 32% for the quarter and six-month period ended June 30, 2010, respectively.

Subsequent to the quarter ended June 30, 2010, a generic version of Pennsaid[®] was approved in Canada, however, it is not yet known if or when this generic version of Pennsaid[®] will be sold in the Canadian market. Should this generic version of Pennsaid[®] commercially launch, the sales of Pennsaid[®] would decline significantly.

Product revenues highlights for the Company's most significant promoted products using IMS Canada data² for the three-month and six-month periods ended June 30, 2010 are as follows:

Promoted Products	Three-month period ended June 30		Six-month period ended June 30	
	Sales per IMS Canada in 2010	% change vs. 2009	Sales per IMS Canada in 2010	% change vs. 2009
	\$		\$	
Tridural [®]	2,654	12%	5,068	16%
Trelstar [®]	1,318	65%	2,358	81%
Testim [®]	798	55%	1,510	54%
Metadol [®]	2,225	10%	4,442	13%
Plan B [®]	2,426	11%	4,678	13%
Total	9,421	20%	18,056	23%

Gross Profit

Total gross profit increased \$4,819 or 26% to \$23,691 for the three-month period ended June 30, 2010 from \$18,872 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, gross profit increased \$7,431 or 19% to \$45,748 from \$38,317 for the same period last year. Gross profit, as a percentage of revenues, remained steady at 72% for the quarter ended June 30, 2010 compared to the same period last year. For the six-month period ended June 30, 2010, gross profit as a percentage of revenues decreased to 72% from 74% for the same period ended last year. The decrease in gross profit as a percentage of revenues for the six-month period ended June 30, 2010 is mainly the result of the effect of reduced margins on the Company's product mix as a result of growth in certain promoted products.

Selling and Marketing Expense

Selling and marketing expense decreased \$1,470 or 21% to \$5,414 for the three-month period ended June 30, 2010 from \$6,884 for the three-month period ended June 30, 2009. For the six-month period ended

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.

June 30, 2010, selling and marketing decreased \$1,194 or 10% to \$11,202 from \$12,396 for the six-month period ended June 30, 2009. Selling and marketing expense, as percentage of revenues, decreased to 16% for the quarter ended June 30, 2010 compared to 26% for the same period last year. For the six-month period ended June 30, 2010, selling and marketing expense, as a percentage of revenues decreased to 18% from 24% for the same period last year. The decrease in selling and marketing expenses is mainly the result of certain sales streamlining efforts, the reduction of promotional spend for certain mature products and the Company's growth in non-promoted product revenue during the quarter and six-months ended June 30, 2010. The promotional activities driving selling and marketing costs primarily relate to Paladin's continued promotional activities for Tridural[®], Plan B[®], Metadol[®], Trelstar[®], and Testim[®].

General and Administrative Expense

General and administrative expense slightly increased \$26 or 1% to \$2,439 for the three-month period ended June 30, 2010 from \$2,413 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, general and administrative expense increased \$395 or 9% to \$4,726 from \$4,331. General and administrative expense, as percentage of revenues, decreased to 7% for the quarter ended June 30, 2010 compared to 9% for the same period last year. For the six-month period ended June 30, 2010, general and administrative expense, as a percentage of revenues decreased to 7% from 8% for the same period last year. The increase in general and administrative expenses in dollar terms for the six-month period end June 30, 2010, is primarily the result of the Pharmaplan (Pty) Ltd. acquisition related costs expensed in accordance with recently adopted accounting standards.

Research and Development Expense

Research and development expense increased \$1,417 or 113% to \$2,675 for the three-month period ended June 30, 2010 from \$1,258 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, research and development expense increased \$2,891 or 115% to \$5,412 from \$2,521 for the six-month period ended June 30, 2009. Research and development expense as a percentage of revenues, increased to 8% for the quarter ended June 30, 2010 compared to 5% for the quarter ended June 30, 2009. For the six-month period ended June 30, 2010, research and development expense as a percentage of revenues increased to 9% from 5% for the same period last year. The increase for the quarter and six-month periods ended June 30, 2010 primarily relates to the on-going research and development efforts at IsoPharma, as further described in note 6 to the quarterly unaudited consolidated financial statements and incremental research and development expenses related to Paladin Biosciences advancements. In addition to the above, the research activities driving research and development expense include managing 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.

Interest Income

Interest income increased \$400 or 430% to \$493 for the three-month period ended June 30, 2010 from \$93 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, interest income increased \$502 or 172% to \$794 from \$292 for the six-month period ended June 30, 2009. The increase for the quarter and six-month period ended June 30, 2010 is primarily the result of the additional interest earned on the Company's investment in a portfolio company in the form of a convertible debenture acquired during the quarter ended March 31, 2010. Furthermore, the Company held higher average daily cash and marketable securities balances and earned a higher effective rate of return over the three and six-month periods ended June 30, 2010 compared to the same comparative periods last year.

Amortization of Pharmaceutical Product Licenses and Rights

Amortization expense increased \$99 or 2% to \$6,071 for the three-month period ended June 30, 2010 from \$5,972 for the same period last year. For the six-month period ended June 30, 2010, amortization expense increased \$277 or 2% to \$12,341 from \$12,064 for the same period last year. The increase in amortization expense for both the three and the six-month periods ended June 30, 2010 is the result of the amortization related to the Company's recently acquired pharmaceutical product licenses and rights partially offset by a reduction in amortization expense for certain pharmaceutical product licenses and rights having reached full amortization during the periods.

Net Gain on Investments

During the six-month period ended June 30, 2010, the Company disposed of certain shares held in a portfolio company for proceeds of \$27, representing a gain of \$7.

During the three-month period ended June 30, 2009, the Company disposed of certain shares held in a portfolio company for proceeds of \$772, representing a gain of \$153. The Company also exercised its right to convert a convertible term note in this same portfolio investment into common shares subsequently selling such shares in the public market for \$3,168 and realizing a gain of \$1,000. Furthermore, during the quarter, the Company also exercised its right to convert warrants in a portfolio investment discussed below into common shares and subsequently disposed such shares for proceeds of \$304, representing a gain of \$133. During the same period, the Company as part of its on-going assessment of investment carrying values determined the investment in a private company, to be permanently impaired and recorded a write-down in the amount of \$801, resulting in a net gain on investments in the amount of \$485 for the quarter ended June 30, 2009.

During the six-month period ended June 30, 2009, in addition to the above, the Company disposed of shares held in a portfolio company for proceeds of \$568, representing a gain of \$62. In addition, during the six-month period ended June 30, 2009, Endo Pharmaceuticals Inc. (“Endo”) acquired Indevus Pharmaceuticals Inc. (“Indevus”) for \$4.50 per Indevus share in cash and up to an additional \$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 a \$416 contingent right 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 \$4.50 cash payment received over a 31 day trading period on NASDAQ. Moreover, in accordance with Section 3856, the Company used the Black-Scholes option pricing model to re-measure the fair value of the conversion option on a secured convertible term note investment in a portfolio company recognizing a gain on the conversion option of \$344 for the six-month period ended June 30, 2009. During the same period, the Company recognized a gain on warrants in a portfolio company of \$15, resulting in a net gain on investments in the amount of \$492 for the six-month periods ended June 30, 2009.

Foreign Exchange (Gain) Loss

During the three-month period ended June 30, 2010, the Company recorded a foreign exchange gain of \$119 [2009 – gain of \$18] mainly as a result of the strengthening of the Canadian dollar relative to the US dollar and Euro and its impact on a EURO denominated investment as well as on the Company’s net monetary position in these currencies for the quarter ended June 30, 2010.

During the six-month period ended June 30, 2010, the Company recorded a foreign exchange loss of \$201 [2009 – loss of \$4], respectively, mainly as a result of the weakening of the Canadian dollar relative to the US dollar and Euro and its impact on a EURO denominated investment as well as on the Company’s net monetary position in these currencies for the six-month period ended June 30, 2010.

Share of Net Income in Companies Subject to Significant Influence

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan (Pty) Ltd. (“Pharmaplan”), a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the transaction, March 16, 2010. The investment was initially recorded at cost and adjustments are made to include the Company’s share of Pharmaplan’s net income. The Company’s share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company’s acquired share of Pharmaplan’s net identifiable assets. Paladin’s share of Pharmaplan’s net income for the three-month period ended June 30, 2010 was \$335 (net of \$290 amortization of fair value adjustments) compared to \$nil for the same period last year. Paladin’s share of Pharmaplan’s net income for the period between the acquisition date, March 16, 2010 and June 30, 2010, amounted to \$466 (net of \$360 amortization of fair value adjustments) compared to \$nil for the same period last year.

Income Tax Expense

Income tax expense increased \$2,115 or 165% to \$3,395 for the three-month period ended June 30, 2010 from \$1,280 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, income tax expense increased \$2,372 or 77% to \$5,444 from \$3,072 for the six-month period ended June 30, 2009. For the three and six-month periods ended June 30, 2010, the effective tax rate was 42% and 41%, respectively, compared to 42% and 39% for the three and six-month period ended June 30, 2009. These increases in effective tax rates are principally due to increases in permanent differences in comparison to the previous periods, mainly capital losses not deductible for tax purposes. 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	68,689	33,600	2013-2028
Provincial	56,749	21,660	2013-2028
Scientific Research and Experimental Development expenditures			
Federal	75,387	61,799	N/A
Provincial	75,492	61,936	N/A
Investment tax credits			
Federal	21,941	14,883	2017-2030

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.

During the quarter ended March 31, 2010, in connection with the Company's previously disclosed tax contingency, the Company received notices of re-assessment from the Canada Revenue Agency ("CRA") and the Ontario Minister of Finance ("OMF") reversing their original position on 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").

As previously disclosed, on various dates during fiscal 2008 and 2009 the Company had received notices of re-assessment from the CRA relating to the taxation years ending August 16, 2005, July 31, 2006, July 31, 2007, and December 31, 2008 and from the OMF for the taxation year ended August 16, 2005, containing adjustments relating to the use of certain non-capital losses. The notices of assessment and re-assessment, if they had stood as a result of the CRA's position, amounted to a total tax liability exposure to the federal and relevant provincial governments of approximately \$11,625 including interest and penalties. The Company filed a Notice of Objection through the CRA appeals process on October 23, 2008. Furthermore, the Company, under the terms of the Share Purchase Agreement ("SPA") for Squire with Nuvo holds indemnities with respect to the status of the Squire tax accounts and certain tax asset values the Company as well as all costs relating to reassessment including advisory fees, interest and penalties, as applicable. In addition, Nuvo had issued additional 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.

In connection with the appeals process, during the years ended December 31, 2009 and 2008, the Company had posted a deposit of \$3,752 to the CRA and \$500 to the OMF, representing up to one half of the tax and interest assessed. In addition, during the year ended December 31, 2009, the Company issued from its revolving unsecured credit facility, a bank guarantee in the amount of \$720 to the OMF. As a result of the Company's success in the appeal process, an amount of \$3,936 was received from the CRA on January 20, 2010 and an amount of \$524 was received from OMF during the second quarter of 2010, representing a refund for the full amount of the deposits above, along with accrued interest in the amount of \$208. In addition, the bank guarantee previously issued to the OMF expired on February 1, 2010 without being drawn-down by the OMF.

Net Income before Extraordinary Gain

Due to the factors set forth above, net income before extraordinary gain increased \$2,914 to \$4,685 for the three-month period ended June 30, 2010 compared to net income of \$1,771 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, net income before extraordinary gain increased \$2,907 to \$7,730 from \$4,823 for the six-month period ended June 30, 2009.

Extraordinary Gain (net of \$nil taxes)

On June 18, 2009, the Company acquired all the issued and outstanding shares of Isotechnika Inc. ("Isotechnika")(TSX:ISA) in accordance with a court supervised Plan of Arrangement whereby the Company paid \$7,594 in cash, and Isotechnika entered into a research and development agreement with Isotechnika Pharma Inc. ("IsoPharma") in exchange for supporting research and development services for the commercialization of voclosporin, Isotechnika's next-generation calcineurin inhibitor, in Canada, Mexico, Central & South America, Israel and South Africa ("Paladin-acquired territories"). The total purchase price of \$14,147 was allocated to the fair value of the net assets acquired in the amount of \$47,204, representing negative goodwill in the amount of the excess of \$33,057. The Company, as per applicable accounting standards, eliminated the value previously assigned to certain prescribed assets in the amount of \$7,098 against the excess of the amounts assigned to assets acquired and undiscounted liabilities assumed over the cost of the purchase above. The remaining excess was presented as an extraordinary gain in the amount of \$25,959. The Company refers the reader to note 6 of the interim unaudited consolidated financial statements, for further details regarding the acquisition.

Net Income

Due to the factors set forth above, net income decreased \$23,045 to \$4,685 for the three-month period ended June 30, 2010 compared to net income of \$27,730 for the three-month period ended June 30, 2009. For the six-month period ended June 30, 2010, net income decreased \$23,052 to \$7,730 from \$30,782 for the six-month period ended June 30, 2009.

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 June 30, 2010, 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 9 to the unaudited interim consolidated financial statements.

The Company has a one-year \$5,000 revolving unsecured credit facility in place with one of its bankers maturing on July 28, 2011. The credit facility may be used for general corporate purposes including financing acquisitions and has been drawn down in the form of security in the amount of \$2,000 mainly to enter into a foreign currency derivative transaction in order to hedge a certain foreign exchange position.

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.

	Three-month period ended		Six-month period ended	
	June 30		June 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
Cash flows from operating activities	15,111	11,262	25,494	19,585
Cash flows used in investing activities	(48,862)	(48,926)	(44,503)	(49,586)
Cash flows from financing activities	639	56,561	1,410	56,749
Foreign exchange rate change on cash and cash equivalents	29	18	11	(39)
Net change in cash position	33,083	18,915	17,588	26,709
Cash and cash equivalents, beginning of period	46,722	12,439	31,227	4,645
Cash and cash equivalents, end of period	13,639	31,354	13,639	31,354
Short and long-term marketable securities, end of period	88,899	59,925	88,899	59,925
Cash, cash equivalents and marketable securities, end of period	105,538	91,279	105,538	91,279

Paladin's cash, cash equivalents and marketable securities increased \$169 to \$105,538 at June 30, 2010 from \$105,369 at December 31, 2009. This increase is primarily a result of the Company's cash flows generated from operating activities in the amount of \$25,494 and common shares issued for cash in the amount of \$1,410 partially offset by the acquisition of investments in the amount of \$24,995 and by a partial repayment of a balance of sale payable in the amount of \$1,650. Working capital (current assets less current liabilities) decreased \$12,949 to \$97,507 at June 30, 2010 from \$110,456 at December 31, 2009 primarily due to the decrease in the cash, cash equivalents and marketable securities explained above.

Cash flows from operating activities increased 34% or \$3,849 to \$15,111 for the three-month period ended June 30, 2010 from \$11,262 for the three-month period ended June 30, 2009. Cash flows from operating activities for the six-month period ended June 30, 2010 were \$25,494 compared to \$19,585 for the six-month period ended June 30, 2009. 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, foreign exchange (gains) losses, share of net income from associates, gains (losses) on investments and derivative instruments and accreted interest.

Cash flows used in investing activities were \$48,862 compared to \$48,926 for the three-month periods ended June 30, 2010 and 2009, respectively. During the three-month period ended June 30, 2010, the Company invested \$48,452 towards the acquisition of short and long-term marketable securities net of cash flows generated by maturing marketable securities, \$383 towards the acquisition of investments and \$27 towards the acquisition of property, plant and equipment. During the quarter ended June 30, 2009, the Company invested \$39,890 towards the acquisition of short and long-term marketable securities net of cash flows generated by maturing marketable securities, \$5,475 towards the acquisition of pharmaceutical product licenses and rights, \$7,594 for the business acquisition of Isotechnika Inc. further described in note 6 to the unaudited interim consolidated financial statements, \$130 towards the acquisition of investments and \$81 for the acquisition of property, plant and equipment, partially offset by proceeds from disposal of investments in portfolio companies in the amount of \$4,244.

Cash flows used in investing activities were \$44,503 compared to \$49,586 for the six-month periods ended June 30, 2010 and 2009, respectively. During the six-month period ended June 30, 2010, the Company invested \$24,995 towards the acquisition of investments, \$17,836 for the acquisition of short and long-term marketable securities net of cash flows generated by maturing marketable securities, \$1,650 towards a partial repayment of a balance of sale payable and \$49 for the acquisition of property, plant and equipment, partially offset by proceeds from disposal of investments in the amount of \$27. During the six-month period ended June 30, 2009, the Company invested \$43,256 towards the acquisition of short and long-term marketable securities net of cash flows generated by maturing marketable securities, \$5,476 for the acquisition of pharmaceutical product licenses and rights, \$7,594 for the business acquisition of Isotechnika

Inc. further described in note 4 to the unaudited interim consolidated financial statements, \$130 towards the acquisition of investments and \$109 for the acquisition of property, plant and equipment, partially offset by proceeds from disposal of investments in portfolio companies in the amount of \$6,979.

Cash flows from financing activities were \$639 compared to \$56,561 for the three-month periods ended June 30, 2010 and 2009, respectively. During the quarter ended June 30, 2010, the cash flows from financing activities represent proceeds from stock option exercises and the issuance of common shares under the stock purchase plan for cash. During the quarter ended June 30, 2009, the Company issued 3,450,000 common shares through a bought deal share offering at a price of \$17.00 per common share for total gross proceeds to the Company in the amount of \$58,650. In conjunction with the offering the Company incurred share issue costs of approximately \$2,826 for total net proceeds amounting to \$55,824. In addition, an amount of \$737 was generated from stock option exercises and the issuance of common shares under the stock purchase plan for cash.

Cash flows from financing activities were \$1,410 compared to \$56,749 for the six-month periods ended June 30, 2010 and 2009, respectively. During the six-month period ended June 30, 2010, the cash flows from financing activities represent proceeds from stock option exercises and the issuance of common shares under the stock purchase plan for cash. During the six-month period ended June 30, 2009, the Company issued 3,450,000 common shares through a bought deal share offering at a price of \$17.00 per common share for total gross proceeds to the Company in the amount of \$58,650. In conjunction with the offering the Company incurred share issue costs of approximately \$2,826 for total net proceeds amounting to \$55,824. In addition, an amount of \$925 was generated from stock option exercises and the issuance of common shares under the stock purchase plan for cash.

Acquisition of Isotechnika Inc.

On June 18, 2009, the Company acquired all the issued and outstanding shares of Isotechnika (TSX:ISA) in accordance with a court supervised Plan of Arrangement. As part of the transaction the Company paid \$7,594 in cash and Isotechnika entered into a collaborative research and development agreement with IsoPharma in exchange for supporting research and development services for the commercialization of voclosporin, Isotechnika's next-generation calcineurin inhibitor, in Canada, Mexico, Central & South America, Israel and South Africa ("Paladin-acquired territories"). The research and development services extend for a period of seven years and included an amount of \$4,350 payable by the Company to IsoPharma over 12 months following the acquisition and expensed as incurred over this same 12 month period. Furthermore, the Research and Development Agreement in conjunction with the Company's Licence Agreement for voclosporin in the Paladin acquired territories, contains certain other voclosporin research, development and commercialization payment arrangements including possible licensing and royalty revenue payments over the remaining period. During the quarter ended June 30, 2010, the Company has expensed \$988 with respect to these research and development services and has fully paid the \$4,350 above as at June 30, 2010.

As part of the acquisition, the Company also received the international rights to a portfolio of products under development and a commercialized diagnostic product portfolio. The Company had also assumed an obligation to pay out certain future contractually pre-defined amounts relating to the commercialization of the diagnostic product portfolio over a period of seven years, estimated to amount to approximately \$5,950 at the time of acquisition (the "contingent balance of sale payable"). This estimated amount was determined based upon the historical sales of the products, current expenditure levels and market conditions and was payable over a seven-year period pursuant to its Research and Development Agreement and represented management's best estimate of this liability at the time of acquisition. It was considered reasonably possible that changes in future conditions could require a material change in the recognized amount. On December 31, 2009, the Company entered into an Amended Agreement with IsoPharma to settle the contingent balance of sale payable for a total amount of \$1,991, of which \$1,650 was paid on February 26, 2010 and the remainder in the amount of \$341, representing the discounted present value on December 31, 2009, is payable on January 31, 2011 if certain conditions are met. This settlement resulted in an adjustment to the extraordinary gain recorded upon acquisition in the amount of \$3,458 which has been recorded in accordance with related party accounting standards (see note 8 to the the interim unaudited consolidated financial statements for additional information). The Company had originally

recorded an extraordinary gain in the amount of \$25,959 upon the acquisition of Isotechnika which in conjunction with the settlement above results in an aggregate extraordinary gain of \$29,417 for the year ended December 31, 2009.

As at June 30, 2010, the Company is carrying a balance of sale payable to Isotechnika in the amount of \$346.

Isotechnika is an international biopharmaceutical company dedicated to the discovery, development and commercialization of novel immunosuppressive therapeutics for the treatment of autoimmune diseases and for use in the prevention of organ rejection in transplantation. In addition to the Company's drug pipeline, Isotechnika also has commercialized diagnostic products. Isotechnika was subsequently wound up into the Company on October 1, 2009. Furthermore, as part of the purchase price, the Company received 24,921,312 common shares, representing a 19 percent interest in IsoPharma as at the date of acquisition, with an approximate value of \$4,348 using the weighted average trading price of the common shares on the TSX for the 20 trading days pre and post acquisition (\$5,732 as at June 30, 2010).

The results of Isotechnika's operations have been included in the Company's results since June 18, 2009, the effective date of acquisition. The Company accounts for its investment in IsoPharma using the equity method of accounting. As per applicable accounting standards, the Company eliminated the value assigned to its investment in common shares of IsoPharma against the excess ("negative goodwill") of the amounts assigned to assets acquired and undiscounted liabilities assumed over the cost of the total purchase price. As a result the Company's investment in IsoPharma has a carrying value of \$nil effective June 18, 2009. Since the Company's acquisition, IsoPharma has incurred net losses from operations. As the Company is not committed to make further capital contributions to IsoPharma, the Company has not recorded its share of IsoPharma's net loss since acquisition as per applicable accounting standards. The Company refers the reader to note 6 of the interim unaudited consolidated financial statements, for further details regarding the acquisition.

Equity investment in Pharmaplan

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan (Pty) Ltd. ("Pharmaplan"), a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan in the amount of \$2,879. In addition, the Company has committed to additional future consideration by increasing its ownership position by 5% per year over the next 3 years to 49.99%, with such additional consideration based upon Pharmaplan's future financial results.

The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the acquisition, March 16, 2010. The investment was initially recorded at cost and adjustments are made to include the Company's share of Pharmaplan's net income. The Company's share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company's share of net identifiable assets of Pharmaplan acquired.

The total cost was allocated to the Company's share of net identifiable assets acquired on the basis of their fair values using the purchase method of accounting. The purchase price allocations are preliminary and are subject to changes once the final valuation of the net identifiable assets acquired has been made. The preliminary allocation of the cost of the investment in Pharmaplan over the underlying net book value of assets acquired amounted to \$13,496 as at March 16, 2010, and represents definite life intangible assets (consisting mainly of exclusive distribution licenses) of \$10,665, indefinite life intangible assets of \$278, future income tax liabilities of \$3,064 and incremental goodwill of \$5,617.

The Company is in the process of finalizing the purchase price allocation which will be completed during 2010.

	\$
Investment in Pharmaplan, March 16, 2010	15,982
Share of net income for the period	201
Amortization of fair value adjustments	(70)
Investment in Pharmaplan, March 31, 2010	16,113
Share of net income for the period	625
Amortization of fair value adjustments	(290)
Investment in Pharmaplan, June 30, 2010	16,448

The Company is presenting selected financial information derived from Pharmaplan's unaudited financial statements using South African GAAP translated into Canadian GAAP for information purposes.

Pharmaplan's statement of income data	Three-month period ended	106 days period ended
(unaudited)	June 30, 2010	June 30, 2010
	\$	\$
Revenues	10,131	12,640
Cost of sales	4,518	5,664
Gross profit	5,613	6,976
Operating expenses	3,057	3,619
Earnings before under-noted items	2,556	3,357
Interest, depreciation and income taxes	770	996
Net income	1,786	2,361

Pharmaplan's balance sheet data	June 30, 2010	March 16, 2010
(unaudited)	\$	\$
Total assets	16,826	16,117
Total liabilities	7,209	9,009

Related Party Transactions

Joddes Limited ["Joddes"], a private Canadian corporation, is a significant shareholder holding approximately 37% 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 and selling 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 \$620 as at June 30, 2010 and is included in the purchase and service based commitments amount in Contractual Obligations and Commitments below.

The Company has also entered into 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 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 June 30, 2010, 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.

The Company owns a 19 percent interest in the common shares of IsoPharma and considers this investment a related party. The Company, in conjunction with the business combination discussed in note 6 to the interim unaudited consolidated financial statements, settled with IsoPharma on December 31, 2009 the balance of sale contingently payable over a seven-year period for an amount of \$1,991, of which \$1,650 was paid on February 26, 2010 and \$341, representing the discounted present value on December 31, 2009, is payable on January 31, 2011 if certain conditions are met. This transaction 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. Furthermore, the Company is committed to a milestone payment with IsoPharma, as further discussed in note 9, in the amount of \$400 that is included in the Contractual Obligations and Commitments paragraph below.

All transactions with related parties, except for the Metadol[®] and IsoPharma transactions 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 are on normal commercial terms and conditions and are non-interest bearing.

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

	Three-month period ended June 30		Six-month period ended June 30	
	2010 \$	2009 \$	2010 \$	2009 \$
Revenues	1,017	992	2,081	1,881
Purchases	2,933	1,683	7,095	3,254
Sales and marketing expenses	1,818	1,433	3,357	2,672
Research and development expenses	1,124	131	2,255	264
General and administrative expenses	168	164	330	285

Quarterly Information (unaudited)

(In thousands of Canadian dollars except per share information)

	Q2 F2010	Q1 F2010	Q4 F2009	Q3 F2009	Q2 F2009	Q1 F2009	Q4 F2008	Q3 F2008
Revenues	32,936	30,837	29,279	28,374	26,255	25,815	23,051	22,191
EBITDA ¹	13,656	11,546	9,661	10,161	8,410	10,955	7,415	9,189
Earnings before income taxes	8,080	5,094	2,501	4,212	3,051	4,844	3,512	5,975
Net Income before extraordinary gain	4,685	3,045	934	2,564	1,771	3,052	2,044	3,617
Net Income	4,685	3,045	4,392	2,564	27,730	3,052	6,116	3,617
Earnings per share before extraordinary gain	\$0.25	\$0.16	\$0.05	\$0.14	\$0.11	\$0.20	\$0.14	\$0.24
Earnings per share	\$0.25	\$0.16	\$0.24	\$0.13	\$1.77	\$0.20	\$0.41	\$0.24
Diluted earnings per share before extraordinary gain	\$0.24	\$0.16	\$0.05	\$0.14	\$0.11	\$0.20	\$0.14	\$0.24
Diluted earnings per share	\$0.24	\$0.16	\$0.23	\$0.13	\$1.71	\$0.20	\$0.41	\$0.24

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 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 9 of the Company's quarterly unaudited 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 generally have an original maturity from three months to twenty-four months from the date of purchase. Marketable securities are substantially all invested with large Canadian financial institutions, with a minor proportion of securities invested in one large U.S. financial institution.

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 June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 29% and 15% of revenues, respectively [2008 – 30% and 15%]. For the six-month period ended June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 29% and 15% of revenues, respectively [2008 – 29% and 15%]. As at June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 14% and 16% of trade accounts receivable, respectively [2009 – 42% and 12%]. For a more detailed analysis and disclosure of credit risk please refer to note 3 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. Similarly, 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 June 30, 2010, 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. All financial liabilities are short term in nature except for the long-term portion of the balance of sale payable, which is payable to the extent of future product sales.

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"), EURO and South African Rand ("ZAR"). This results in financial risk due to fluctuations in the value of the USD, EURO and ZAR relative to the Canadian dollar ("CAD"). The Company has significant monetary assets denominated in USD, EURO and ZAR that are required to be revalued in CAD at each period end. On March 31, 2010, the Company has entered into a forward foreign exchange contract expiring on October 15, 2012 to cover the foreign exchange exposure related to a certain investment denominated in EURO. With the exception of the forward contract described above, the Company does not currently use derivative financial instruments to reduce its foreign exchange exposure and often relies on natural hedges to mitigate foreign currency risk. Based on the net exposure described in note 3 within the unaudited interim consolidated financial statements, and assuming that all other variables remain constant, a ten-point increase or decrease in the CAD/USD, CAD/EURO and CAD/ZAR exchange rates would have an effect of \$362 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 filed on SEDAR at www.sedar.com.

Internal Control Over Financial Reporting

No changes were made in the Company's internal control over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's 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 \$23,563, including €3,724, to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 5 to the unaudited interim consolidated financial statements, is also committed to purchase an additional 15% of Pharmaplan's common shares evenly over 3 years, currently estimated to amount to \$8,700 (ZAR62,590) and subject to change based upon Pharmaplan's future operating results. 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	23,563	5,727	15,998	1,838	—

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 \$15,369 including US\$11,211, €952 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	8,715	437	4,235	532	3,511
Revenues based commitments	6,654	—	1,065	532	5,057

**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 June 30, 2010 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
August 4, 2010

(signed) Samira Sakhia

Samira Sakhia C.A., M.B.A.
Chief Financial Officer

Montreal, Canada
August 4, 2010

CONSOLIDATED BALANCE SHEETS

[In thousands of Canadian dollars]

	June 30 2010 \$ (unaudited)	December 31 2009 \$ (audited ³)
ASSETS		
Current		
Cash and cash equivalents	13,639	31,227
Marketable securities	74,833	73,274
Accounts receivable <i>[note 3]</i>	16,604	14,167
Inventories	13,807	12,361
Other current assets	4,694	2,668
Income taxes receivable <i>[note 4]</i>	—	4,630
Investment tax credits recoverable	147	776
Future income tax assets	6,746	6,196
Total current assets	130,470	145,299
Long-term marketable securities	17,066	868
Property, plant and equipment	305	691
Pharmaceutical product licences and rights	30,579	42,543
Investments <i>[note 5]</i>	22,398	62
Investments tax credits recoverable	14,736	14,903
Future income tax assets	27,642	31,029
Total assets	243,196	235,395
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	22,655	22,934
Accounts payable to related parties	447	1,122
Deferred revenue	57	1,776
Income taxes payable	9,045	7,109
Balance of sale payable	715	1,650
Future income tax liabilities	44	252
Total current liabilities	32,963	34,843
Long-term		
Balance of sale payable	1,402	1,743
Future income tax liabilities	3,968	4,007
Total liabilities	38,333	40,593
Shareholders' equity		
Capital stock <i>[note 7]</i>	121,826	119,652
Other paid-in capital	4,620	4,408
Accumulated other comprehensive income	43	98
Retained earnings	78,374	70,644
Total shareholders' equity	204,863	194,802
Total liabilities and shareholders' equity	243,196	235,395

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 June 30		Six-month period ended June 30	
	2010	2009	2010	2009
Revenues	32,936	26,225	63,773	52,040
Cost of sales	9,245	7,353	18,025	13,723
Gross profit	23,691	18,872	45,748	38,317
Expenses (income)				
Selling and marketing	5,414	6,884	11,202	12,396
General and administrative	2,439	2,413	4,726	4,331
Research and development	2,675	1,258	5,412	2,521
Interest income	(493)	(93)	(794)	(292)
Earnings before under-noted items	13,656	8,410	25,202	19,361
Amortization of pharmaceutical product licenses and rights	6,071	5,972	12,341	12,064
Net gain on investments	—	(485)	(7)	(492)
Foreign exchange (gain) loss	(119)	(18)	201	4
Other income	(41)	(110)	(41)	(110)
Share of net income in companies subject to significant influence [note 5]	(335)	—	(466)	—
Income before income taxes	8,080	3,051	13,174	7,895
Provision for income taxes				
Current	2,416	(2,228)	2,838	(2,034)
Future	979	3,508	2,606	5,106
	3,395	1,280	5,444	3,072
Net income before extraordinary gain	4,685	1,771	7,730	4,823
Extraordinary gain (net of \$nil taxes) [note 6]	—	25,959	—	25,959
Net income for the period	4,685	27,730	7,730	30,782
Earnings per share before extraordinary gain				
Basic	0.25	0.11	0.41	0.31
Diluted	0.24	0.11	0.40	0.30
Earnings per share				
Basic	0.25	1.77	0.41	1.96
Diluted	0.24	1.71	0.40	1.89
Weighted average number of shares outstanding				
Basic	18,668,015	15,706,245	18,632,017	15,320,105
Diluted	19,334,082	16,251,887	19,247,928	15,741,757

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]

[unaudited]

	Three-month period ended June 30		Six-month period ended June 30	
	2010	2009	2010	2009
Operating activities				
Net income	4,685	27,730	7,730	30,782
Add items not affecting cash				
Extraordinary gain [note 6]	—	(25,959)	—	(25,959)
Amortization	6,283	6,038	12,768	12,187
Future income taxes	979	3,508	2,606	5,106
Stock based compensation expense [note 7]	606	687	959	1,089
Unrealized foreign exchange (gain) loss	(148)	(36)	190	43
Net gain on investments	—	(485)	(7)	(493)
Net accreted interest (income) expense	(50)	24	(68)	(1)
Share of net income in companies subject to significant influence [note 5]	(335)	—	(466)	—
	12,020	11,507	23,712	22,754
Net change in non-cash balances relating to operations	3,091	(245)	1,782	(3,169)
Cash flows from operating activities	15,111	11,262	25,494	19,585
Investing activities				
Acquisition of investments	(383)	(130)	(24,995)	(130)
Repayment of balance of sale payable	—	—	(1,650)	—
Additions to pharmaceutical product licenses and rights	—	(5,475)	—	(5,476)
Business acquisition [note 6]	—	(7,594)	—	(7,594)
Acquisition of property, plant and equipment	(27)	(81)	(49)	(109)
Purchases of short-term marketable securities	(31,493)	(32,988)	(70,908)	(43,350)
Maturities of short-term marketable securities	65	2,333	74,469	11,298
Purchases of long-term marketable securities	(17,024)	(9,235)	(21,397)	(11,204)
Proceeds from the disposal of investments	—	4,244	27	6,979
Cash flows used in investing activities	(48,862)	(48,926)	(44,503)	(49,586)
Financing activities				
Net proceeds on issuance of common shares	639	56,561	1,410	56,749
Cash flows from financing activities	639	56,561	1,410	56,749
Foreign exchange rate change on cash and cash equivalents	29	18	11	(39)
Net change in cash and cash equivalents during the period	(33,083)	18,915	(17,588)	26,709
Cash and cash equivalents, beginning of period	46,722	12,439	31,227	4,645
Cash and cash equivalents, end of period	13,639	31,354	13,639	31,354
Cash and cash equivalents	13,639	31,354		
Short-term marketable securities	74,833	48,722		
Long-term marketable securities	17,066	11,203		
	105,538	91,279		

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 June 30		Six-month period ended June 30	
	2010	2009	2010	2009
Net income for the period	4,685	27,730	7,730	30,782
Other comprehensive (loss) income:				
Change in fair value of available-for-sale financial instruments [net of taxes of \$1 for the three-month period [2009 – (\$nil)] and (\$1) for the six-month period [2009 – (\$29)]]	(6)	(2)	7	183
Reclassification adjustment for (losses) gains on available-for-sale financial instruments included in net income in the current period [net of taxes of \$9 for the three-month period [2009 – \$3] and \$10 for the six-month period [2009 – (\$216)]]	(52)	(58)	(62)	1,341
Other comprehensive (loss) income for the period	(58)	(60)	(55)	1,524
Comprehensive income for the period	4,627	27,670	7,675	32,306
Accumulated other comprehensive income (loss), beginning of period	101	164	98	(1,420)
Other comprehensive (loss) income for the period	(58)	(60)	(55)	1,524
Accumulated other comprehensive income (loss), end of period	43	104	43	104
Retained earnings, beginning of period	73,689	36,001	70,644	32,949
Net income for the period	4,685	27,730	7,730	30,782
Retained earnings, end of period	78,374	63,731	78,374	63,731
Retained earnings and accumulated other comprehensive income, end of period	78,417	63,835	78,417	63,835

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. The Company’s 34.99% ownership in Pharmaplan Ltd. [“Pharmaplan”] is accounted for using the equity method as the Company exercises significant influence. These financial statements 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, 2009.

Information with respect to the December 31, 2009 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, 2009.

Changes in accounting policies

Effective January 1, 2010, the Company adopted the following recently introduced Canadian Institute of Chartered Accountants [“CICA”] Handbook Sections:

Section 1582, Business Combinations. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. The initial application of this standard did not have a significant impact on the Company’s consolidated financial statements.

Section 1601, Consolidated Financial Statements. This section establishes the standards for preparing consolidated financial statements. The initial application of this standard did not have a significant impact on the Company’s consolidated financial statements.

Section 1602, Non-controlling Interests, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. These changes did not have any impact on the Company’s consolidated financial statements as the Company owns 100% of its current subsidiaries.

3. 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.

June 30, 2010	Available- for-sale	Loans and receivables	Other financial liabilities	Derivatives	Carrying value	Fair value
	\$	\$	\$	\$	\$	\$
Financial assets						
Cash and cash equivalents	13,639				13,639	13,639
Marketable securities	74,833				74,833	74,833
Accounts receivable		16,604			16,604	16,604
Other current assets		3,642			3,642	3,642
Long term marketable securities	17,066				17,066	17,066
Investments ⁴	440	4,755		755	5,950	5,950
Total financial assets	105,978	25,001	—	755	131,734	131,734
Financial liabilities						
Accounts payable and accrued liabilities			22,655		22,655	22,655
Accounts payable to related parties			447		447	447
Balance of sale payable			715		715	715
Long-term balance of sale payable			1,402		1,402	1,402
Total financial liabilities	—	—	25,069	—	25,219	25,219

⁴ In accordance with Section 3856, certain 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.

3. Financial Instruments (cont'd)

December 31, 2009	Available- for-sale	Loans and receivables	Other financial liabilities	Derivatives	Carrying value	Fair value
	\$	\$	\$	\$	\$	\$
Financial assets						
Cash and cash equivalents	31,227				31,227	31,227
Marketable securities	73,274				73,274	73,274
Accounts receivable		14,167			14,167	14,167
Other current assets		901			901	901
Long-term marketable securities	868				868	868
Investments ⁴	62				62	62
Total financial assets	105,431	15,068	—	—	120,499	120,499
Financial liabilities						
Accounts payable and accrued liabilities			22,934		22,934	22,934
Accounts payable to related parties			1,122		1,122	1,122
Balance of sale payable			1,650		1,650	1,650
Long-term balance of sale payable			1,743		1,743	1,743
Total financial liabilities	—	—	27,449	—	27,449	27,449

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. Estimates used in arriving at fair value 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.

The carrying amounts of cash and cash equivalents, accounts receivable, other current assets, accounts payable and accrued liabilities, accounts payable to related parties and the short-term portion of the balance of sale payable are a reasonable estimate of their fair values because of the short maturity of these instruments.

In accordance with CICA Section 3856, certain 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 unless evidence of an other than temporary impairment exists in which case they are written down to their recoverable amount. Fair value has not been disclosed because fair value cannot be measured reliably.

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 residual amount method. The allocated loan portion described above classified as "Loans and receivables" and the long-term portion of the balance of sale payable classified as "Other financial liabilities" are being discounted using a 20% and 2.5% discount rates, respectively, such approximating market value for such financial instruments.

3. Financial Instruments (cont'd)

Cash, cash equivalents, marketable securities and investments were measured using level 1 in the fair value hierarchy. The balance of sale payable and a secured convertible term note were measured using level 2 in the fair value hierarchy.

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 generally have an original maturity from three months to twenty-four months from the date of purchase. Marketable securities are substantially all invested with large Canadian financial institutions, with a minor proportion of securities invested in one large U.S. financial institution.

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 June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 29% and 15% of revenues, respectively [2008 – 30% and 15%]. For the six-month period ended June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 29% and 15% of revenues, respectively [2008 – 29% and 15%]. As at June 30, 2010, two customers, a major wholesale distributor and a major retail chain, represented 14% and 16% of trade accounts receivable, respectively [2009 – 42% and 12%]. These above concentrations on the Company's customers are considered normal for the Company and its industry.

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

	June 30, 2010	December 31, 2009
	\$	\$
Accounts receivable	21,793	19,188
Allowance for product returns and credits	(5,086)	(4,918)
Allowance for doubtful accounts	(103)	(103)
Total accounts receivable	16,604	14,167

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

	2010	2009
	\$	\$
Balance, beginning of the year	5,021	3,980
Change in provision for doubtful accounts	—	(27)
Change in provision for product returns and credits	168	257
Balance at June 30	5,189	4,210

3. Financial Instruments (cont'd)

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

	June 30, 2010	December 31, 2009
	\$	\$
Trade accounts receivable not passed due	18,657	13,212
Trade accounts receivable passed due and not provisioned		
Under 30 days	3,007	4,402
31 to 60 days	26	1,269
Over 60 days	—	202
Allowance for product returns and credits	(5,086)	(4,918)
Total accounts receivable, net of allowance for doubtful accounts and product returns and credits	16,604	14,167

Liquidity risk

The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. Similarly, the Company has sufficient funds available through its cash, cash equivalents and marketable securities to cover all financial liability obligations should its cash requirements exceed cash generated from operations. As at June 30, 2010, 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 9.

All financial liabilities are short term in nature except for the long-term portion of the balance of sale payable, which is payable to the extent of future product sales.

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"], EURO and South African Rand ["ZAR"]. This results in financial risk due to fluctuations in the value of the USD, EURO and ZAR relative to the Canadian dollar ["CAD"]. The Company has significant monetary assets denominated in USD, EURO and ZAR that are required to be revalued in CAD at each period end. On March 31, 2010, the Company entered into a forward foreign exchange contract expiring on October 15, 2012 to cover the foreign exchange exposure related to a certain investment denominated in EURO. With the exception of the forward contract described above, the Company does not currently use derivative financial instruments to reduce its foreign exchange exposure and often relies on natural hedges to mitigate foreign currency risk.

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 June 30, 2010 are as follows:

	U.S. dollars	EURO	ZAR
	\$	€	
Cash, cash equivalents and deposits	848	706	21,000
Accounts receivable	96	216	—
Accounts payable and accrued liabilities	(1,372)	(31)	—
Net Exposure	(428)	890	21,000

3. Financial Instruments (cont'd)

Based on the aforementioned net exposure as at June 30, 2010, and assuming that all other variables remain constant, a ten-point increase or decrease in the CAD/USD, CAD/EURO and CAD/ZAR exchange rates would have an effect of \$362 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.

4. Income Taxes Receivable

During the quarter ended March 31, 2010, in connection with the Company's previously disclosed tax contingency, the Company received notices of re-assessment from the Canada Revenue Agency ["CRA"] and the Ontario Minister of Finance ["OMF"] reversing their original position on 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"].

As previously disclosed, on various dates during fiscal 2008 and 2009 the Company had received notices of re-assessment from the CRA relating to the taxation years ending August 16, 2005, July 31, 2006, July 31, 2007, and December 31, 2008 and from the OMF for the taxation year ended August 16, 2005, containing adjustments relating to the use of certain non-capital losses. The notices of assessment and re-assessment, if they had stood as a result of the CRA's position, amounted to a total tax liability exposure to the federal and relevant provincial governments of approximately \$11,625 including interest and penalties. The Company filed a Notice of Objection through the CRA appeals process on October 23, 2008. Furthermore, the Company, under the terms of the Share Purchase Agreement ["SPA"] for Squire with Nuvo holds indemnities with respect to the status of the Squire tax accounts and certain tax asset values the Company as well as all costs relating to reassessment including advisory fees, interest and penalties, as applicable. In addition, Nuvo had issued additional 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.

In connection with the appeals process, during the years ended December 31, 2009 and 2008, the Company had posted a deposit of \$3,752 to the CRA and \$500 to the OMF, representing up to one half of the tax and interest assessed. In addition, during the year ended December 31, 2009, the Company issued from its revolving unsecured credit facility, a bank guarantee in the amount of \$720 to the OMF. As a result of the Company's success in the appeal process, an amount of \$3,936 was received from the CRA on January 20, 2010 and an amount of \$524 was received from OMF during the second quarter of 2010, representing a refund for the full amount of the deposits above, along with accrued interest in the amount of \$208. In addition, the bank guarantee previously issued to the OMF expired on February 1, 2010 without being drawn-down by the OMF.

5. Investments

	June 30, 2010	December 31, 2009
	\$	\$
Companies subject to significant influence	16,448	—
Portfolio investments	5,950	62
Total investments	22,398	62

Investment in Pharmaplan

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan (Pty) Ltd. [“Pharmaplan”], a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan in the amount of \$2,879. In addition, the Company has committed to additional future consideration by increasing its ownership position by 5% per year over the next 3 years to 49.99%, with such additional consideration based upon Pharmaplan’s future financial results.

The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the acquisition, March 16, 2010. The investment was initially recorded at cost and adjustments are made to include the Company’s share of Pharmaplan’s net income. The Company’s share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company’s share of net identifiable assets of Pharmaplan acquired.

The total cost was allocated to the Company’s share of net identifiable assets acquired on the basis of their fair values using the purchase method of accounting. The purchase price allocations are preliminary and are subject to changes once the final valuation of the net identifiable assets acquired has been made. The preliminary allocation of the cost of the investment in Pharmaplan over the underlying net book value of assets acquired amounted to \$13,496 as at March 16, 2010, and represents definite life intangible assets [consisting mainly of exclusive distribution licenses] of \$10,665, indefinite life intangible assets of \$278, future income tax liabilities of \$3,064 and incremental goodwill of \$5,617.

The Company is in the process of finalizing the purchase price allocation which will be completed during 2010.

	\$
Investment in Pharmaplan, March 16, 2010	15,982
Share of net income for the period	201
Amortization of fair value adjustments	(70)
Investment in Pharmaplan, March 31, 2010	16,113
Share of net income for the period	625
Amortization of fair value adjustments	(290)
Investment in Pharmaplan, June 30, 2010	16,448

The Company is presenting selected financial information derived from Pharmaplan’s unaudited financial statements using South African GAAP translated into Canadian GAAP for information purposes.

5. Investments (cont'd)

Pharmaplan's statement of income data (unaudited)	Three-month period ended June 30, 2010	106 days period ended June 30, 2010
	\$	\$
Revenues	10,131	12,640
Cost of sales	4,518	5,664
Gross profit	5,613	6,976
Operating expenses	3,057	3,619
Earnings before under-noted items	2,556	3,357
Interest, depreciation and income taxes	770	996
Net income	1,786	2,361

Pharmaplan's balance sheet data (unaudited)	June 30, 2010	March 16, 2010
	\$	\$
Total assets	16,826	16,117
Total liabilities	7,209	9,009

Investment in Isotechnika

On June 18, 2009, as part of the Isotechnika acquisition, the Company received 24,921,312 common shares, representing a 19 percent interest in IsoPharma, with an approximate value of \$4,348 using the weighted average trading price of the common shares on the TSX for the 20 trading days pre and post acquisition [\$5,732 as at June 30, 2010]. The Company accounts for its investment in IsoPharma using the equity method of accounting. As per applicable accounting standards, the Company had eliminated upon acquisition the value assigned to its investment in common shares of IsoPharma against the excess ["negative goodwill"] of the amounts assigned to assets acquired and undiscounted liabilities assumed over the cost of the total purchase price. As a result the Company's investment in IsoPharma had a carrying value of \$nil effective June 18, 2009. Since the Company's acquisition, IsoPharma had incurred net losses from operations. As the Company is not committed to make further capital contributions to IsoPharma, the Company has not recorded its share of IsoPharma's net loss since acquisition as per applicable accounting standards. The Company refers the reader to note 6 for further details regarding the acquisition.

6. Business acquisition

On June 18, 2009, the Company acquired all the issued and outstanding shares of Isotechnika Inc. ["Isotechnika"][TSX:ISA] in accordance with a court supervised Plan of Arrangement. As part of the transaction the Company paid \$7,594 in cash and Isotechnika entered into a collaborative research and development agreement with Isotechnika Pharma Inc. ["IsoPharma"] in exchange for supporting research and development services for the commercialization of voclosporin, Isotechnika's next-generation calcineurin inhibitor, in Canada, Mexico, Central & South America, Israel and South Africa ["Paladin-acquired territories"]. The research and development services extend for a period of seven years and included an amount of \$4,350 payable by the Company to IsoPharma over the 12 months following the acquisition and expensed as incurred over this same 12 month period. Furthermore, the Research and Development Agreement in conjunction with the Company's Licence Agreement for voclosporin in the Paladin acquired territories, contains certain other voclosporin research, development and commercialization payment arrangements including possible licensing and royalty revenue payments over the remaining period.

6. Business acquisition (cont'd)

During the quarter ended June 30, 2010, the Company has expensed \$988 with respect to these research and development services and has fully paid the \$4,350 above as at June 30, 2010.

As part of the acquisition, the Company also received the international rights to a portfolio of products under development and a commercialized diagnostic product portfolio. The Company had also assumed an obligation to pay out certain future contractually pre-defined amounts relating to the commercialization of the diagnostic product portfolio over a period of seven years, estimated to amount to approximately \$5,950 at the time of acquisition [the “contingent balance of sale payable”]. This estimated amount was determined based upon the historical sales of the products, current expenditure levels and market conditions and was payable over a seven-year period pursuant to its Research and Development Agreement and represented management’s best estimate of this liability at the time of acquisition. It was considered reasonably possible that changes in future conditions could require a material change in the recognized amount. On December 31, 2009, the Company entered into an Amended Agreement with IsoPharma to settle the contingent balance of sale payable for a total amount of \$1,991, of which \$1,650 was paid on February 26, 2010 and the remainder in the amount of \$341, representing the discounted present value on December 31, 2009, is payable on January 31, 2011 if certain conditions are met. This settlement resulted in an adjustment to the extraordinary gain recorded upon acquisition in the amount of \$3,458 which has been recorded in accordance with related party accounting standards [see note 8 for additional information]. The Company had originally recorded an extraordinary gain in the amount of \$25,959 upon the acquisition of Isotechnika which in conjunction with the settlement above results in an aggregate extraordinary gain of \$29,417 for the year ended December 31, 2009.

As at June 30, 2010, the Company is carrying a balance of sale payable to Isotechnika in the amount of \$346.

Isotechnika is an international biopharmaceutical company dedicated to the discovery, development and commercialization of novel immunosuppressive therapeutics for the treatment of autoimmune diseases and for use in the prevention of organ rejection in transplantation. In addition to the Company’s drug pipeline, Isotechnika also has commercialized diagnostic products. Isotechnika was subsequently wound up into the Company on October 1, 2009.

Furthermore, as part of the purchase price, the Company received 24,921,312 common shares, representing a 19 percent interest in IsoPharma as at the date of acquisition, with an approximate value of \$4,348 using the weighted average trading price of the common shares on the TSX for the 20 trading days pre and post acquisition (\$5,732, as at June 30, 2010). In connection with the acquisition, the Company had incurred transaction costs in the amount of \$530 included in the purchase price below.

The acquisition was accounted for using the purchase method. The results of Isotechnika's operations have been included in the Company's results since June 18, 2009, the effective date of acquisition. The total purchase price of \$10,689 was allocated to the fair value of the net assets acquired in the amount of \$47,204, representing negative goodwill in the amount of the excess of \$36,515. The Company, as per applicable accounting standards, eliminated the value previously assigned to certain prescribed assets in the amount of \$7,098 against the excess of the amounts assigned to assets acquired and undiscounted liabilities assumed over the cost of the purchase above. The remaining excess is presented as an extraordinary gain in the amount of \$29,417. The purchase price was preliminarily allocated as follows:

6. Business acquisition (cont'd)

Purchase price allocation	\$
Cash	1,565
Current assets	627
Future income tax assets	39,440
Current liabilities	(1,526)
	<u>40,106</u>
Consideration represented by:	
Cash paid	7,594
Balance of sale payable	2,565
Acquisition costs	530
	<u>10,689</u>
Extraordinary gain [net of \$nil taxes]	<u>29,417</u>

The Company is in the process of finalizing the purchase price allocation which will be completed during 2010.

7. 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	18,563,250	\$119,652
Issued upon exercise of stock options	138,587	2,061
Issued under employee share purchase plan	5,312	113
Balance at June 30, 2010	18,707,149	\$121,826

Stock option plan

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

	2010		2009	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance at beginning of year	1,246,518	10.65	1,067,948	9.03
Granted	355,701	19.98	394,000	12.80
Exercised	(138,587)	9.48	(117,084)	7.18
Expired or forfeited	(68,693)	14.09	(17,175)	12.20
Balance at June 30	1,394,939	12.97	1,327,689	10.27
Options exercisable at June 30	506,970	9.75	381,593	7.60

7. Capital Stock (cont'd)

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 June 30		Six-month period ended June 30	
	2010	2009	2010	2009
Stock option compensation expense	\$606	\$687	\$959	\$1,089
Weighted average fair value of options	\$7.34	\$7.96	\$6.20	\$6.03
Weighted average risk-free interest rate	2.80%	2.44%	2.30%	2.44%
Dividend yield	Nil	Nil	Nil	Nil
Weighted average volatility factor	33%	42%	34%	42%
Weighted average expected life	4 years	7 years	4 years	7 years

8. Related party transactions

Joddes Limited [“Joddes”], a private Canadian corporation, together with its affiliates own in aggregate approximately 37% of the outstanding shares of the Company, and one director of the Company, the Company’s President and CEO, is related to this group.

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 and selling services on a contractual pay-for-use basis. In addition, the Company 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 \$620 as at June 30, 2010 and is included in the purchase and service based commitments in Note 9.

The Company has also entered into 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 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 June 30, 2010, 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.

8. Related party transactions (cont'd)

The Company owns a 19 percent interest in the common shares of IsoPharma and considers this investment a related party. The Company, in conjunction with the business combination discussed in note 6, settled with IsoPharma on December 31, 2009 the balance of sale contingently payable over a seven-year period for an amount of \$1,991, of which \$1,650 was paid on February 26, 2010 and \$341, representing the discounted present value on December 31, 2009, is payable on January 31, 2011 if certain conditions are met. This transaction 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. Furthermore, the Company is committed to a milestone payment with IsoPharma, as further discussed in note 4, in the amount of \$400 that is included in the purchase and service based commitments in note 9.

All transactions with related parties, except for the Metadol[®] and IsoPharma transactions 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 are on normal commercial terms and conditions and are non-interest bearing.

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

	Three-month period ended June 30		Six-month period ended June 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
Revenues	1,017	992	2,081	1,881
Purchases	2,933	1,683	7,095	3,254
Sales and marketing expenses	1,818	1433	3,357	2,672
Research and development expenses	1,124	131	2,255	264
General and administrative expenses	168	164	330	285

9. 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 \$6,654 [US\$6,250] if it achieves specific sales volumes on specific products in the future, over a maximum of ten years.

9. Commitments (cont'd)

Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties upon milestone attainment in the amount of \$1,741, including €952, 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 \$6,974, including US\$4,961 and GBP£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 \$23,563, including €3,724, to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 5, is also committed to purchase an additional 15% of Pharmaplan's common shares evenly over 3 years, currently estimated to amount to \$8,700 [ZAR62,590] and subject to change based upon Pharmaplan's future operating results. These commitments end in 2015 and annual commitments are as follows:

	\$
2010	5,727
2011	7,911
2012	4,062
2013	4,026
2014	955
2015	882

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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