

**PALADIN LABS INC.**  
**CONDENSED INTERIM CONSOLIDATED FINANCIAL**  
**STATEMENTS**

**September 30, 2011**



## **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 an overview of the Company's operations, performance and financial condition for the quarter and nine months ended September 30, 2011 and compares these unaudited quarterly results to those of the quarter and nine months ended September 30, 2010. 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](http://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 October 28, 2011 and as at this date 20,201,553 shares and 1,272,779 options were issued and outstanding. Reference to "Paladin" or the "Company" includes Paladin Labs Inc. and all its subsidiaries.

### **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, 2010. 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](http://www.sedar.com).

### **OVERVIEW & CORPORATE HIGHLIGHTS**

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

#### **Third quarter highlights:**

- Revenues reached \$36,660, an increase of 15% over the same period last year
- Net income was \$9,496, an increase of 19% over the same period last year
- Cash flows from operations reached \$24,765, a 16% increase over the same period last year
- EBITDA<sup>1</sup> was \$18,099, an increase of 14% over the same period last year
- Acquired an additional 5,374,500 common shares of Afexa Life Sciences Inc. (TSX:FXA) ("Afexa") giving Paladin beneficial ownership of a total of 15,421,300 common shares of Afexa or approximately 14.95% of Afexa's total issued and outstanding common shares.
- Announced a take-over bid for any and all outstanding shares of Afexa
- Entered into a definitive agreement with Labopharm Inc. ("Labopharm") (TSX: DDS) to acquire all of the issued and outstanding common shares of Labopharm at a price of \$0.2857 per share in cash, representing a 57.4% premium over the volume-weighted average price of Labopharm's shares of \$0.1815 for the 30 trading days prior to the August 17, 2011
- Entered into a distribution agreement with Common Sense Limited, a privately-owned Israeli company, under which Paladin received the exclusive rights to market and sell two diagnostic products: AL-SENSE OTC and VS-SENSE OTC in Canada, Latin America and Sub-Saharan Africa.
- Increased its offer to acquire any and all of the issued and outstanding common shares of Afexa to \$0.81 per share, following a competing offer made by Valeant Pharmaceuticals International Inc. ("Valeant" – NYSE/TSX: VRX)

#### **Subsequent to the quarter ended September 30, 2011:**

- The Company announced that it would not take up any shares of Afexa owing to the non-fulfillment of a basic condition of its offer and tendered its shares in Afexa to Valeant
- Completed the acquisition of Labopharm following the approval of the transaction by Labopharm shareholders

Paladin's revenues are principally derived from sales of pharmaceutical products to large pharmaceutical wholesalers and large 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, general and administrative and research and development expenses. In addition, a substantial portion of the Company's expenses are related to the 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.

#### **<sup>1</sup> EBITDA – NON-IFRS FINANCIAL MEASURES**

The term EBITDA (earnings before interest, taxes, depreciation and amortization) does not have any standardized meaning under International Financial Reporting Standards ("IFRS") and therefore may not be comparable to similar measures presented by other companies. The Company defines EBITDA as earnings before interest expense, other finance expense (income), taxes, amortization, foreign exchange gains (losses), share of net income in associate 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 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 IFRS, applied on a consistent basis. Paladin's significant accounting estimates and judgments include revenue recognition, inventory valuation, the useful lives and fair value of pharmaceutical product licenses and rights, income taxes and share-based compensation expense. For a more detailed discussion of the Company's critical accounting estimates, please refer to the management discussion & analysis included in the Company's 2010 Annual Report. There have been no material changes to accounting estimates since June 30, 2011.

#### **ADOPTION OF IFRS**

In February 2008 the Canadian Accounting Standards Board ("AcSB") confirmed that the use of 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 implemented these standards on January 1, 2011. These consolidated financial statements have been prepared as described in Note 1 of the condensed interim unaudited consolidated financial statements ("condensed interim financial statements"). The condensed interim financial statements are in compliance with IAS 34, *Interim Financial Reporting*, with IFRS 1, *First Time Adoption of IFRS*, and with the accounting policies the Company expects to adopt in its December 31, 2011 annual consolidated financial statements. These condensed interim financial statements do not include all the information and disclosures required according to IFRS for annual financial statements and should be read in conjunction with the Company's interim unaudited consolidated financial statements and notes thereto for the quarter ended March 31, 2011.

In preparing the condensed interim financial statements in accordance with IFRS 1, the Company has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS. The Company has also applied the transitional provision in International Financial Reporting Interpretations Committee ("IFRIC") 4, *Determining Whether an Arrangement Contains a Lease*, and has assessed all arrangements as at the date of transition.

The condensed interim financial statements for the three and nine months ended September 30, 2011 contain a detailed description of the Company's conversion to IFRS in Note 11, including a line-by-line reconciliation of the Company's condensed interim financial statements previously prepared under Canadian GAAP to those under IFRS for the three and nine months ended September 30, 2010 and for the year ended December 31, 2010.

## RECENT ACCOUNTING PRONOUNCEMENTS

IASB has issued the following standards that are applicable to the Company:

- IFRS 9 – *Financial Instruments (Classification and Measurement)*
- IFRS 10 – *Consolidated Financial Statements*
- IFRS 12 – *Disclosure of Interests in Other Entities*
- IAS 28 – *Investments in Associates and Joint Ventures*

These standards are mandatory for accounting periods beginning January 1, 2013. The Company is assessing the impact of these standards on its consolidated results and financial position.

## CORPORATE ANNOUNCEMENT: JONATHAN ROSS GOODMAN

On August 18, 2011, the Company announced that its President and CEO, Mr. Jonathan Ross Goodman, was involved in an accident and was hospitalized with serious injuries. As Mr. Goodman was unable to perform his duties as President and CEO, the Board of Directors of Paladin asked Mr. Mark Beaudet, Co-Founder, Director and Vice President Marketing and Sales of Paladin, to assume such duties on an interim basis. Mr. Goodman is pursuing a recovery and rehabilitation program. As a result, Mr. Goodman will remain absent from the Company for an indeterminate period of time. The Company will provide further updates on Mr. Goodman's condition only when a change in circumstance warrants same.

## RESULTS OF OPERATIONS

Three months ended September 30, 2011 compared to three months ended September 30, 2010, and nine months ended September 30, 2011 compared to nine months ended September 30, 2010.

### Revenues

Revenues increased \$4,878 or 15% to \$36,660 for the three months ended September 30, 2011 from \$31,782 for the three months ended September 30, 2010. For the nine months ended September 30, 2011, revenues increased \$8,828 or 9% to \$104,383 from \$95,555 for the same nine-month period last year.

The increase in revenues for the third quarter of 2011 is attributable to the sales growth of certain significant promoted products, including Tridural<sup>®</sup>, Trelstar<sup>®</sup>, Testim<sup>®</sup>, Metadol<sup>®</sup>, Plan B<sup>®</sup> and Abstral<sup>®</sup> which combined increased by 11% for the quarter and 15% for the nine months ended September 30, 2011 compared to the same periods in 2010. Furthermore, incremental revenues from products acquired and/or launched after the comparative quarter and nine months ended September 30, 2010, contributed \$976 to the quarter and \$2,681 for the nine months ended September 30, 2011.

In July 2010 and in March 2011, generic versions of Pennsaid<sup>®</sup> and Plan B<sup>®</sup>, respectively, were approved in Canada. It is not yet known if or when the generic version of Pennsaid<sup>®</sup> will be sold in the Canadian market. The generic version of Plan B<sup>®</sup> was launched in September 2011. Should these generic versions of Pennsaid<sup>®</sup> and Plan B<sup>®</sup> successfully commercially launch the sales of Pennsaid<sup>®</sup> and Plan B<sup>®</sup> would decline significantly.

Product revenues highlights for the Company's most significant promoted products using IMS Canada data<sup>2</sup> for the quarter and nine months ended September 30, 2011 compared to the quarter and nine months ended September 30, 2010 are as follows:

Promoted Products	Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Sales data per IMS Canada	% change vs. 2010	Sales data per IMS Canada	% change vs. 2010
	\$			
Tridural <sup>®</sup>	2,965	3%	8,695	9%
Metadol <sup>®</sup>	2,814	22%	7,975	18%
Plan B <sup>®</sup>	2,680	1%	7,771	6%
Trelstar <sup>®</sup>	1,782	22%	5,119	34%
Testim <sup>®</sup>	1,061	13%	3,026	24%
Abstral <sup>®</sup> (i)	42	n/a	44	n/a
<b>Total</b>	<b>11,344</b>	<b>11%</b>	<b>32,630</b>	<b>15%</b>

(i) Abstral<sup>®</sup> was launched on June 13, 2011

<sup>2</sup> The Company has chosen not to disclose detailed product by 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 revenues changes from period to period on certain significant products. It is important that readers of this sales data note that IMS Canada sales data may not necessarily correspond to the Company's recording of revenue in accordance with IFRS.

### **Gross Profit**

Total gross profit increased \$2,350 or 10% to \$26,411 for the quarter ended September 30, 2011 from \$24,061 for the same comparative quarter last year. For the nine months ended September 30, 2011, gross profit increased \$6,823 or 10% to \$76,632 from \$69,809 for the same period last year. Gross profit, as a percentage of revenues, decreased 4% to 72% for the three month periods ended September 30, 2011 from 76% in the same period last year. For the nine month periods ended September 30, 2011 and 2010, gross profit, as a percentage of revenues, remained steady at 73%. The decrease in gross profit as a percentage of revenues for the quarter ended September 30, 2011 relative to the comparative period last year is mainly the result of product mix and the strengthening of the US dollar relative to the Canadian dollar.

### **Selling, General and Administrative Expense**

Selling, general and administrative expense increased \$509 or 7% to \$7,824 for the quarter ended September 30, 2011 from \$7,315 for the same comparative period last year. For the nine months ended September 30, 2011, selling, general and administrative expense slightly decreased \$180 or 1% to \$23,051 from \$23,231. Selling, general and administrative expense, as percentage of revenues, decreased 2% to 21% for the quarter ended September 30, 2011 compared to 23% for the same quarter last year. For the nine months ended September 30, 2011, selling, general and administrative expense, as a percentage of revenues decreased 2% to 22% from 24% for the same period last year. The increase in selling, general and administrative expense for the quarter ended September 30, 2011 is mainly the result of increased business development projects, including professional, legal and securities fees related to the Afexa and Labopharm transactions, as well as newly launched product sales and marketing costs. The slight decrease in selling, general and administrative expenses for the nine-month period ended September 30, 2011 is mainly the result of certain sales and marketing streamlining efforts, partially offset by increased business development projects including professional, legal and securities fees related to the Afexa and Labopharm transactions and newly launched product sales and marketing costs. Selling, marketing and administrative expenses have decreased as a percentage of revenues primarily as a result of growth in non promoted revenues and certain sales and marketing streamlining efforts. The promotional activities driving selling and marketing costs primarily relate to Paladin's continued promotional activities for Tridural<sup>®</sup>, Plan B<sup>®</sup>, Trelstar<sup>®</sup> and the launch costs related to Abstral<sup>®</sup>.

### **Research and Development Expense**

Research and development expense increased \$372 or 25% to \$1,849 for the quarter ended September 30, 2011 from \$1,477 for the same comparative quarter last year. For the nine months ended September 30, 2011, research and development expense decreased \$749 or 11% to \$6,145 from \$6,894 for the nine months ended September 30, 2010. For the three month period ended September 30, 2011, research and development expense, as percentage of revenues, remained steady at 5%. Research and development expense, as percentage of revenues, decreased to 6% for the nine-month period ended September 30, 2011 compared to 7% for the same period last year. The increase in research and development expenses during the quarter ended September 30, 2011 is mainly driven by incremental research and development expenses related to certain development projects with licensors and on-going internal development projects. The decrease in the research and development expenses during the nine months ended September 30, 2011 primarily relates to payments made for the committed research and development efforts with respect to Isotechnika Pharma Inc. ("IsoPharma") which ended June 30, 2010, partially offset by incremental research and development expenses in 2011 related to certain development projects with licensors and license payments related to products not yet approved.

### **Interest Income**

Interest income increased \$781 or 135% to \$1,361 for the three months ended September 30, 2011 from \$580 for the three months ended September 30, 2010. This increase is mainly the result of incremental interest earned on Company's strategic investment in Labopharm in the amount of \$368, higher average daily cash and marketable securities balances and a higher effective rate of return earned on the Company's holdings over the three-month period ended September 30, 2011 compared to the same comparative period last year.

For the nine months ended September 30, 2011, interest income increased \$4,901 or 375% to \$6,207 from \$1,306 for the nine months ended September 30, 2010. This increase is primarily the result of the incremental interest earned on the Company's strategic investments in partner companies, primarily the ProStrakan convertible debenture, from which the Company generated \$2,777 from January 12 to May 17, 2011, and loans acquired during and subsequent to the quarter ended September 30, 2010. In addition, the Company held higher average daily cash and marketable securities balances and earned a higher effective rate of return over the nine month period ended September 30, 2011 compared to the same comparative period last year.

### **Amortization of Pharmaceutical Product Licenses and Rights**

Amortization expense decreased \$187 or 4% to \$4,959 for the three months ended September 30, 2011 from \$5,146 for the same period last year. For the nine months ended September 30, 2011, amortization expense decreased \$1,627 or 9% to \$15,860 from \$17,487 for the same period last year. Amortization expense decreased since certain pharmaceutical product licenses and rights were fully amortized during and after the three and nine-months periods ended September 30, 2010, partially offset by incremental amortization related to the Company's recently acquired pharmaceutical product licenses and rights.

### **Foreign Exchange (Gain) Loss**

During the quarter ended September 30, 2011, the Company recorded a foreign exchange loss of \$251 compared to a foreign exchange gain of \$322 for the quarter ended September 30, 2010, mainly as a result of the weakening of the Canadian dollar relative to the US dollar and as a result of the strengthening of the Canadian dollar relative to the EURO and ZAR and its impact on Company's net monetary position in these currencies during the quarters ended September 30, 2011 and September 30, 2010.

During the nine months ended September 30, 2011, the Company recorded a foreign exchange gain of \$204, compared to a foreign exchange gain of \$115 for the nine months ended September 30, 2010, mainly as a result of the net strengthening of the Canadian dollar relative to the US dollar, EURO and ZAR and their impact on Company's net monetary position in these currencies during the nine months ended September 30, 2011.

### **Other Finance Income**

During the quarter ended September 30, 2011, the Company recorded interest accretion on a strategic investment in convertible debenture of \$56 compared to \$61 for the same period last year.

In addition, during the nine months ended September 30, 2011, the Company redeemed its Prostrakan secured convertible debt facility ("Facility") for proceeds of \$86,432, made up of: the principal of the Facility of \$77,232; the interest accrued at May 17, 2011 of \$778; a break free of \$3,089; and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. In connection with the same Facility, in accordance to applicable accounting standards, the Company re-measured the fair value of a conversion option on the Facility, deemed to be \$nil and recorded an unrealized loss of \$4,572, partially offset by a gain of \$3,568 on the remeasurement of an early redemption option. Furthermore, the Company recorded \$1,116 in interest accretion on the Company's convertible debentures, principally the Facility. Moreover the Company disposed of certain shares held in portfolio companies for proceeds of \$3,344, representing a net gain of \$24. Please refer to Significant Transaction section below for additional details on the Facility.

During the nine months ended September 30, 2010, the Company disposed of certain shares held in a portfolio company for proceeds of \$27, representing a gain of \$7 and recorded \$68 in interest accretion on Company's loans.

### **Other Income**

Other income was \$97 for the three and nine months ended September 30, 2011, respectively, compared to \$nil and \$41 for the same periods last year. During the quarter and nine-month periods ended September 30, 2011, the Company received a contractual partner payment of \$97 and recorded a \$97 gain in other income. During the nine-month period ended September 30, 2010, the Company disposed of a pharmaceutical product license for proceeds of \$41, representing a net gain of \$41.

### **Share of Net Income of an Associate**

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. On March 1, 2011, the Company acquired an additional 10% ownership interest in Pharmaplan, increasing Paladin's ownership from 34.99% to 44.99%. 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 share of Pharmaplan's net identifiable assets acquired and the tax impact on the distributable earnings. The Company's share of Pharmaplan's net income for the three months ended September 30, 2011 increased \$40 or 14% to \$331 compared to \$291 for the same period last year. The Company's share of Pharmaplan's net income for the nine months ended September 30, 2011 increased \$339 or 45% to \$1,096 compared to \$757 for the 198 day period from the acquisition date, March 16, 2010 to September 30, 2010.

### Provision for Income Taxes

The provision for income taxes increased \$459 or 13% to \$3,877 for the quarter ended September 30, 2011 from \$3,418 for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, income tax expense increased \$4,830 or 56% to \$13,418 from \$8,588 for the nine months ended September 30, 2010. For the three and nine-month periods ended September 30, 2011, the effective tax rate was 29% and 28%, respectively, compared to 30% and 35% for the three and nine months ended September 30, 2010. The decrease in effective rates in the current year is principally due to a net decrease in permanent differences as a pro-portion of net income before taxes in comparison to the previous period related to certain income amounts treated as capital 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	21,778	3,659	2025-2028
Provincial	1,218	1,218	2025-2028
Scientific Research and Experimental Development expenditures			
Federal	74,898	62,971	N/A
Provincial	72,637	60,755	N/A
Investment tax credits			
Federal	20,229	14,874	2016-2030

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.

### Net Income

Due to the factors set forth above, net income increased by \$1,537 or 19% to \$9,496 for the quarter ended September 30, 2011 compared to net income of \$7,959 for the same comparative quarter last year. For the nine months ended September 30, 2011, net income increased \$18,415 or 115% to \$34,379 from \$15,964 for the nine months ended September 30, 2010.

### 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 in strategic investments in the form of equity or strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates.

The Company believes that its existing cash, cash equivalents and marketable securities, as well as cash generated from operations, are sufficient to finance its current operations, working capital needs and future acquisitions. At present, the Company is actively pursuing acquisitions that may require the use of substantial capital resources. There are no present agreements or commitments with respect to any such acquisitions except as separately disclosed in Notes 7 and 10 to the condensed interim financial statements.

The Company has entered into an extendable one-year agreement with one of the Company's bankers for a \$5,000 revolving unsecured credit facility. As at September 30, 2011, approximately \$1,300 is being utilized for the Company's use of forward contracts to manage certain foreign exchange exposure. The credit facility may also be used for general corporate purposes.

The table below sets forth a summary of cash flow activity and should be read in conjunction with the Company's consolidated cash flows statements.

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Cash inflow from operating activities	<b>24,765</b>	21,398	<b>55,972</b>	46,892
Net cash inflow (outflow) from investing activities	<b>17,958</b>	(18,939)	<b>(109,548)</b>	(63,442)
Net cash (outflow) inflow from financing activities	<b>(144)</b>	613	<b>40,717</b>	2,023
Foreign exchange rate loss (gain) on cash and cash equivalents	<b>53</b>	29	<b>(105)</b>	40
Increase (decrease) in cash and cash equivalents during the period	<b>42,632</b>	3,101	<b>(12,964)</b>	(14,487)
Cash and cash equivalents, beginning of period	<b>40,699</b>	13,639	<b>96,295</b>	31,227
Cash and cash equivalents, end of period	<b>83,331</b>	16,740	<b>83,331</b>	16,740
Marketable securities, end of period	<b>143,369</b>	110,629	<b>143,369</b>	110,629
Cash, cash equivalents and marketable securities, end of period	<b>226,700</b>	127,369	<b>226,700</b>	127,369

Paladin's cash, cash equivalents and marketable securities increased \$87,311 to \$226,700 at September 30, 2011 from \$139,389 at December 31, 2010. This increase is primarily the result of common shares issued for cash of \$41,038, cash flows generated from operating activities of \$55,972 and dividends received from an associate of \$891, partially offset by the purchase of pharmaceutical product licenses and rights of \$7,617, the investment in an associate of \$2,936, share buy-back of \$321 and a partial payment of the balance of sale payable of \$250. Working capital (current assets less current liabilities) increased \$72,233 to \$200,906 at September 30, 2011 from \$128,673 at December 31, 2010 primarily due to the increase in the cash, cash equivalents and marketable securities explained above.

Cash flows from operating activities increased 16% or \$3,367 to \$24,765 for the quarter ended September 30, 2011 from \$21,398 for the same comparative quarter last year. Cash flows from operating activities for the nine months ended September 30, 2011 increased 19% or \$9,080 to \$55,972 compared to \$46,892 for the nine months ended September 30, 2010. Cash flows from operating activities represent the cash flows from net earnings, excluding revenues and expenses not affecting cash, principally amortization, deferred taxes, share-based compensation expense, other finance expenses (income), foreign exchange (gains) losses and changes in working capital.

Cash flows from investing activities were \$17,958 compared to cash flows used in investing activities of \$18,939 for the quarters ended September 30, 2011 and 2010, respectively. During the quarter ended September 30, 2011, the Company collected \$20,259 from maturing marketable securities net of cash flows used to acquire marketable securities, received \$640 in dividends from an associate, invested \$2,937 towards the acquisition of financial assets and \$4 towards the acquisition of property, plant and equipment. During the quarter ended September 30, 2010, the Company invested \$18,621 in marketable securities net of cash flows generated by maturing marketable securities, \$300 towards the acquisition of financial assets and \$18 towards the purchases of property, plant and equipment.

Cash flows used in investing activities were \$109,548 compared to \$63,442 for the nine-month periods ended September 30, 2011 and 2010, respectively. During the nine months ended September 30, 2011, the Company invested \$99,704 in marketable securities net of cash flows generated by maturing marketable securities, 7,617 towards purchases of pharmaceutical product licenses and rights, \$2,936 towards an addition of 10% interest in an associate, \$250 towards a partial payment of a balance of sale payable and \$69 for the purchases of property, plant and equipment, partially offset by dividends from an associate of \$891 and net proceeds from disposal of financial assets in the amount of \$137. During the nine months ended September 30, 2010, the Company invested \$36,457 in marketable securities net of cash flows generated by maturing marketable securities, \$15,982 towards a 34.99% interest in an associate, \$9,286 towards the net acquisition of financial assets, \$1,650 towards the repayment of a balance of sale payable, and \$67 for the purchases of property, plant and equipment.

Cash flows used in financing activities were \$144 compared to cash flows from financing activities of \$613 for the quarters ended September 30, 2011 and 2010, respectively. During the quarter ended September 30, 2011, \$321 was used by the Company to repurchase 9,236 of its own common shares under the terms of its normal course issuer bid, offset by \$177 received from share option exercises and the

issuance of common shares under the stock purchase plan for cash. During the quarter ended September 30, 2010, the Company received \$613 from share option exercises and the issuance of common shares under the stock purchase plan for cash.

Cash flows from financing activities were \$40,717 compared to \$2,023 for the nine-month periods ended September 30, 2011 and 2010, respectively. During the nine months ended September 30, 2011, the Company issued 1,150,000 common shares through a bought deal share offering at a price of \$35.00 per common share for total gross proceeds to the Company in the amount of \$40,250. In conjunction with the offering, the Company incurred share issue costs of approximately \$1,643, for total net proceeds amounting to \$38,607. In addition, an amount of \$2,431 was generated from share option exercises and the issuance of common shares under the stock purchase plan for cash. During the nine months ended September 30, 2010 an amount of \$2,023 was generated from share option exercises and the issuance of common shares under the stock purchase plan for cash.

#### **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, a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan of \$2,879 (ZAR21,000). In addition, the Company 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. In addition, the Company has the option to increase its ownership interest in Pharmaplan to 100% in 2013, at a purchase price determined using Pharmaplan's future financial results, payable in South African Rand ("ZAR").

On March 1, 2011, the Company entered into an agreement with Pharmaplan to accelerate the purchase of Pharmaplan shares leading to the acquisition of a total 10% ownership interest in Pharmaplan. This increased Paladin's ownership from 34.99% to 44.99% effective March 1, 2011. The Company paid \$5,975 including the settlement of the non-interest bearing loan mentioned above.

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 investments were 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 the net identifiable assets of Pharmaplan acquired and the tax impact on the distributable earnings.

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 allocation of the cost of the investment in Pharmaplan for the March 16, 2010 and March 1, 2011 purchases is identified herein below:

	March 16, 2010 34.99% purchase	March 1, 2011 10% purchase <sup>(i)</sup>	<b>Total 44.99% purchase</b>
	\$	\$	\$
Net book value of identifiable assets acquired	2,486	1,089	<b>3,575</b>
Definite life intangibles	10,665	3,723	<b>14,388</b>
Indefinite life intangibles	278	80	<b>358</b>
Future income tax liabilities	(3,064)	(1,065)	<b>(4,129)</b>
Goodwill	5,617	2,148	<b>7,765</b>
	<b>15,982</b>	<b>5,975</b>	<b>21,957</b>

<sup>(i)</sup>The Company is in the process of finalizing the March 1, 2011 purchase price allocation which will be completed during the year ended December 31, 2011.

	Three months ended September 30		Nine months ended September 30	106 days ended September 30
	2011 \$	2010 \$	2011 \$	2010 \$
<b>Carrying values, beginning of period</b>	<b>22,479</b>	16,448	<b>15,739</b>	—
<b>Additions in the period</b>	<b>—</b>	—	<b>5,975</b>	15,982
Share of net income for the period before adjustments	<b>886</b>	665	<b>2,767</b>	1,491
Adjustments to net income:				
Amortization of fair value adjustments	<b>(442)</b>	(374)	<b>(1,321)</b>	(734)
Taxation	<b>(113)</b>	—	<b>(350)</b>	—
<b>Share of net income for the period</b>	<b>331</b>	291	<b>1,096</b>	757
<b>Share of dividends received in the period</b>	<b>(640)</b>	—	<b>(640)</b>	—
<b>Carrying values, end of period</b>	<b>22,170</b>	16,739	<b>22,170</b>	16,739

The Company is presenting selected financial information derived from Pharmaplan's unaudited financial statements in ZAR using South African GAAP converted into IFRS in Canadian dollars ("CAD") for information purposes.

<b>Pharmaplan's statement of income data (unaudited)</b>	Three months ended September 30		Nine months ended September 30	106 days ended September 30
	2011 \$	2010 \$	2011 \$	2010 \$
Revenues	<b>11,752</b>	9,653	<b>34,619</b>	22,293
Cost of sales	<b>5,768</b>	3,952	<b>16,876</b>	9,616
<b>Gross profit</b>	<b>5,984</b>	5,701	<b>17,743</b>	12,677
Operating expenses	<b>3,058</b>	3,044	<b>8,773</b>	6,663
<b>Earnings before under-noted items</b>	<b>2,926</b>	2,657	<b>8,970</b>	6,014
Interest income, amortization and income taxes	<b>956</b>	757	<b>2,610</b>	1,753
<b>Net income for the period</b>	<b>1,970</b>	1,900	<b>6,360</b>	4,261

<b>Pharmaplan's balance sheet data (unaudited)</b>	<b>September 30, 2011</b> \$	December 31, 2010 \$
Total assets	<b>21,882</b>	18,943
Total liabilities	<b>8,171</b>	8,281

## SIGNIFICANT TRANSACTIONS

### PROSTRAKAN FACILITY

On January 11, 2011, the Company invested £50,000 (\$77,230) in ProStrakan through the acquisition by way of assignment of ProStrakan's existing secured debt facility with the addition of certain conversion rights. The secured facility was amended and provided by the Company in CAD at a rate of interest of 10.5%. The amended secured debt facility was repayable in full at the end of three years and the Company had the option to convert the outstanding principal debt into new ProStrakan ordinary shares at any point after the initial nine months of the term of the amended agreement. In the event of a change in control of ProStrakan during this same initial time period, along with the Company consenting to early redemption, the Company was entitled to receive a payment equivalent to the balance of interest for the first year of the loan together with a break fee of £2,000 (\$3,089). The strike price for the conversion rights were set at £1.10 per share, a 24% premium to the closing price of ProStrakan's common shares on December 14, 2010.

According to financial instruments accounting standards, the facility was initially recognized at its respective fair value through the bifurcation of the conversion option and early redemption option being classified and subsequently re-measured as derivative assets. The fair value of the conversion option was obtained by using the Black-Scholes option pricing model, adjusted for credit risk and a 25% likelihood of conversion, using the following assumptions, as at January 11, 2011: volatility factor: 59.43%, risk free interest rate: 2.01% and time to expiry: 3 years. The fair value of the early redemption option, as at January 11, 2011, was obtained using a probability factor of 75% and a discount factor of 20.8%. The allocated loan portion of

the facility was classified as "Loans and receivables" and recorded at fair value upon initial measurement and subsequently recorded at amortized cost using the effective interest rate method at a rate of 20.8% per year.

On February 21, 2011, in connection with the proposed acquisition by Kyowa Hakko Kirin Co., Ltd. ("KHK"), the Company consented to the repayment of its facility subject to closing of the acquisition. On March 31, 2011, the general meeting of ProStrakan's shareholders approved the acquisition of ProStrakan by KHK. As a result the conversion option was deemed to have a fair value of \$nil and the early redemption option was re-measured using a probability factor of 100%.

On May 17, 2011, the Company received gross proceeds of \$86,432 representing the aggregate of: the principal of the ProStrakan facility of \$77,232; the interest accrued at May 17, 2011 of \$778; a break free of \$3,089; and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. The Company has recorded interest accretion of \$1,004 for the nine months ended September 30, 2011 in the interim consolidated income statement. Moreover, the Company has retained the rights to the products it had previously been licensed in connection with the agreement.

#### **AFEXA OFFER**

On August 10, 2011, the Company issued a take-over bid circular making an offer to purchase (the "Offer"), on the terms and subject to the conditions of the Offer, any and all of the issued and outstanding common shares of Afexa (the "Afexa Common Shares"), together with any associated rights (the "SRP Rights") issued under the Shareholder Rights Plan of Afexa, which included Afexa Common Shares that might have become issued and outstanding after the date of the Offer but before the expiry time of the Offer upon the exercise of options issued under Afexa's Stock Option Plan ("Afexa Options") together with their associated SRP Rights.

Under the terms of the Offer, Afexa Shareholders had the alternative to either receive \$0.55 in cash (the "Cash Alternative") or 0.013 common shares ("Paladin Shares") of the Company (the "Share Alternative"). Based on the Cash Alternative of \$0.55 per Common Share, the consideration offered under the Offer represented a premium of approximately 57% over the closing price of \$0.35 per Afexa Common Share on the TSX on July 14, 2011 and a premium of approximately 45% over the volume-weighted average price of \$0.38 per Afexa Common Share over the 20 trading days on the TSX ending July 14, 2011. The 0.013 Paladin Shares per Common Share exchange ratio was calculated based on the Company's volume-weighted average price of \$43.14 over the 20 trading days on the TSX ending August 9, 2011 compared to the cash consideration under the Cash Alternative, being a cash amount of \$0.55.

On August 30, 2011, Valeant, through a subsidiary, made a competing offer to acquire the issued and outstanding common shares of Afexa for \$0.71 per share. Following this offer, on September 26, 2011, the Company increased its Offer to acquire any and all of the issued and outstanding common shares of Afexa to \$0.81 per share. On September 30, 2011 Valeant further announced it had increased its bid to \$0.85 per share. On October 3, 2011, the Company announced it would not take up any shares under its offer due to the non-fulfillment of a condition of the offer.

#### **ACQUISITION OF LABOPHARM**

On August 17, 2011, the Company entered into a definitive agreement (the "Arrangement Agreement") pursuant to which the Company would acquire all of the issued and outstanding common shares of Labopharm at a price of \$0.2857 per share in cash, representing a 57.4% premium over the volume-weighted average price of Labopharm's shares of \$0.1815 for the 30 trading days prior to the August 17, 2011 announcement. The transaction was carried out pursuant to the Arrangement Agreement under a court-approved statutory plan of arrangement governed by the Business Corporations Act (Québec). The completion of the proposed Arrangement was subject to a number of customary conditions, including the approval of the Superior Court of Québec and the approval of 66 2/3% of the votes cast by Labopharm's shareholders present in person or represented by proxy at a special meeting convened for such purpose and held on October 5, 2011, each of which was met. The Company completed the acquisition of all the outstanding common shares of Labopharm on October 7, 2011 for a total cash consideration payable of \$20,448 further disclosed in the Commitments section below.

## RELATED PARTY TRANSACTIONS

### Joddes Limited

Joddes Limited ("Joddes"), a private Canadian corporation, together with its affiliates own in aggregate approximately 35% 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 \$684 as at September 30, 2011 and is included in the purchase and service based commitments amount in the "Contractual Obligations and Commitments" section 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 performance 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.

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Revenues	477	1,229	2,467	3,310
Purchases	3,044	3,103	8,013	10,198
Selling, general and administrative	2,200	2,093	6,136	5,780
Research and development	114	389	488	2,644

As at September 30, 2011, the Company has an amount payable to a wholly-owned subsidiary of Joddes, included in Payables, accruals and provisions on the interim consolidated balance sheets, of \$2,392 (December 31, 2010: \$834).

### Pharmaplan

The Company owns a 44.99% interest in the common shares of Pharmaplan and considers this investment a related party. During the quarter ended September 30, 2011, Pharmaplan declared and paid dividends of ZAR15,000, the Company's share amounting to ZAR6,750 or \$640. During the year ended December 31, 2010, Pharmaplan declared dividends of ZAR20,000 the Company's share amounting to ZAR7,000 or \$1,043, of which \$792 was received during the year ended December 31, 2010 and \$251 was received during the three months ended March 31, 2011. On March 1, 2011, the Company entered into an agreement with Pharmaplan to accelerate the purchase of Pharmaplan shares leading to an acquisition of a total of 10% ownership interest in Pharmaplan, as further discussed in note 4 to the condensed interim financial statements. The Company paid \$5,975 which included the settlement of a previous investment in a non-interest bearing loan in Pharmaplan of \$2,879. The Company is committed to pay an additional future consideration by increasing its ownership position to 49.99% by March 2013, with such additional consideration based upon Pharmaplan's future financial results, payable in ZAR.

All transactions with related parties 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 following table presents the principal subsidiaries and associates of the Company as at September 30, 2011. The equity share capital of these undertakings is wholly-owned by the Company except where its percentage interest is shown otherwise and where the Company has significant influence.

<b>Name of subsidiary/associate</b>	<b>Country of registration</b>	<b>%</b>	<b>Nature of business</b>
Chimigen Inc.	Canada	100	Develop, acquire, in-license, market and distribute innovative pharmaceutical products internationally
Paladin Labs (Barbados) Inc.	Barbados	100	Develop, acquire, in-license, market and distribute innovative pharmaceutical products internationally
Paladin Labs (USA) Inc.	USA	100	Develop, acquire, in-license, market and distribute innovative pharmaceutical products in the United States
Pharmaplan (Pty) Ltd.	South Africa	44.99	Search, acquire, commercialize specialty pharmaceutical products in South Africa and sub-Saharan African region

#### **QUARTERLY INFORMATION (UNAUDITED)**

*(In thousands of Canadian dollars except per share information)*

	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>
	<b>F2011</b>	<b>F2011</b>	<b>F2011</b>	<b>F2010</b>	<b>F2010</b>	<b>F2010</b>	<b>F2010</b>	<b>F2009<sup>3</sup></b>
Revenues	<b>36,660</b>	35,971	31,752	32,434	31,782	32,936	30,837	29,279
EBITDA <sup>1</sup>	<b>18,099</b>	18,273	17,270	15,451	15,849	13,621	11,520	9,961
Net income before income taxes	<b>13,373</b>	22,475	11,949	16,797	11,355	8,095	5,112	2,501
Net Income	<b>9,496</b>	16,783	8,100	13,893	7,959	4,862	3,142	4,392 <sup>4</sup>
Earnings per share	<b>0.47</b>	0.83	\$0.42	\$0.74	\$0.43	\$0.26	\$0.17	\$0.24
Diluted earnings per share	<b>0.46</b>	0.80	\$0.40	\$0.72	\$0.41	\$0.25	\$0.16	\$0.23

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 the "Contractual Obligations and Commitments" section below 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 IFRS standards.

#### **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.

#### **CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS**

The Company considers its maximum credit risk from financial instruments to be \$32,209 (December 31, 2010: \$37,335) which is the total of the following financial assets: trade and other

<sup>3</sup> The Company has transitioned to IFRS starting with January 1, 2010 and the quarterly information disclosed for fiscal years 2010 and 2011 is IFRS compliant – refer to Note 1 and 11 to the interim financial statements for additional details. The quarterly information disclosed for fiscal year 2009 is not IFRS compliant and was prepared in accordance to Canadian GAAP.

<sup>4</sup> During the fourth quarter of 2009, in conjunction with the Isotechnika acquisition and in accordance to Canadian GAAP the Company recorded an extraordinary gain of \$3,458.

receivables, loans and other receivables and derivatives at fair value through income and loss. The Company's cash, cash equivalents, marketable securities, 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.

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. In line with other pharmaceutical companies, the Company sells its products through a small number of wholesalers and retail pharmacy chains in addition to hospitals, pharmacies, physicians and other groups. For the three months ended September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 34% and 17% of revenues, respectively (2010: 29% and 16%). For the nine months ended September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 32% and 16% of revenues, respectively (2010: 29% and 15%). As at September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 14% and 18% of trade accounts receivable, respectively (December 31, 2010: 6% and 13%). These above concentrations on the Company's customers are considered normal for the Company and its industry.

A further source of credit risk for the Company arises from its strategic investments in third-parties with whom it has commercial relationships. In connection with a licensing arrangement with Labopharm, the Company advanced Labopharm \$10,000 against future product supply, and has a balance outstanding as at September 30, 2011 of \$9,686. On October 7, 2011, the Company acquired all the outstanding common shares of Labopharm as further disclosed in the Significant Transactions section above. In connection with a license arrangement with SpePharm Holding B.V., the Company invested €4,000 (\$5,751) through a secured convertible debenture. The Company continuously monitors the risks associated with these amounts.

#### **LIQUIDITY RISK**

All financial liabilities with the exception of the long-term portion of the balances of sale payable are current. The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. The Company has sufficient funds available through its cash, cash equivalents and marketable securities, should its cash requirements exceed cash generated from operations, to cover all financial liability obligations. As at September 30, 2011, 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, ZAR and Swiss francs ("CHF"). This results in financial risk due to fluctuations in the value of the USD, EURO, ZAR and CHF relative to CAD. The Company has significant monetary assets and liabilities denominated in USD, EURO, ZAR and CHF that are required to be revalued in CAD at each period end. On March 31, 2010, the Company entered into a €4,000 notional amount 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. Based on the net exposure described in Note 3 to the condensed interim financial statements as at September 30, 2011, and assuming that all other variables remain constant, a ten-point increase or decrease on the September 30, 2011 CAD/USD, CAD/EURO, CAD/ZAR and CAD/CHF exchange rate would have an effect of \$96 (December 31, 2010: \$694) on net income. For a more detailed analysis and disclosure of the foreign exchange risk please refer to Note 3 to the condensed interim financial statements.

#### **INTEREST RATE RISK**

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

## EQUITY PRICE RISK

Equity price risk arises from changes in market prices of the available-for-sale equity securities. The carrying values of investments subject to equity price risk are, in almost all instances, based on quoted market prices as of the balance sheet dates with an estimated fair value of \$16,447 at September 30, 2011 (December 31, 2010: \$7,394). The Company monitors its equity investments for impairment on a periodic basis. Market prices are subject to fluctuation and, consequently, the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

The Company manages the equity price risk through the use of strict investment policies approved by the Board of Directors. Reports on the equity portfolio are submitted to the Company's senior management on a regular basis. The Company's Board of Directors reviews and approves all equity investment decisions.

A hypothetical 10% adverse change in the stock prices of the Company's available-for-sale equity securities would result in an approximate \$1,645 other comprehensive income (loss) (December 31, 2010: \$739). The Company does not include in the analysis above investments which are subject to significant influence. The adverse change above does not reflect what could be considered the best or worst case scenarios. Indeed, results could be worse due both to the nature of equity markets and the concentrations existing in the Company's equity investment portfolio, in particular where there is less liquidity available as in the case of the small capitalization companies included in the available-for-sale equity 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](http://www.sedar.com).

## INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes were made in our internal control over financial reporting during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The conversion to IFRS from Canadian GAAP impacts the way the Company presents its financial results. In conjunction with its conversion to IFRS, the Company completed an assessment of its information systems and based on this review no significant changes to the information systems were required as part of the IFRS conversion process. In addition, the effect of the adoption of IFRS on the Company's business activities and internal controls, including disclosure controls and procedures, were reviewed and no significant changes to the Company's business activities and internal control environment were required.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business, the Company secures development, sales, marketing and distribution rights to innovative drug products requiring royalties or product payments considered normal operating commitments and as such not included herein. The Company has entered into various agreements which include contractual obligations extending beyond the current year. These obligations due to their significance and being considered outside of the Company's normal course of business are separately disclosed. The Company is committed to making minimum purchases of inventory, and minimum expenditures for regulatory, selling and marketing services in the amount of \$6,150, including €2,877, to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 7 to the condensed interim financial statements is also committed to purchase an additional 5% interest in Pharmaplan's common shares in 2013, currently estimated to amount to \$2,900 (ZAR22,394) and subject to change based upon Pharmaplan's future operating results. These purchase and service-based commitments end in 2015 and annual commitments are as follows:

<b>Contractual Obligations</b> (in thousands of Canadian dollars)	<b>Total</b>	Less than 1 year	1-3 years	4-5 years	After 5 years
Purchase and service based commitments	<b>9,050</b>	346	7,108	1,596	—

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 \$11,037 including US\$8,111, €672 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:

<b>Commitments</b> (in thousands of Canadian dollars)	<b>Total</b>	Less than 1 year	1-3 years	4-5 years	After 5 years
Milestone based commitments	<b>6,457</b>	670	1,807	—	3,980
Revenues based commitments	<b>4,580</b>	—	—	524	4,056

Furthermore, as disclosed in the Significant Transactions and Subsequent Events paragraphs, the Company was committed to acquire all of the outstanding common shares of Labopharm for a total cash consideration of \$20,448. The Labopharm transaction closed and was fully paid for on October 7, 2011, subsequent to the quarter end.

#### **SUBSEQUENT EVENTS**

##### **Afexa offer**

On October 3, 2011, the Company announced that it would not take up any shares under its Enhanced Offer to acquire any and all of the issued and outstanding common shares of Afexa due to the non-fulfillment of a condition to the Company's Offer. In addition, on October 17, 2011, the Company tendered its shares in Afexa to Valeant for a gain on disposition of \$5,081.

##### **Acquisition of Labopharm**

On October 7, 2011, following the Labopharm Shareholder and Quebec Superior Court approval, the Company completed the acquisition of Labopharm for cash consideration of \$20,448.

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

The condensed interim consolidated financial statements of Paladin Labs Inc. (the “**Company**”) and the accompanying condensed interim consolidated balance sheet as at September 30, 2011 and the condensed interim consolidated income statements, cash flows, comprehensive income and changes in shareholders’ equity for the three-month period then ended are the responsibility of the Company’s management. These condensed interim consolidated financial statements have not been audited or reviewed on behalf of the shareholders by the independent external auditors, Ernst & Young LLP.

The condensed 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 International Financial Reporting Standards. Management has determined such amounts on a reasonable basis in order to ensure that the condensed interim 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 condensed interim consolidated financial statements may not be appropriate for their purposes.

*(signed) Mark Beaudet* \_\_\_\_\_  
Mark Beaudet  
Interim President and Chief Executive Officer

Montreal, Canada  
November 3, 2011

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

Montreal, Canada  
November 3, 2011

## INTERIM CONSOLIDATED BALANCE SHEETS

[In thousands of Canadian dollars]  
[unaudited]

	Notes	September 30, 2011	December 31, 2010
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents		83,331	96,295
Marketable securities		143,369	43,094
Trade and other receivables		18,572	21,912
Inventories		12,267	13,877
Income tax receivable		42	17
Other current assets		870	4,717
<b>Total current assets</b>		<b>258,451</b>	<b>179,912</b>
Investment in an associate	4	22,170	15,739
Financial assets		31,997	22,835
Property, plant and equipment		125	221
Pharmaceutical product licenses and rights		14,276	20,594
Investment tax credits recoverable		14,874	14,736
Deferred income tax assets		23,526	26,586
<b>Total assets</b>		<b>365,419</b>	<b>280,623</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current</b>			
Payables, accruals and provisions		34,114	36,901
Income tax payable		20,478	11,254
Deferred revenue		619	1,939
Balances of sale payable		2,334	1,145
<b>Total current liabilities</b>		<b>57,545</b>	<b>51,239</b>
Balances of sale payable		1,024	539
<b>Total liabilities</b>		<b>58,569</b>	<b>51,778</b>
<b>Shareholders' equity</b>			
Share capital	5	165,396	123,136
Other paid-in capital		5,156	4,892
Other capital reserves		1,522	175
Retained earnings		134,776	100,642
<b>Total shareholders' equity</b>		<b>306,850</b>	<b>228,845</b>
<b>Total liabilities and shareholders' equity</b>		<b>365,419</b>	<b>280,623</b>

Commitments [note 7]  
Subsequent events [note 10]

See accompanying notes

## INTERIM CONSOLIDATED INCOME STATEMENTS

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

	Notes	Three months ended September 30		Nine months ended September 30	
		2011	2010	2011	2010
Revenues	6	<b>36,660</b>	31,782	<b>104,383</b>	95,555
Cost of sales		<b>10,249</b>	7,721	<b>27,751</b>	25,746
<b>Gross profit</b>		<b>26,411</b>	24,061	<b>76,632</b>	69,809
<b>Expenses (income)</b>					
Selling, general and administrative	6	<b>7,824</b>	7,315	<b>23,051</b>	23,231
Research and development		<b>1,849</b>	1,477	<b>6,145</b>	6,894
Interest income		<b>(1,361)</b>	(580)	<b>(6,207)</b>	(1,306)
<b>Earnings before under-noted items</b>		<b>18,099</b>	15,849	<b>53,643</b>	40,990
Amortization of pharmaceutical product licenses and rights		<b>4,959</b>	5,146	<b>15,860</b>	17,487
Other finance income	2	<b>(56)</b>	(61)	<b>(8,617)</b>	(136)
Foreign exchange loss (gain)		<b>251</b>	(322)	<b>(204)</b>	(115)
Other income		<b>(97)</b>	—	<b>(97)</b>	(41)
Share of net income from an associate	4	<b>(331)</b>	(291)	<b>(1,096)</b>	(757)
<b>Income before income tax</b>		<b>13,373</b>	11,377	<b>47,797</b>	24,552
Provision for income taxes		<b>3,877</b>	3,418	<b>13,418</b>	8,588
<b>Net income for the period</b>		<b>9,496</b>	7,959	<b>34,379</b>	15,964
<b>Attributable to shareholders</b>					
Basic earnings per share		<b>0.47</b>	0.43	<b>1.73</b>	0.86
Diluted earnings per share		<b>0.46</b>	0.41	<b>1.67</b>	0.83
<b>Weighted average number of shares outstanding</b>					
Basic		<b>20,204,105</b>	18,746,237	<b>19,882,261</b>	18,670,511
Diluted		<b>20,864,049</b>	19,406,637	<b>20,595,223</b>	19,303,642

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

[In thousands of Canadian dollars]  
[unaudited]

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
<b>Net income for the period</b>	<b>9,496</b>	7,959	<b>34,379</b>	15,964
<b>Other comprehensive (loss) income:</b>				
Change in fair value of available-for-sale financial instruments [net of \$nil taxes for the three-month period [2010 – (\$40)] and \$34 for the nine-month period [2010 – (\$41)]]	<b>3,942</b>	227	<b>1,510</b>	234
Reclassification adjustment for gains on available-for-sale financial instruments included in net income in the period [net of \$nil taxes for the three-month period [2010 - \$3] and (\$3) for the nine-month period [2010 - \$13]]	<b>(69)</b>	(17)	<b>(163)</b>	(79)
<b>Other comprehensive income for the period</b>	<b>3,873</b>	210	<b>1,347</b>	155
<b>Total comprehensive income attributable to shareholders for the period</b>	<b>13,369</b>	8,169	<b>35,726</b>	16,119

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]  
[unaudited]

		Three months ended September 30		Nine months ended September 30	
	Notes	2011	2010	2011	2010
<b>Operating activities</b>					
Net income for the period		9,496	7,959	34,379	15,964
Adjustments reconciling net income to operating cash flows					
Amortization of pharmaceutical product licenses and rights		4,959	5,146	15,860	17,487
Deferred tax		(201)	1,633	3,721	3,966
Share-based compensation expense	5	385	391	1,508	1,342
Other finance income		(57)	(61)	(8,618)	(136)
Unrealized foreign exchange loss (gain)		182	(329)	(832)	(139)
Depreciation of property, plant and equipment		36	57	165	484
Share of net income from an associate	4	(331)	(291)	(1,096)	(757)
Changes in working capital and other non-cash balances	8	10,296	6,893	10,885	8,681
<b>Cash inflow from operating activities</b>		<b>24,765</b>	<b>21,398</b>	<b>55,972</b>	<b>46,892</b>
<b>Investing activities</b>					
Purchases of marketable securities		(15,000)	(35,257)	(151,057)	(127,562)
Purchases of financial assets		(2,937)	(300)	(88,873)	(9,313)
Purchases of pharmaceutical product licenses and rights		—	—	(7,617)	—
Investment in an associate	4	—	—	(2,936)	(15,982)
Repayment of balances of sale payable		—	—	(250)	(1,650)
Purchases of property, plant and equipment		(4)	(18)	(69)	(67)
Proceeds from disposal of financial assets	2	—	—	89,010	27
Disposals and maturities of marketable securities		35,259	16,636	51,353	91,105
Dividends from an associate	4	640	—	891	—
<b>Net cash inflow (outflow) from investing activities</b>		<b>17,958</b>	<b>(18,939)</b>	<b>(109,548)</b>	<b>(63,442)</b>
<b>Financing activities</b>					
Common shares issued for cash, net of issue costs	5	177	613	41,038	2,023
Common shares repurchased	5	(321)	—	(321)	—
<b>Net cash (outflow) inflow from financing activities</b>		<b>(144)</b>	<b>613</b>	<b>40,717</b>	<b>2,023</b>
Foreign exchange rate gain (loss) on cash and cash equivalents		53	29	(105)	40
<b>Increase (decrease) in cash and cash equivalents during the period</b>		<b>42,632</b>	<b>3,101</b>	<b>(12,964)</b>	<b>(14,487)</b>
Cash and cash equivalents, beginning of period		40,699	13,639	96,295	31,227
<b>Cash and cash equivalents, end of period</b>		<b>83,331</b>	<b>16,740</b>	<b>83,331</b>	<b>16,740</b>
<b>Supplemental cash flow information</b>					
Interest received		1,070	360	4,657	1,797
Income taxes (paid) received		(6)	38	(65)	4,402
Cash and cash equivalents		83,331	16,740		
Marketable securities		143,369	110,629		
		<b>226,700</b>	<b>127,369</b>		

Amounts received for interest and paid for income taxes were reflected as operating cash flows in the interim consolidated statements of cash flows.

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

[In thousands of Canadian dollars]  
[unaudited]

	For the nine months ended September 30, 2011 and 2010					
	Note	Share capital	Other paid-in capital	Other capital reserves (deficit)	Retained earnings	Total shareholders' equity
<b>Balance as at January 1, 2011</b>		123,136	4,892	175	100,642	228,845
Net income for the period					34,379	34,379
Other comprehensive income for the period				1,347		1,347
Shares issued	5	41,091				41,091
Shares repurchased	5	(76)			(245)	(321)
Share-based incentive plans	5		1,509			1,509
Transfers upon exercise of share options		1,245	(1,245)			—
<b>Balance as at September 30, 2011</b>		165,396	5,156	1,522	134,776	306,850
<b>Balance as at January 1, 2010</b>		119,652	4,362	98	70,786	194,898
Net income for the period					15,964	15,964
Other comprehensive income for the period				155		155
Shares issued	5	2,050				2,050
Share-based incentive plans	5		1,342			1,342
Transfers upon exercise of share options		1,081	(1,081)			—
<b>Balance as at September 30, 2010</b>		122,783	4,623	253	86,750	214,409

See accompanying notes

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

### 1. PRESENTATION OF FINANCIAL STATEMENTS

#### DESCRIPTION OF THE BUSINESS

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

#### BASIS OF PREPARATION

These condensed unaudited interim consolidated financial statements [“condensed interim financial statements”] of the Company were prepared in accordance with International Financial Reporting Standards [“IFRS”] as issued by the International Accounting Standards Board [“IASB”]. The condensed interim financial statements have been prepared on a historical cost basis, except for items that are required to be accounted for at fair value. The condensed interim financial statements are in compliance with IAS 34, *Interim Financial Reporting*, with IFRS 1, *First Time Adoption of IFRS*, and with the accounting policies the Company expects to adopt in its December 31, 2011 financial statements. Those accounting policies are based on the IFRS standards and International Financial Reporting Interpretations Committee [“IFRIC”] interpretations that the Company expects to be applicable at that time. These condensed interim financial statements do not include all the information and disclosures required according to IFRS for annual financial statements and should be read in conjunction with the Company’s interim consolidated financial statements and notes thereto for the quarter ended March 31, 2011. The accounting policies underlining these condensed interim financial statements are those set forth in note 2 of the unaudited interim consolidated financial statements for the quarter ended March 31, 2011.

For all periods up to and including the year ended December 31, 2010, the Company prepared its consolidated financial statements in accordance with Canadian generally accepted accounting principles [“Canadian GAAP”]. Canadian GAAP differs in some areas from IFRS. In preparing these condensed interim financial statements, management has amended certain accounting, valuation and presentation methods previously applied in the Canadian GAAP financial statements to comply with IFRS. The comparative figures for 2010 were restated to reflect these adjustments. Note 11 contains reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS on equity, net income and comprehensive income along with line-by-line reconciliations of the income statements and balance sheet for the year ended December 31, 2010, as well as interim periods relevant to the computation of these condensed interim financial statements.

The preparation of the Company’s consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

These condensed interim financial statements were authorised for issue by the Company’s Board of Directors on November 2, 2011.

#### RECENT ACCOUNTING PRONOUNCEMENTS

IASB has issued the following standards that are applicable to the Company:

- IFRS 9 – *Financial Instruments (Classification and Measurement)*
- IFRS 10 – *Consolidated Financial Statements*
- IFRS 12 – *Disclosure of Interests in Other Entities*
- IAS 28 – *Investments in Associates and Joint Ventures*

These standards are mandatory for accounting periods beginning January 1, 2013. The Company is assessing the impact of these standards on its consolidated results and financial position.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 2. SIGNIFICANT TRANSACTION

#### Prostrakan Facility

On January 11, 2011, the Company invested £50,000 [\$77,230] in ProStrakan Group plc ["Prostrakan"] through the acquisition by way of assignment of ProStrakan's existing secured debt facility with the addition of certain conversion rights. The secured facility was amended and provided by the Company in CAD at a rate of interest of 10.5%. The amended secured facility ["Facility"] was repayable in full at the end of three years and the Company had the option to convert the outstanding principal debt into new ProStrakan ordinary shares at any point after the initial nine months of the term of the amended agreement. In the event of a change in control of ProStrakan during this same initial time period, along with the Company consenting to early redemption, the Company was entitled to receive a payment equivalent to the balance of interest for the first year of the loan together with a break fee of £2,000 [\$3,089]. The strike price for the conversion rights was set at £1.10 per share, a 24% premium to the closing price of ProStrakan's common shares on December 14, 2010.

According to financial instruments accounting standards, the Facility was initially recognized at its respective fair value through the bifurcation of the conversion option and early redemption option being classified and subsequently re-measured as derivative assets. The fair value of the conversion option was obtained by using the Black-Scholes option pricing model, adjusted for credit risk and a 25% likelihood of conversion, using the following assumptions, as at January 11, 2011: volatility factor: 59.43%, risk free interest rate: 2.01% and time to expiry: 3 years. The fair value of the early redemption option, as at January 11, 2011, was obtained using a probability factor of 75% and a discount factor of 20.8%. The allocated loan portion of the Facility was classified as "Loans and receivables" and recorded at fair value upon initial measurement and subsequently recorded at amortized cost using the effective interest rate method at a rate of 20.8% per year.

On February 21, 2011, in connection with the proposed acquisition of ProStrakan by Kyowa Hakko Kirin Co., Ltd. ["KHK"], the Company consented to the repayment of its Facility subject to closing of the acquisition. On March 31, 2011, the general meeting of Prostrakan's shareholders approved the acquisition of ProStrakan by KHK. As a result the conversion option was deemed to have a fair value of \$nil and the early redemption option was re-measured using a probability factor of 100%.

On May 17, 2011, the Company received gross proceeds of \$86,432 representing the aggregate of: the principal of the ProStrakan Facility of \$77,232; the interest accrued at May 17, 2011 of \$778; a break free of \$3,089; and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. The Company has recorded interest accretion of \$nil and \$1,004 for the three and nine months ended September 30, 2011, respectively, in the interim consolidated income statement. Moreover, the Company has retained the rights to the products it had previously been licensed in connection with the agreement.

#### Afexa Offer

On August 10, 2011, the Company issued a take-over bid circular making an offer to purchase [the "Offer"], on the terms and subject to the conditions of the Offer, any and all of the issued and outstanding common shares [the "Afexa Common Shares"] of Afexa Life Sciences Inc. ["Afexa"], together with any associated rights [the "SRP Rights"] issued under the Shareholder Rights Plan of Afexa, which included Afexa Common Shares that might have become issued and outstanding after the date of the Offer but before the expiry time of the Offer upon the exercise of options issued under Afexa's Stock Option Plan ["Afexa Options"] together with their associated SRP Rights.

Under the terms of the Offer, Afexa Shareholders had an alternative to either receive \$0.55 in cash [the "Cash Alternative"] or 0.013 common shares ["Paladin Shares"] of the Company [the "Share Alternative"]. Based on the Cash Alternative of \$0.55 per Common Share, the consideration offered under the Offer represented a premium of approximately 57% over the closing price of \$0.35 per Afexa Common Share on the TSX on July 14, 2011 and a premium of approximately 45% over the volume-weighted average price of \$0.38 per Afexa Common Share over the 20 trading days on the TSX ending July 14, 2011.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 2. SIGNIFICANT TRANSACTION (CONT'D)

The 0.013 Paladin Shares per Common Share exchange ratio was calculated based on the Company's volume-weighted average price of \$43.14 over the 20 trading days on the TSX ending August 9, 2011 compared to the cash consideration under the Cash Alternative, being a cash amount of \$0.55.

On August 30, 2011, Valeant Pharmaceuticals International Inc. ["Valeant" – NYSE/TSX: VRX], through a subsidiary, made a competing offer to acquire the issued and outstanding common shares of Afexa for \$0.71 per share. Following this offer, on September 26, 2011, the Company increased its Offer to acquire any and all of the issued and outstanding common shares of Afexa to \$0.81 per share. On September 30, 2011 Valeant further announced it had increased its bid to \$0.85 per share. On October 3, 2011, the Company announced it would not take up any shares under its offer due to the non-fulfillment of a condition of the offer.

#### Acquisition of Labopharm

On August 17, 2011, the Company entered into a definitive agreement [the "Arrangement Agreement"] pursuant to which the Company would acquire all of the issued and outstanding common shares of Labopharm Inc. ["Labopharm"] [TSX: DDS] at a price of \$0.2857 per share in cash, representing a 57.4% premium over the volume-weighted average price of Labopharm's shares of \$0.1815 for the 30 trading days prior to the August 17, 2011 announcement. The transaction was carried out pursuant to the Arrangement Agreement under a court-approved statutory plan of arrangement governed by the Business Corporations Act. The completion of the proposed Arrangement was subject to a number of customary conditions, including the approval of the Superior Court of Québec and the approval of 66 2/3% of the votes cast by Labopharm's shareholders present in person or represented by proxy at a special meeting convened for such purpose and held on October 5, 2011, each of which was met. The Company completed the acquisition of all the outstanding common shares of Labopharm on October 7, 2011 for a total cash consideration payable of \$20,448 which is included in the commitments section further disclosed in note 7.

### 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.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 3. FINANCIAL INSTRUMENTS [CONT'D]

	Carrying value		Fair Value	
	September 30, 2011	December 31, 2010	September 30, 2011	December 31, 2010
	\$	\$	\$	\$
<b>Financial assets</b>				
Cash and cash equivalents	83,331	96,295	83,331	96,295
Marketable securities	143,369	43,094	143,369	43,094
Trade and other receivables	16,659	21,894	16,659	21,894
Other current assets	188	3,480	188	3,480
Other financial assets				
Loans and other receivables	15,052	14,725	15,052	14,725
Available-for-sale financial investments	16,447	7,394	16,447 <sup>1</sup>	7,394 <sup>1</sup>
Derivatives at fair value through income and loss	498	716	498 <sup>1</sup>	716 <sup>1</sup>
<b>Total financial assets</b>	<b>275,544</b>	<b>187,598</b>	<b>275,544</b>	<b>187,598</b>
<b>Financial liabilities</b>				
Payables, accruals and provisions	34,114	36,901	34,114	36,901
Balances of sale payable	2,334	1,145	2,334	1,145
Long-term balances of sale payable	1,024	539	1,024	539
<b>Total financial liabilities</b>	<b>37,472</b>	<b>38,585</b>	<b>37,472</b>	<b>38,585</b>

#### Financial assets and liabilities – fair values

The carrying amounts of cash and cash equivalents, marketable securities, trade and other receivables, certain other current assets, payables, accruals and provisions, and the short-term portion of the balances of sale payable are a reasonable estimate of their fair values because of the short maturity of these instruments.

The long-term portion of the balances of sale payable has been recorded at its discounted value, using a discount rate of 3.25% [December 31, 2010: 3.25%], and approximates its fair value.

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments, other than the short term maturity instruments described above, by valuation technique:

Level 1: quoted [unadjusted] prices in active markets for identical assets or liabilities

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

	September 30, 2011	Level 1	Level 2	Level 3
	\$	\$	\$	\$
Assets measured at fair value				
Marketable securities	143,369	143,369	—	—
Available-for-sale financial investments	16,447	16,447	—	—
Derivatives at fair value through income and loss	498	(78)	576	—
<b>Total</b>	<b>160,314</b>	<b>159,738</b>	<b>576</b>	<b>—</b>

<sup>1</sup> In accordance with existing accounting standards, 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.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 3. FINANCIAL INSTRUMENTS [CONT'D]

	December 31, 2010	Level 1	Level 2	Level 3
	\$	\$	\$	\$
Assets measured at fair value				
Marketable securities	43,094	43,094	—	—
Available-for-sale financial investments	7,394	7,394	—	—
Derivatives at fair value through income and loss	716	140	576	—
<b>Total</b>	<b>51,204</b>	<b>50,628</b>	<b>576</b>	<b>—</b>

#### LIQUIDITY RISK

All financial liabilities with the exception of the long-term portion of the balances of sale payable are current. The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. The Company has sufficient funds available through its cash, cash equivalents and marketable securities, should its cash requirements exceed cash generated from operations, to cover all financial liability obligations. As at September 30, 2011, there were no restrictions on the flow of these funds nor have any of these funds been committed in any way, except as set out in Note 7 and Note 10 to the condensed interim financial statements.

#### CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

The Company considers its maximum credit risk from financial instruments to be \$32,209 [December 31, 2010: \$37,335] which is the total of the following financial assets: trade and other receivables, loans and other receivables and derivatives at fair value through income and loss. The Company's cash, cash equivalents, marketable securities, 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.

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. In line with other pharmaceutical companies, the Company sells its products through a small number of wholesalers and retail pharmacy chains in addition to hospitals, pharmacies, physicians and other groups. For the three months ended September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 34% and 17% of revenues, respectively [2010: 29% and 16%]. For the nine months ended September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 32% and 16% of revenues, respectively [2010: 29% and 15%]. As at September 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 14% and 18% of trade accounts receivable, respectively [December 31, 2010: 6% and 13%]. These above concentrations on the Company's customers are considered normal for the Company and its industry.

Another source of credit risk for the Company arises from its strategic investments in third-parties with whom it has commercial relationships. In connection with a licensing arrangement with Labopharm Inc. ["Labopharm"], Paladin advanced Labopharm \$10,000 against future product supply, and has a balance outstanding as at September 30, 2011 of \$9,686. On October 7, 2011, the Company acquired all the outstanding common shares of Labopharm as further disclosed in note 2. Moreover, in connection with a license arrangement with SpePharm Holding B.V., the Company invested €4,000 [\$5,751] through a secured convertible debenture. The Company continuously monitors the risks associated with these amounts.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 3. FINANCIAL INSTRUMENTS [CONT'D]

#### 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 CAD. The Company has significant monetary assets and liabilities 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 €4,000 notional amount 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 are as follows:

	September 30, 2011				December 31, 2010			
	USD	EURO	ZAR	CHF	USD	EURO	ZAR	CHF
Cash and cash equivalents	970	454	11,138	—	1,869	2,588	21,000	—
Trade and other receivables	1,128	635	—	—	647	209	1,750	—
Other current assets	—	—	—	—	—	—	5,249	—
Payables, accruals and provisions	3,497	—	—	471	3,078	344	—	—

These four currencies are the foreign currencies in which the Company's financial instruments are denominated. The Company has considered movements in these currencies over the last three years and has concluded that a 10% movement in rates is a reasonable benchmark. Based on the aforementioned net exposure as at September 30, 2011, and assuming that all other variables remain constant, a ten-point increase or decrease on the CAD/USD, CAD/EURO, CAD/ZAR and CAD/CHF September 30, 2011 exchange rate would have an effect of \$96 [December 31, 2010: \$694] on net income.

#### EQUITY PRICE RISK

Equity price risk arises from changes in market prices of the available-for-sale equity securities. The carrying values of investments subject to equity price risk are, in almost all instances, based on quoted market prices as of the balance sheet dates with an estimated fair value of \$16,447 at September 30, 2011 [December 31, 2010: \$7,394]. The Company monitors its equity investments for impairment on a periodic basis. Market prices are subject to fluctuation and, consequently, the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

The Company manages the equity price risk through the use of strict investment policies approved by the Board of Directors. Reports on the equity portfolio are submitted to the Company's senior management on a regular basis. The Company's Board of Directors reviews and approves all equity investment decisions.

A hypothetical 10% adverse change in the stock prices of the Company's available-for-sale equity securities would result in an approximate \$1,645 other comprehensive income (loss) [December 31, 2010: \$739]. The Company does not include in the analysis above investments which are subject to significant influence. The adverse change above does not reflect what could be considered the best or worst case scenarios. Indeed, results could be worse due both to the nature of equity markets and the concentrations existing in the Company's equity investment portfolio, in particular where there is less liquidity available as in the case of the small capitalization companies included in the available-for-sale equity securities.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 3. FINANCIAL INSTRUMENTS [CONT'D]

#### INTEREST RATE RISK

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

### 4. INVESTMENT IN AN ASSOCIATE

	Three months ended September 30		Nine months ended September 30		106 days ended September 30	
	2011	2010	2011	2010	2011	2010
	\$	\$	\$	\$	\$	\$
<b>Carrying values, beginning of period</b>	<b>22,479</b>	16,448	<b>15,739</b>	—	—	—
<b>Additions in the period</b>	<b>—</b>	—	<b>5,975</b>	15,982	15,982	—
Share of net income for the period before adjustments	<b>886</b>	665	<b>2,767</b>	1,491	1,491	—
Adjustments to net income:						
Amortization of fair value adjustments	<b>(442)</b>	(374)	<b>(1,321)</b>	(734)	(734)	—
Taxation	<b>(113)</b>	—	<b>(350)</b>	—	—	—
<b>Share of net income for the period</b>	<b>331</b>	291	<b>1,096</b>	757	757	—
<b>Share of dividends received in the period</b>	<b>(640)</b>	—	<b>(640)</b>	—	—	—
<b>Carrying values, end of period</b>	<b>22,170</b>	16,739	<b>22,170</b>	16,739	16,739	—

#### Investment in Pharmaplan [Pty] Ltd ["Pharmaplan"]

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan, a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan of \$2,879 [ZAR21,000]. In addition, the Company 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. In addition, the Company has the option to increase its ownership interest in Pharmaplan to 100% in 2013, at a purchase price determined using Pharmaplan's future financial results, payable in ZAR.

On March 1, 2011, the Company entered into an agreement with Pharmaplan to accelerate the purchase of Pharmaplan shares leading to the acquisition of a total 10% ownership interest in Pharmaplan. This increased Paladin's ownership from 34.99% to 44.99% effective March 1, 2011. The Company paid \$5,975 including the settlement of the non-interest bearing loan mentioned above.

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 investments were 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 the net identifiable assets of Pharmaplan acquired and the tax impact on the distributable earnings.

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 allocation of the cost of the investment in Pharmaplan for the March 16, 2010 and March 1, 2011 purchases is identified herein below:

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 4. INVESTMENT IN AN ASSOCIATE [CONT'D]

	March 16, 2010 34.99% purchase \$	March 1, 2011 10% purchase <sup>(i)</sup> \$	Total 44.99% purchase \$
Net book value of identifiable assets acquired	2,486	1,089	3,575
Definite life intangibles	10,665	3,723	14,388
Indefinite life intangibles	278	80	358
Future income tax liabilities	(3,064)	(1,065)	(4,129)
Goodwill	5,617	2,148	7,765
	15,982	5,975	21,957

<sup>(i)</sup>The Company is in the process of finalizing the March 1, 2011 purchase price allocation which will be completed during the year ended December 31, 2011.

The Company is presenting selected financial information derived from Pharmaplan's unaudited financial statements in South African Rand using South African GAAP converted into IFRS in CAD for information purposes.

Pharmaplan's statement of income data (unaudited)	Three months ended September 30		Nine months ended September 30	106 days ended September 30
	2011 \$	2010 \$	2011 \$	2010 \$
Revenues	11,752	9,653	34,619	22,293
Cost of sales	5,768	3,952	16,876	9,616
<b>Gross profit</b>	<b>5,984</b>	<b>5,701</b>	<b>17,743</b>	<b>12,677</b>
Operating expenses	3,058	3,044	8,773	6,663
<b>Earnings before under-noted items</b>	<b>2,926</b>	<b>2,657</b>	<b>8,970</b>	<b>6,014</b>
Interest income, amortization and income taxes	956	757	2,610	1,753
<b>Net income for the period</b>	<b>1,970</b>	<b>1,900</b>	<b>6,360</b>	<b>4,261</b>

  

Pharmaplan's balance sheet data (unaudited)	September 30, 2011 \$	December 31, 2010 \$
Total assets	21,882	18,943
Total liabilities	8,171	8,281

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 5. SHARE CAPITAL

#### Authorized

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

#### Issued and outstanding

	Nine months ended September 30, 2011					
	Balance beginning of year	Issued upon common share offering [i]	Exercise of share options	Employee share purchase plan	Share buy-back	Balance end of period [ii]
Number of shares	18,803,384	1,150,000	250,060	6,170	(9,236)	20,200,378
Amount (\$)	123,136	38,607	3,511	218	(76)	165,396

[i] On February 24, 2011, the Company issued 1,150,000 common shares including an over-allotment of 150,000 common shares pursuant to a bought deal share offering at a price of \$35.00 per common share for total gross proceeds to the Company of \$40,250. In conjunction with the offering, the Company incurred share issue costs of approximately \$1,643, net of taxes, and recorded these as a reduction of share capital.

[ii] The balance at September 30, 2011 is net of the 9,236 shares repurchased during the period under the normal course issuer bid and cancelled subsequent to the quarter on October 13, 2011.

#### Share option issuances and option compensation expense

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Share-based compensation expense	\$385	\$391	\$1,508	\$1,342
Weighted average fair value of options	\$9.77	\$7.81	\$9.96	\$6.25
Weighted average risk-free interest rate	1.73%	2.29%	2.29%	2.30%
Dividend yield	Nil	Nil	Nil	Nil
Weighted average volatility factor	31%	33%	31%	34%
Weighted average expected life	3.3 years	4 years	3.3 years	4 years

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

	2011		2010	
	Weighted average exercise price		Weighted average exercise price	
	#	\$	#	\$
Balance at January 1st	1,286,177	13.38	1,246,518	10.65
Options granted	311,539	35.67	363,951	20.13
Options exercised	(250,060)	9.06	(212,819)	8.87
Options expired/forfeited	(72,544)	21.85	(80,728)	14.10
Balance at September 30 <sup>th</sup>	1,275,112	19.19	1,316,922	13.34
Options exercisable at September 30 <sup>th</sup>	452,301	11.77	448,238	10.19

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 5. SHARE CAPITAL [CONT'D]

#### SHARE BUYBACK

On May 26, 2011, the Company received regulatory approval from the Toronto Stock Exchange ["TSX"] to carry out a normal course issuer bid effective May 30, 2011. The Company had been authorized to purchase up to 935,367 of its common shares in the twelve-month period following the bid's effective date. During the three and nine months ended September 30, 2011, the Company repurchased 9,236 of its common shares at an average price of \$34.77.

### 6. RELATED PARTY DISCLOSURES

#### Joddes Limited

Joddes Limited ["Joddes"], a private Canadian corporation, together with its affiliates own in aggregate approximately 35% of the outstanding shares of the Company as at September 30, 2011, 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 \$684 as at September 30, 2011 and is included in the purchase and service based commitments in Note 7.

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 performance 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.

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
	\$	\$	\$	
Revenues	477	1,229	2,467	3,310
Purchases	3,044	3,103	8,013	10,198
Selling, general and administrative	2,200	2,093	6,136	5,780
Research and development	114	389	488	2,644

As at September 30, 2011, the Company has a balance payable to a wholly-owned subsidiary of Joddes, included in payables, accruals and provisions on the interim consolidated balance sheet, of \$2,392 [December 31, 2010: \$834].

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 6. RELATED PARTY DISCLOSURES [CONT'D]

#### Pharmaplan

The Company owns a 44.99% interest in the common shares of Pharmaplan and considers this investment a related party. During the quarter ended September 30, 2011, Pharmaplan declared and paid dividends of ZAR15,000, the Company's share amounting to ZAR6,750 or \$640. During the year ended December 31, 2010, Pharmaplan declared dividends of ZAR20,000, the Company's share amounting to ZAR7,000 or \$1,043, of which \$792 was received during the year ended December 31, 2010 and \$251 was received during the three months ended March 31, 2011. On March 1, 2011, the Company entered into an agreement with Pharmaplan to accelerate the purchase of Pharmaplan shares leading to an acquisition of a total of 10% ownership interest in Pharmaplan, as further discussed in note 4. The Company paid \$5,975 which included the settlement of a previous investment in a non-interest bearing loan in Pharmaplan of \$2,879. The Company is committed to pay additional future consideration by increasing its ownership position to 49.99% by March 2013, with such additional consideration based upon Pharmaplan's future financial results, payable in ZAR.

All transactions with related parties 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.

### 7. COMMITMENTS

In the normal course of business, the Company secures development, sales, marketing and distribution rights to innovative drug products requiring royalties or product payments considered normal operating commitments and as such are not included herein. The Company has entered into various agreements which include contractual obligations extending beyond the current year. These obligations due to their significance and being considered outside of the Company's normal course of business are separately disclosed and are classified into three major categories: revenue based, milestone based, and purchase and services based commitments.

#### REVENUE BASED COMMITMENTS

The Company may have to pay up to \$11,280 [2010 – \$6,431] including US\$4,250 [2010 – US\$6,250] if it achieves specific sales volumes on specific products in the future, over a maximum of ten years [2010 – ten years].

#### MILESTONE BASED COMMITMENTS

The Company has also committed to fund certain research and development expenditures of third parties in the amount of \$1,438 [2010 – \$1,838] including €672 [2010 – €955] over the next three years. In addition, certain additional payments may be required under these agreements if milestones are met, such as regulatory approval in Canada. Based on the outcome of these milestones, the Company may have to pay up to \$5,519 [2010 – \$2,905], including US\$3,861 [2010 – US\$1,161] and £500 [2010 – £500], over a maximum period of 15 years [2010 – 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 \$6,125 [2010 – \$12,300], including €2,877 [2010 – €3,554], to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 4, is also committed to purchase an additional 5% interest in Pharmaplan's common shares in 2013, currently estimated to amount to \$2,900 [ZAR22,394] and subject to change based upon Pharmaplan's future operating results. Furthermore, as discussed in note 2, as at September 30, 2011, the Company was committed to acquire all of the outstanding common shares of Labopharm for a total cash consideration of \$20,448. The Labopharm transaction closed and was fully paid for on October 7, 2011, subsequent to the quarter end. These purchase and service based commitments end in 2015.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 8. SUPPLEMENTAL DISCLOSURE FOR CONSOLIDATED STATEMENTS OF CASH FLOWS

Effect on cash flows of changes in working capital and other non-cash balances are as follows:

	Three months ended		Nine months ended	
	September 30		September 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Decrease (increase) in inventories	2,082	526	1,610	(921)
Decrease (increase) in trade and other receivables	1,559	(5,314)	3,340	(7,315)
Increase (decrease) in payables, accruals and provisions	3,151	8,398	(2,784)	7,444
Increase (decrease) in deferred revenue	85	2,200	(1,320)	481
Other working capital non-cash balances	3,419	1,083	10,039	8,992
	10,296	6,893	10,885	8,681

### 9. COMPARATIVE FIGURES

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

### 10. SUBSEQUENT EVENTS

#### Afexa offer

On October 3, 2011, the Company announced that it would not take up any shares under its Enhanced Offer to acquire any and all of the issued and outstanding common shares of Afexa due to the non-fulfillment of a condition to the Company's Offer. In addition, on October 17, 2011, the Company tendered its shares in Afexa to Valeant for a gain on disposition of \$5,081.

#### Acquisition of Labopharm

On October 7, 2011, following the Labopharm Shareholder and Quebec Superior Court approval, the Company completed the acquisition of Labopharm for cash consideration of \$20,448.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS

These consolidated financial statements have been prepared as described in Note 1.

The Company's transition date was January 1, 2010. The Company prepared its opening IFRS balance sheet at that date. The reporting date of these interim consolidated financial statements is September 30, 2011. The Company's IFRS adoption date is January 1, 2011.

In preparing these interim consolidated financial statements in accordance with IFRS 1, the Company has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS for first time adopters. The Company has also applied the transitional provision in IFRIC 4, "Determining whether an arrangement contains a lease", and has assessed all arrangements as at the date of transition.

#### IFRS EXEMPTION OPTIONS

##### [a] Business combinations exemption

The Company has elected to apply the business combinations exemption and it has not restated business combinations that took place prior to the January 1, 2010 transition date.

##### [b] Share-based payment transaction exemption

The Company has elected to apply the share-based payment exemption. It applied IFRS 2 from January 1, 2010 to those options that were issued after November 7, 2002 but that have not vested by January 1, 2010.

#### IFRS MANDATORY EXCEPTIONS

##### [a] Estimates

Hindsight is not used to create or revise estimates. The estimates previously made by the Company under Canadian GAAP were not revised for application of IFRS.

##### [b] Derecognition of financial assets and financial liabilities

The derecognition requirements in IAS39 were applied prospectively for transactions occurring on or after January 1, 2004.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### RECONCILIATION OF CANADIAN GAAP TO IFRS

IFRS 1 requires an entity to reconcile shareholder's equity, comprehensive income and cash flows for prior periods. The Company's first time adoption of IFRS did not have a significant impact on the total consolidated operating, investing or financing cash flows. The following represents the reconciliations from Canadian GAAP to IFRS on the Company's consolidated financial statements as of January 1, 2010 and December 31, 2010 and for the year to date periods ended September 30, 2010 and December 31, 2010.

#### [a] Shareholders' equity

As of	December 31, 2010	September 30, 2010	January 1, 2010
	\$	\$	\$
Shareholders' equity under Canadian GAAP	228,587	214,095	194,802
Differences increasing reported shareholders' equity:			
Income taxes	258	314	96
<b>Total shareholders' equity under IFRS</b>	<b>228,845</b>	<b>214,409</b>	<b>194,898</b>

#### [b] Comprehensive income

For the year to date periods ended	December 31, 2010	September 30, 2010
	\$	\$
Comprehensive income under Canadian GAAP	29,824	15,867
Differences increasing (decreasing) reported income:		
Share-based compensation	(53)	33
Income taxes	162	219
<b>Comprehensive income under IFRS</b>	<b>29,933</b>	<b>16,119</b>

#### CHANGES IN ACCOUNTING POLICIES

##### SHARE-BASED COMPENSATION

IFRS 2 is effective for the Company as of January 1, 2010 and is applicable to stock options and grants that are unvested at that date. The transition rules in IFRS 1 and IFRS 2 as applied by the Company result in the following:

- Share options prior to November 7, 2002 are not taken into account for IFRS 2;
- Share options subsequent to November 7, 2002 are only taken into account if they have not vested as at January 1, 2010; and,
- From January 1, 2010, all share options and other share-based payments will be expensed in accordance with the policy stated in note 2 of the condensed interim financial statements for the quarter ended March 31, 2011.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

The table below reflects the significant differences between the Company's previous Canadian GAAP accounting policies and the current IFRS policies applied by the Company:

	CANADIAN GAAP	IFRS
<b>SHARE-BASED COMPENSATION</b>		
RECOGNITION OF EXPENSE	For grants of share-based awards with graded vesting, the total fair value of the award is recognized on a straight-line basis over the employment period necessary to vest the award.	Each tranche in an award with graded vesting is considered a separate grant with a different vesting date and fair value. Each grant is accounted for on that basis. As a result, the Company adjusted its expense for share-based awards to reflect this difference in recognition.
FORFEITURES	Forfeitures of awards are recognized as they occur.	An estimate is required of the number of awards expected to vest, which is revised if subsequent information indicates that actual forfeitures are likely to differ from the estimate. As a result, the Company adjusted its expense to reflect this difference.
<b>INCOME TAXES</b>		
INTERCOMPANY TRANSACTIONS	Recognition of a deferred tax asset or liability for a temporary difference arising from intercompany transactions is prohibited. Such temporary differences may arise when the tax base of the asset in the buyer's jurisdiction differs from the carrying amount of the asset in the consolidated financial statements. Further, cash tax paid or recovered as a result of a transfer of an asset is recorded as a deferred tax asset or liability in the financial statements and recognized through tax expense when the asset leaves the Company or is otherwise utilized.	There are no such exceptions under IFRS. Therefore, deferred tax is recognized for temporary differences arising on intercompany transactions measured at the tax rate of the buyer, and cash tax paid or recovered on intercompany transactions is recognized in the period incurred. As a result, the Company reversed certain tax deferrals on intercompany transactions.
ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES IN BUSINESS COMBINATIONS	Changes to provisions for uncertain tax position relating to pre-acquisition periods are adjusted through the purchase price allocation, first reducing goodwill and intangible assets associated with the business combination and, only after exhausting those amounts, reducing income tax expense.	Changes to pre-acquisition provisions for uncertain tax positions beyond 12 months of the acquisition date are recorded to the consolidated income statement. As a result, the Company adjusted its tax expense to reflect this difference.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### PRESENTATION RECLASSIFICATIONS

The table below reflects the presentation reclassifications between the Company's previous Canadian GAAP and the current IFRS consolidated financial statements:

	CANADIAN GAAP	IFRS
DEFERRED TAX	Deferred taxes are split between current and non-current components on the basis of either the underlying asset or liability or the expected reversal of items not related to an asset or liability.	All deferred tax assets and liabilities are classified as non-current.
OTHER RECEIVABLES	Other receivables and interest receivable were classified under "Other current assets" on the consolidated balance sheet.	Other receivables and interest receivable are classified under "Trade and other receivables" on the consolidated balance sheet.
ACCOUNTS PAYABLE TO RELATED PARTIES	Accounts payable to related parties were disclosed separately on the consolidated balance sheet.	Accounts payable to related parties are classified under "Payables, accruals and provisions" on the consolidated balance sheet.
INVESTMENT IN AN ASSOCIATE	Investment in an associate was classified under "Investments" on the consolidated balance sheet.	Investment in an associate is disclosed separately on the consolidated balance sheet.
GENERAL AND ADMINISTRATIVE EXPENSES	General and administrative expenses were disclosed separately on the consolidated income statement.	General and administrative expenses are classified under "Selling, general and administrative" on the consolidated income statement.
ACCRETED INTEREST	Accreted interest was classified under "Interest Income" on the consolidated income statement.	Accreted interest is classified under "Other Finance Expense (Income)" on the consolidated income statement.
TRANSLATION OF FOREIGN CURRENCY DEFERRED TAX BALANCES	The translation of foreign currency deferred tax balances was classified under "Foreign exchange loss" on the consolidated income statement.	The translation of foreign currency deferred tax balances is classified under "Provision for income taxes" on the consolidated income statement.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

11. TRANSITION TO IFRS [CONT'D]

Reconciliation of Consolidated Balance Sheet as of January 1, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
<b>ASSETS</b>					
<b>Current</b>					
Cash and cash equivalents	31,227			31,227	Cash and cash equivalents
Marketable securities	74,142			74,142	Marketable securities
Accounts receivable	14,167		1,076	15,243	Trade and other receivables
Inventories	12,361			12,361	Inventories
Investment tax credits recoverable	776			776	Investment tax credits recoverable
Income taxes receivable	4,630			4,630	Income tax receivable
Future income tax assets	6,196		(6,196)	—	N/A
Other current assets	2,668		(1,076)	1,592	Other current assets
<b>Total current assets</b>	<b>146,167</b>	<b>—</b>	<b>(6,196)</b>	<b>139,971</b>	<b>Total current assets</b>
N/A	—			—	Investment in an associate
Investments	62			62	Long-term financial assets
Investment tax credits recoverable	14,903			14,903	Investment tax credits recoverable
Future income tax assets	31,029	96	1,937	33,062	Deferred income tax assets
Property, plant and equipment	691			691	Property, plant and equipment
Pharmaceutical product licenses and rights	42,543			42,543	Pharmaceutical product licenses and rights
<b>Total assets</b>	<b>235,395</b>	<b>96</b>	<b>(4,259)</b>	<b>231,232</b>	<b>Total assets</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>					
<b>Current</b>					
Accounts payable and accrued liabilities	22,934		1,122	24,056	Payables, accruals and provisions
Accounts payable to related parties	1,122		(1,122)	—	N/A
Income taxes payable	7,109			7,109	Income tax payable
Deferred revenue	1,776			1,776	Deferred revenue
Balance of sale payable	1,650			1,650	Balances of sale payable
Future income tax liabilities	252		(252)	—	N/A
<b>Total current liabilities</b>	<b>34,843</b>	<b>—</b>	<b>(252)</b>	<b>34,591</b>	<b>Total current liabilities</b>
Balance of sale payable	1,743			1,743	Long-term balances of sale payable
Future income tax liabilities	4,007		(4,007)	—	N/A
<b>Total liabilities</b>	<b>40,593</b>	<b>—</b>	<b>(4,259)</b>	<b>36,334</b>	<b>Total liabilities</b>
<b>Shareholders' equity</b>					
Capital stock	119,652			119,652	Share capital
Other paid-in capital	4,408	(46)		4,362	Other paid-in capital
Accumulated other comprehensive	98			98	Other capital reserves
Retained earnings	70,644	142		70,786	Retained earnings
<b>Total shareholders' equity</b>	<b>194,802</b>	<b>96</b>	<b>—</b>	<b>194,898</b>	<b>Total shareholders' equity</b>
<b>Total liabilities and shareholders' equity</b>	<b>235,395</b>	<b>96</b>	<b>(4,259)</b>	<b>231,232</b>	<b>Total liabilities and shareholders' equity</b>

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### Reconciliation of Consolidated Balance Sheet as of December 31, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS balance	IFRS accounts
<b>ASSETS</b>					
<b>Current</b>					
Cash and cash equivalents	96,295			96,295	Cash and cash equivalents
Marketable securities	43,094			43,094	Marketable securities
Accounts receivable	21,504		408	21,912	Trade and other receivables
Inventories	13,877			13,877	Inventories
Investment tax credits recoverable	—			—	Investment tax credits recoverable
Income taxes receivable	17			17	Income tax receivable
Future income tax assets	8,042		(8,042)	—	N/A
Other current assets	5,125		(408)	4,717	Other current assets
<b>Total current assets</b>	<b>187,954</b>	<b>—</b>	<b>(8,042)</b>	<b>179,912</b>	<b>Total current assets</b>
N/A	—		15,739	15,739	Investment in an associate
Investments	38,574		(15,739)	22,835	Long-term financial assets
Investment tax credits recoverable	14,736			14,736	Investment tax credits recoverable
Future income tax assets	22,378	258	3,950	26,586	Deferred income tax assets
Property, plant and equipment	221			221	Property, plant and equipment
Pharmaceutical product licenses and rights	20,594			20,594	Pharmaceutical product licenses and rights
<b>Total assets</b>	<b>284,457</b>	<b>258</b>	<b>(4,092)</b>	<b>280,623</b>	<b>Total assets</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>					
<b>Current</b>					
Accounts payable and accrued liabilities	36,066		835	36,901	Payables, accruals and provisions
Accounts payable to related parties	835		(835)	—	N/A
Income taxes payable	11,254			11,254	Income tax payable
Deferred revenue	1,939			1,939	Deferred revenue
Balance of sale payable	1,145			1,145	Balances of sale payable
Future income tax liabilities	26		(26)	—	N/A
<b>Total current liabilities</b>	<b>51,265</b>	<b>—</b>	<b>(26)</b>	<b>51,239</b>	<b>Total current liabilities</b>
Balance of sale payable	539			539	Long-term balances of sale payable
Future income tax liabilities	4,066		(4,066)	—	N/A
<b>Total liabilities</b>	<b>55,870</b>	<b>—</b>	<b>(4,092)</b>	<b>51,778</b>	<b>Total liabilities</b>
<b>Shareholders' equity</b>					
Capital stock	123,136			123,136	Share capital
Other paid-in capital	4,885	7		4,892	Other paid-in capital
Accumulated other comprehensive	175			175	Other capital reserves
Retained earnings	100,391	251		100,642	Retained earnings
<b>Total shareholders' equity</b>	<b>228,587</b>	<b>258</b>	<b>—</b>	<b>228,845</b>	<b>Total shareholders' equity</b>
<b>Total liabilities and shareholders' equity</b>	<b>284,457</b>	<b>258</b>	<b>(4,092)</b>	<b>280,623</b>	<b>Total liabilities and shareholders' equity</b>

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### Reconciliation of Consolidated Income Statement and Consolidated Statement of Comprehensive Income for the three months ended September 30, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
Revenues	31,782			31,782	Revenues
Cost of sales	7,721			7,721	Cost of sales
<b>Gross profit</b>	<b>24,061</b>	<b>—</b>	<b>—</b>	<b>24,061</b>	<b>Gross profit</b>
<b>Expenses (income)</b>					
Selling and marketing	5,473	(23)	1,865	7,315	Selling, general and administrative
General and administrative	1,865		(1,865)	—	N/A
Research and development	1,480	(3)		1,477	Research and development
Interest income	(641)		61	(580)	Interest income
<b>Earnings before under-noted items</b>	<b>15,884</b>	<b>26</b>	<b>(61)</b>	<b>15,849</b>	<b>Earnings before under-noted items</b>
Amortization of pharmaceutical product licenses and rights	5,146			5,146	Amortization of pharmaceutical product licenses and rights
Net (gain) loss on investments	—		(61)	(61)	Other finance expense (income)
Foreign exchange loss	(300)		(22)	(322)	Foreign exchange (gain) loss
Other income	—			—	Other income
Share of net income in companies subject to significant influence	(291)			(291)	Share of net income of an associate
<b>Income before income tax</b>	<b>11,329</b>	<b>26</b>	<b>22</b>	<b>11,377</b>	<b>Income before income tax</b>
Provision for income taxes	3,347	49	22	3,418	Provision for income taxes
<b>Net income for the period</b>	<b>7,982</b>	<b>(23)</b>	<b>—</b>	<b>7,959</b>	<b>Net income for the period</b>
Change in fair value of available- for-sale financial instruments	227			227	Change in fair value of available-for-sale financial instruments
Reclassification adjustments for gains on available-for-sale financial instruments included in net income	(17)			(17)	Reclassification adjustments for gains on available-for-sale financial instruments included in net income
<b>Other comprehensive income for the period</b>	<b>210</b>	<b>—</b>	<b>—</b>	<b>210</b>	<b>Other comprehensive income for the period</b>
<b>Total comprehensive income for the period</b>	<b>8,192</b>	<b>(23)</b>	<b>—</b>	<b>8,169</b>	<b>Total comprehensive income for the period</b>
Basic earnings per share	0.43	—	—	0.43	Basic earnings per share
Diluted earnings per share	0.41	—	—	0.41	Diluted earnings per share

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### Reconciliation of Consolidated Income Statement and Consolidated Statement of Comprehensive Income for the nine months ended September 30, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
Revenues	95,555			95,555	Revenues
Cost of sales	25,746			25,746	Cost of sales
<b>Gross profit</b>	<b>69,809</b>	<b>—</b>	<b>—</b>	<b>69,809</b>	<b>Gross profit</b>
<b>Expenses (income)</b>					<b>Expenses (income)</b>
Selling and marketing	16,675	(35)	6,591	23,231	Selling, general and administrative
General and administrative	6,591		(6,591)	—	N/A
Research and development	6,892	2		6,894	Research and development
Interest income	(1,435)		129	(1,306)	Interest income
<b>Earnings before under-noted items</b>	<b>41,086</b>	<b>33</b>	<b>(129)</b>	<b>40,990</b>	<b>Earnings before under-noted items</b>
Amortization of pharmaceutical product licenses and rights	17,487			17,487	Amortization of pharmaceutical product licenses and rights
Net (gain) loss on investments	(7)		(129)	(136)	Other finance expense (income)
Foreign exchange loss	(99)		(16)	(115)	Foreign exchange (gain) loss
Other income	(41)			(41)	Other income
Share of net income in companies subject to significant influence	(757)			(757)	Share of net income of an associate
<b>Income before income tax</b>	<b>24,503</b>	<b>33</b>	<b>16</b>	<b>24,552</b>	<b>Income before income tax</b>
Provision for income taxes	8,791	(219)	16	8,588	Provision for income taxes
<b>Net income for the period</b>	<b>15,712</b>	<b>252</b>	<b>—</b>	<b>15,964</b>	<b>Net income for the period</b>
Change in fair value of available- for-sale financial instruments	234			234	Change in fair value of available-for-sale financial instruments
Reclassification adjustments for gains on available-for-sale financial instruments included in net income	(79)			(79)	Reclassification adjustments for gains on available-for-sale financial instruments included in net income
<b>Other comprehensive income for the period</b>	<b>155</b>	<b>—</b>	<b>—</b>	<b>155</b>	<b>Other comprehensive income for the period</b>
<b>Total comprehensive income for the period</b>	<b>15,867</b>	<b>252</b>	<b>—</b>	<b>16,119</b>	<b>Total comprehensive income for the period</b>
Basic earnings per share	0.84	0.02	—	0.86	Basic earnings per share
Diluted earnings per share	0.81	0.02	—	0.83	Diluted earnings per share

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS [CONT'D]

#### Reconciliation of Consolidated Income Statement and Consolidated Statement of Comprehensive Income for the Twelve Months ended December 31, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
Revenues	127,989			127,989	Revenues
Cost of sales	34,127			34,127	Cost of sales
<b>Gross profit</b>	<b>93,862</b>	<b>—</b>	<b>—</b>	<b>93,862</b>	<b>Gross profit</b>
<b>Expenses (income)</b>					
Selling and marketing	22,079	29	8,417	30,525	Selling, general and administrative
General and administrative	8,417		(8,417)	—	N/A
Research and development	9,094	24		9,118	Research and development
Interest income	(2,380)		158	(2,222)	Interest income
<b>Earnings before under-noted items</b>	<b>56,652</b>	<b>(53)</b>	<b>(158)</b>	<b>56,441</b>	<b>Earnings before under-noted items</b>
Amortization of pharmaceutical product licenses and rights	22,844			22,844	Amortization of pharmaceutical product licenses and rights
Unrealized gain on investments	(6,347)	9	(158)	(6,496)	Other finance expense (income)
Net realized loss on investments	9	(9)		—	N/A
Other income	(540)			(540)	Other income
Foreign exchange loss	100		(41)	59	Foreign exchange (gain) loss
Share of net income in companies subject to significant influence	(800)			(800)	Share of net income of an associate
<b>Income before income tax</b>	<b>41,386</b>	<b>(53)</b>	<b>41</b>	<b>41,374</b>	<b>Income before income tax</b>
Provision for income taxes	11,639	(162)	41	11,518	Provision for income taxes
<b>Net income for the period</b>	<b>29,747</b>	<b>109</b>	<b>—</b>	<b>29,856</b>	<b>Net income for the period</b>
Change in fair value of available-for-sale financial instruments	251			251	Change in fair value of available-for-sale financial instruments
Reclassification adjustments for gains on available-for-sale financial instruments included in net income	(174)			(174)	Reclassification adjustments for gains on available-for-sale financial instruments included in net income
<b>Other comprehensive income for the period</b>	<b>77</b>	<b>—</b>	<b>—</b>	<b>77</b>	<b>Other comprehensive income for the period</b>
<b>Total comprehensive income for the period</b>	<b>29,824</b>	<b>109</b>	<b>—</b>	<b>29,933</b>	<b>Total comprehensive income for the period</b>
Basic earnings per share	1.59	0.01	—	1.60	Basic earnings per share
Diluted earnings per share	1.54	—	—	1.54	Diluted earnings per share

#### Reconciliation of Consolidated Statement of Cash Flows the Nine Months ended September 30, 2010

There are no material differences between the consolidated statement of cash flows presented under IFRS and the consolidated statement of cash flows presented under previous Canadian GAAP.

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