

ANNUAL REPORT 2001

RELENTLESS
EXECUTION OF
STRATEGY



PROFILE

Paladin Labs Inc. is a Canadian specialty pharmaceutical company focused on marketing pharmaceutical products to Canada's specialist physicians. We commercialize product lines in therapeutic areas such as urology, endocrinology, and women's health.

Paladin's strategy is to acquire the Canadian rights to innovative pharmaceutical products, submit these products for Canadian regulatory approval, and then successfully launch them in the Canadian market. The products that we seek are those that complement our existing product lines and lend themselves to high sales potential through focused promotion and marketing.

With a proven track record of relentlessly executing its strategy, and a strong balance sheet boasting over \$20 million in cash, Paladin is rapidly becoming the partner of choice for commercializing innovative pharmaceuticals in Canada.

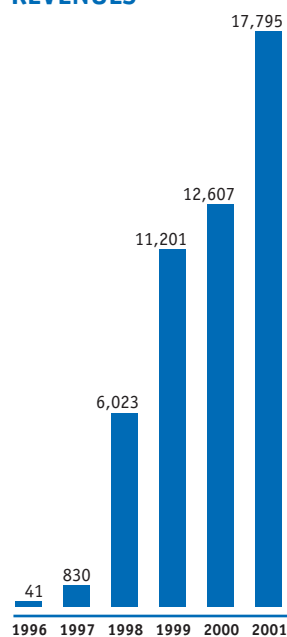
Paladin is a publicly traded company listed on the Toronto Stock Exchange (TSE) under the symbol PLB.

Financial data for six years

(In thousands of Canadian dollars except for share and per share amounts)

	1996	1997	1998	1999	2000	2001
Revenues	41	830	6,023	11,201	12,607	17,795
Income (Loss) before write-down of intellectual property and taxes	(594)	(4)	2,437	2,856	2,991	4,330
Net Income (Loss)	(1,868)	(1,006)	836	2,016	2,797	1,485
Earnings (Loss) Per Share (Basic)	(0.50)	(0.25)	0.13	0.22	0.24	0.12
Cash Flows From Operating Activities	(285)	(446)	1,343	2,896	1,507	5,154
Cash & Temporary Investments	759	563	8,545	9,886	24,339	22,448
Shareholders' Equity	3,146	2,390	9,886	13,830	35,769	37,836
Shares Issued (Dec 31)	3,823,991	3,990,659	9,057,731	9,466,338	12,394,038	12,539,247

REVENUES



INCOME (LOSS) before write-down of intellectual property and taxes

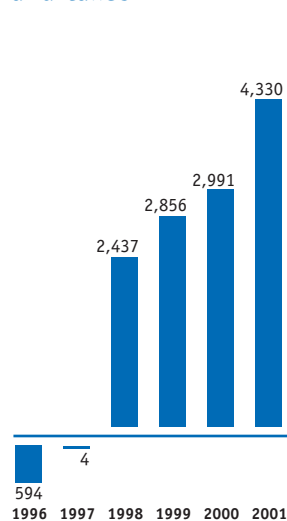


TABLE OF CONTENTS

Message to Shareholders	1
Paladin's Product Line	3
New Product Launches	4
Business Development Activities	6
Selected Products in Development	7
Management Discussion & Analysis	8
Financial Statements	13
Notes to Financial Statements	16
Corporate Information	23

MESSAGE TO SHAREHOLDERS

Dear Shareholders,

Paladin Labs Inc. recorded a number of exciting accomplishments in fiscal 2001. The relentless execution of our strategy resulted in our sixth consecutive year of record revenues as we continued the aggressive expansion of our product pipeline. We acquired six new products over the course of the year and launched eight brands under the Paladin banner. We continued this

aggressive expansion in January 2002 with the acquisition of five new products from

Pharmacia Canada Inc. This success was formally recognized, as Paladin was named one of Canada's 50 Best Managed Companies by the National Post, Andersen, CIBC, and Queen's School of Business. Paladin's success in 2001 demonstrates that our steadfast commitment to acquiring and marketing innovative pharmaceuticals for the Canadian marketplace delivers strong corporate growth.



Jonathan Ross Goodman, B.A., LL.B., M.B.A.
President & CEO

Financial performance

Our record revenues were driven by our aggressive strategy of acquiring late-stage or already commercialized products, and increasing their value through focused promotion and marketing. Overall, Paladin's revenues increased \$5.2 million or 41% to \$17.8 million in the year ended December 31, 2001, from \$12.6 million for the year ended December 31, 2000. Products acquired last year and recently launched such as Androderm®, Plan B™, MUSE®, and Tapazole®, continue to drive our success. Earnings before write-down of intellectual property and taxes increased 61% to \$4.3 million, as the operating efficiency of our business increased. Net income for 2001 totalled \$1.5 million compared to net income of \$2.8 million in 2000.

Building a Strategic Portfolio

In 2000, we made a commitment to our shareholders that we would be true to our strategy of in-licensing and acquiring innovative therapeutics, submitting these products for Canadian regulatory approval, and then successfully launching them in the Canadian market.

To this end, we added Oesclim® to our women's health portfolio in February 2001. Licensed from Laboratoires Fournier S.A., Oesclim® is an estrogen patch indicated for the relief of menopausal and post-menopausal symptoms.

We completed the acquisition of Propyl-Thyracil® from Merck Frosst Canada & Co. in August 2001. Propyl-Thyracil®, indicated for the treatment of hyperthyroidism, strengthens our position in the growing Canadian endocrinology market.

In December 2001, we acquired the Canadian rights to the Locacorten® Vioform® family of dermatological products from Novartis Pharmaceuticals Canada Inc. These proven products expanded our existing dermatology franchise. Earlier in the year, Paladin completed two other transactions with Novartis Pharmaceuticals Canada Inc. by acquiring the Canadian rights to Rogitine®, an alpha-adrenoreceptor blocker that complements our established urology franchise, and Fiorinal®, an established brand for the treatment of migraine headaches.

In early 2002, Paladin entered into a significant agreement with Pharmacia Canada Inc. to be the exclusive Canadian distributor of a portfolio of endocrinology and women's health brands. The products include the brands Dostinex®, Estring®, and Dalacin® Vaginal Cream, which recorded sales of approximately \$5.0 million in 2001.

Consistently throughout 2001, the products that we acquired were immediately accretive to earnings. Moreover, these products further enhanced our current product lines, allowing us to leverage our strong sales and marketing capabilities. In short, the addition of each of these products was a perfect fit with our strategy.

Strategic Thinking

Paladin's business model of growth through carefully selected acquisitions and strategic marketing has provided the Company with a solid platform for success. Our strategy has proven fruitful by combining the selection of late stage (and thus low risk) developmental products with our focus on strategic markets such as endocrinology, urology, and women's health. What has been an extraordinary year has been so because of the commitment of the people involved, and particularly, the excellence, the skill, and the diligence they have lent to our strategy.

Our 2001 achievements have set the stage for future growth. We created a rich portfolio of innovative products and built a strong sales and marketing presence. The relentless execution of our strategy brought us record results in 2001 and we are well positioned for continued success in 2002.



On behalf of the Board of Directors and everyone at Paladin Labs Inc.,
thank you for your continued support.

Sincerely,

Handwritten signature of Jonathan Ross Goodman

Jonathan Ross Goodman B.A., LL.B., M.B.A.
President & CEO

PALADIN'S PRODUCT LINE

Product	Indication	Licensor/Vendor	Development Phases				
			Phase 1	Phase 2	Phase 3	Regulatory Approval	Sales and Marketing
Urology							
Urispas	Urinary Incontinence	Byk Gulden GmbH					Existing
MUSE	Erectile Dysfunction	VIVUS, Inc.					Existing
Valtalin	Bladder Cancer	Anthra Pharmaceuticals, Inc.					Existing
Cystistat	Interstitial Cystitis	Bioniche Life Sciences, Inc.					Existing
Pacis	Bladder Cancer	Shire Pharmaceuticals Group plc					Existing
NMP-22	Bladder Cancer Detection	Matritech, Inc.					Existing
pms-Yohimbine	Alpha-adrenergic blocking agent	Pharmascience Inc.					Existing
Rogitine	Alpha-andrenoreceptor antagonist	Novartis Pharmaceuticals Canada Inc.					New in 2001 and 2002
Aptosyn	Prostate cancer	Cell Pathways, Inc.					Existing
Endocrinology							
Androderm	Hypogonadism	Watson Laboratories, Inc.					Existing
Tapazole	Hyperthyroidism	Eli Lilly and Company					Existing
Propyl-Thyracil	Hyperthyroidism	Merck Frosst Canada & Co.					New in 2001 and 2002
Dostinex	Hyperprolactinemia	Pharmacia Canada Inc.					Existing
Circadin	Insomnia	Neurim Pharmaceuticals (1991) Ltd.					Existing
DHEA	Addison's Disease	Neuroscience Pharma Inc.					Existing
Women's Health							
Plan B	Emergency Contraceptive	Women's Capital Corp.					Existing
Oesclim	Menopause symptoms	Laboratoires Fournier S.A.					Existing
Estring	Urogenital menopause symptoms	Pharmacia Canada Inc.					New in 2001 and 2002
Dalacin Vaginal Cream	Bacterial vaginosis	Pharmacia Canada Inc.					Existing
Prostin	Labour induction	Pharmacia Canada Inc.					Existing
Prepidil	Cervical ripening	Pharmacia Canada Inc.					New in 2001 and 2002
Estradiol Gel	Menopause symptoms	BioSante Pharmaceuticals, Inc.					Existing
Estradiol + Testosterone Gel	Menopause symptoms	BioSante Pharmaceuticals, Inc.					Existing
Dermatology							
Canthacur	Plantar Warts	Pharmascience Inc.					Existing
Histofreezer	Common Warts	OraSure Technologies, Inc.					Existing
Podofilm	Genital Warts	Pharmascience Inc.					Existing
Wartec	Genital Warts	Stiefel Laboratories Inc.					Existing
Allergens	Allergy Testing	Hermal GmbH					Existing
Baker Cummins Line ¹	OTC Products	IVAX Corp.					Existing
Locacorten-Vioform Line ²	Topical Antimicrobial Corticosteroids	Novartis Pharmaceuticals Canada Inc.					New in 2001 and 2002
Palliative Care							
Statex	Narcotic Analgesic	Pharmascience Inc.					Existing
Moi-Stir	Xerostomia (Dry-mouth)	Solvay Pharma, Inc.					Existing
Sialor	Xerostomia (Dry-mouth)	Solvay Pharma, Inc.					Existing
Statex SR	Narcotic Analgesic	Amarin Corporation plc					Existing
ER and Hospital Products							
Antizol	Ethylene Glycol and Methanol Poisoning	Orphan Medical Inc.					Existing
DepoCyt	Lymphomatous & Neoplastic Meningitis	SkyePharma, Inc.					Existing
Other Products							
Fiorinal	Tension Headaches / Mixed Migraines	Novartis Pharmaceuticals Canada Inc.					Existing
Cedocard	Anti-Anginal	Byk Gulden GmbH					Existing
Cerumol	Ear Wax removal	Laboratories for Applied Biology Ltd.					Existing
Nitrol	Anti-Anginal	Aventis S.A.					Existing
Ridaura	Rheumatoid Arthritis	Prometheus Laboratories, Inc.					Existing
Remodulin	Pulmonary Hypertension	United Therapeutics Corp.					Existing
Neuralgon	Spasticity	WTD Pharmaceutical Consultants Inc.					Existing
ConXn	Peripheral Vascular Disease	Connetics Corp.					Existing
Generic Products							
pms - Lithium Carbonate	Anti-Manic Agent	Pharmascience Inc.					Existing
pms - Tryptophan	Affective Disorders	Pharmascience Inc.					Existing
pms - Valproic Acid	Anti-Convulsant	Pharmascience Inc.					Existing
pms - Selegilene	Parkinson's Disease	Pharmascience Inc.					Existing

¹The Baker Cummins Line consists of: Aquaderm, P&S, X-Seb and Ultramide.

²The Locacorten Vioform Line consists of: Locacorten Vioform cream, Locacorten Vioform eardrops and Vioform Hydrocortisone cream.

NEW PRODUCT LAUNCHES

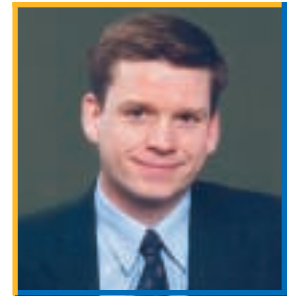


The Only Transdermal Testosterone Patch Available in Canada

Androderm® (testosterone transdermal system) is a testosterone patch indicated for the treatment of testosterone deficiency in men. Unusually low testosterone levels in men can be due to the natural ageing process or as a result of a variety of other conditions such as infection, testicular injury, and testicular or pituitary tumours. Testosterone deficiency may cause symptoms such as low energy, poor libido, erectile dysfunction, and depression.

Androderm®'s unique transdermal system delivers continuous, physiological levels of testosterone, in a way that mimics the body's own natural rhythm. Androderm®'s effectiveness in treating testosterone deficiency along with its convenient once-a-day format makes it an innovative new option for the treatment of testosterone deficiency. Launched by Paladin in 2001, Androderm® is competing in a \$14 million market that has grown at a four-year compound annual growth rate of over 30%.

Exclusive Canadian distributor for: Watson Laboratories, Inc., Corona, CA, USA
For more information on andropause go to www.andropause.com



Mark A. Beaudet
Vice President, Marketing & Sales



A New Generation Emergency Contraceptive

Plan B™ is the first progestin-only pill developed to prevent pregnancy after a contraceptive failure. This new prescription product is the most effective emergency contraceptive available, and boasts a significantly better safety and side effect profile than existing emergency contraceptives. Plan B™ is most effective when taken within seventy-two hours of a contraceptive failure; it cannot terminate a pregnancy that has already occurred.

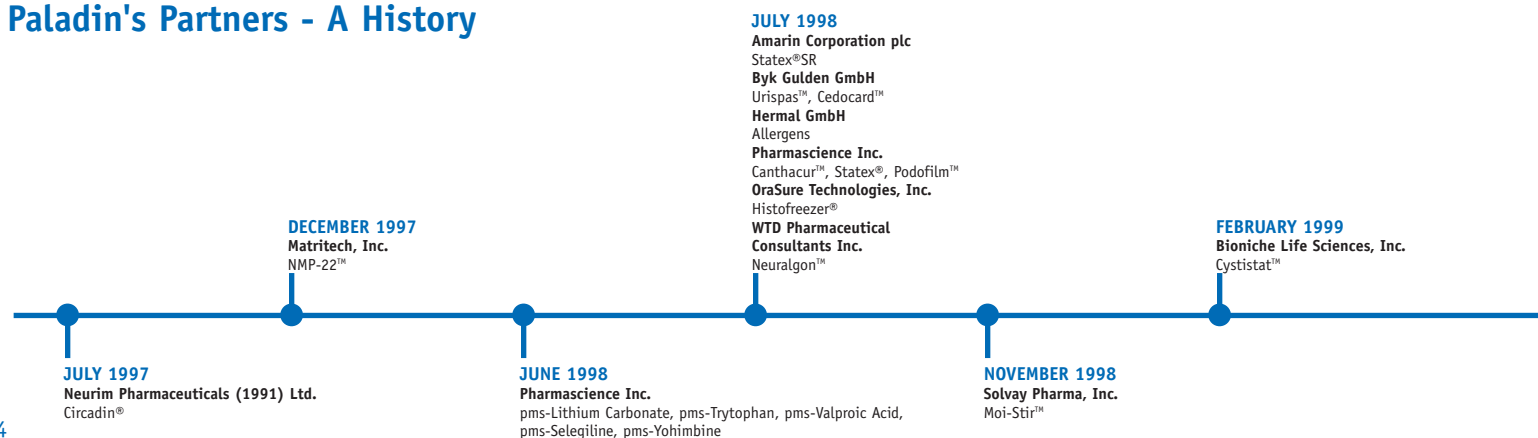
The small, discreet Plan B™ package (about the size of a woman's compact) consists of two, 0.75 mg tablets of levonorgestrel, a synthetic derivative of the hormone progesterone, which is one of the two active compounds commonly used in combination oral contraceptive pills. The first Plan B™ tablet must be taken within seventy-two hours of a contraceptive failure; the second tablet is taken twelve hours later.

The Plan B™ regimen was tested by the World Health Organisation (WHO) in almost 2,000 women in fourteen countries, including the United States and Canada. The results of the study, published in *The Lancet* (August 8, 1998) stated that the use of levonorgestrel alone for emergency contraception is more effective and much better tolerated than the Yuzpe regimen which involves two high doses of oral contraceptives containing both estrogen and progestin. Plan B™ has been added to The WHO Model List of Essential Drugs.

In 2001, Paladin's efforts to make Plan B™ more accessible to Canadian women met with increasing success. Paladin has teamed up with the Canadian Pharmacists Association and the Society of Obstetricians and Gynaecologists of Canada to petition Health Canada to approve Plan B™ for sale as a non-prescription, behind-the-counter drug. British Columbia and Quebec have already authorised making Plan B™ available behind the counter, and Ontario is currently running a pilot program. Paladin hopes that Health Canada will prioritize the approval process to make the drug available from pharmacists across the country.

Exclusive Canadian distributor for: Women's Capital Corp., Bellevue, WA, USA
For more information on Plan B™ go to www.go2planb.com

Paladin's Partners - A History





An Alternative Treatment for Erectile Dysfunction

MUSE® (transurethral alprostadil) is a single-use, non-injectable, local delivery system for treating erectile dysfunction, consisting of a micro-suppository of alprostadil for delivery to the male urethra. Alprostadil, among other things, initiates the natural haemodynamic effects of an erection.

MUSE® has been available in Canada since September 1998. According to IMS Canada, MUSE® recorded sales of \$1.1 million in 2000 prior to being discontinued by a previous distributor. MUSE® was re-launched by Paladin in the first half of 2001, and competes in the \$57 million market for erectile dysfunction treatments. Paladin has positioned MUSE® as the alternative for those men who either fail or are contra-indicated for oral therapy.

Exclusive Canadian distributor for: VIVUS, Inc., Mountain View, CA, USA
For more information go to www.vivus.com



Treatment for BCG-Refractory Carcinoma in situ of the Bladder

Valtaxis™ (valrubicin) sterile solution for intravesical instillation was developed as a treatment option for carcinoma in situ (CIS) when Bacillus Calmette-Guerin (BCG) fails. Valtaxis™ is a semi-synthetic analogue of the anthracycline doxorubicin and was approved by the TPD in February 2001. Valtaxis™ penetrates cells readily and inhibits the incorporation of nucleosides into nucleic acids - causing extensive chromosomal damage in the tumour cells, resulting in cell-cycle arrest.

While first-line treatments such as Pacis® (distributed by Paladin on behalf of Shire Pharmaceuticals Group plc) have proven efficacy both in CIS and in resectable superficial tumours (TCC), approximately 20% to 30% of patients go on to have multiple tumour recurrences. Valtaxis™ has been shown to provide 32% clinical benefit in these extremely difficult to treat cases. Mean duration of response was twenty-one months as measured until time of documented recurrence.

In 2001, Paladin launched Valtaxis™ in Canada, working closely with a key group of Canadian urologists as advisors. The Company's sales and marketing efforts were focused on navigating Canada's complex reimbursement system for oncology products, and resulted in the increased availability of Valtaxis™ across Canada.

Under license from: Anthra Pharmaceuticals, Inc., Princeton, NJ, USA
For more information on bladder cancer go to www.concerningcancer.com/fasttrack/bladderca.htm

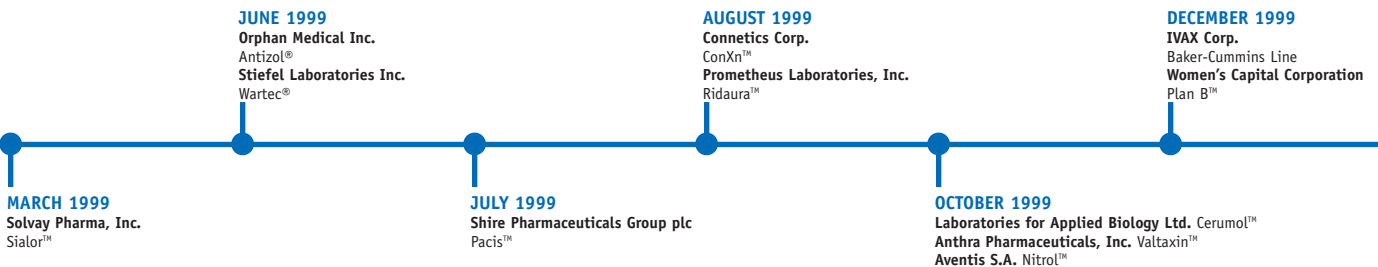


DOSTINEX® *A Preferred Treatment for Hyperprolactinemia*

Dostinex® (cabergoline) is a recently introduced medication indicated for the treatment of hyperprolactinemia, a condition characterized by an excess secretion of the hormone prolactin. Often due to a pituitary tumour, symptoms of hyperprolactinemia in women include infertility, absence of menstrual periods and the discharge of breast milk. In men, hyperprolactinemia can cause lowered testosterone levels resulting in decreased libido, impotence and infertility.

Dostinex® treats hyperprolactinemia by producing long-lasting reductions in prolactin. Taken only once or twice per week, Dostinex® achieves normal prolactin levels and resumption of normal gonadal function in 80% of patients with microadenomas. Additionally, galactorrhea improves or is resolved in 90% of patients. It is effective in cases of resistance to bromocriptine, the previous gold standard, and adverse effects and intolerance are encountered less frequently. Dostinex® is also prescribed to prevent the production of breast milk in cases where breast feeding following childbirth is not medically advisable. An exciting new launch for Paladin in 2002, Dostinex® will compete in a potential market of approximately \$10 million.

Exclusive Canadian distributor for: Pharmacia Canada Inc., Mississauga, ON, Canada
For more information go to www.pharmacia.com or www.pharmacia.com/products/pharm.asp



BUSINESS DEVELOPMENT ACTIVITIES

Throughout 2001, Paladin continued to execute its strategy of in-licensing or acquiring innovative pharmaceutical products for the Canadian market. Working with some of the world's leading pharmaceutical companies, Paladin demonstrated that there are outstanding growth opportunities for a Canadian emerging pharmaceutical player. In the past thirteen months, Paladin completed six agreements to secure rights to eleven products and invested over \$17 million along the way. At this rate, Paladin has maintained a pace that is unmatched by any other comparable company in Canada.

During the year, Paladin licensed Oesclim® (a new-generation estrogen patch) from Laboratoires Fournier S.A.; acquired Propyl-Thyracil® (a proven drug for the treatment of hyperthyroidism) from Merck Frosst Canada & Co; licensed Fiorinal® (an established brand for the treatment of migraines), Rogitine® (phentolamine mesylate), and the Locacorten®Vioform® family of products (corticosteroid formulations with antimicrobial activity) from Novartis Pharmaceuticals Canada Inc. In early 2002, Paladin became the exclusive Canadian distributor for five women's health brands for Pharmacia Canada Inc. These products include Dostinex® (a new option for the treatment of hyperprolactinemia), Estring® (local estrogen therapy for genito-urinary complaints associated with menopause), Dalacin®-V (an antibiotic for bacterial vaginosis), Prepidil® (for cervical ripening prior to delivery), and Prostin® (for the induction of labour).

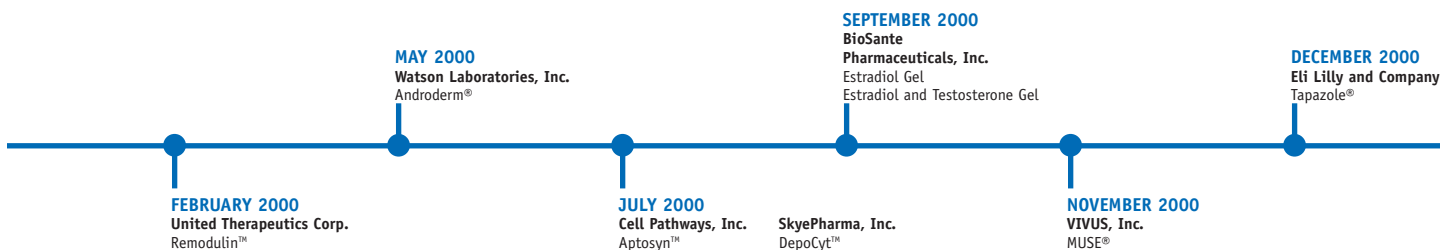
Looking ahead, Paladin intends to continue to execute its strategy of securing the Canadian rights to innovative pharmaceutical products that will have a near-term positive impact on its financial results. Providing Paladin's first-rate sales and marketing team with innovative, medically-necessary products ensures that the needs of Canada's specialist physicians and their patients are being met. Paladin is proud of the increasingly prominent role that it plays in the Canadian pharmaceutical market.



David MacNaughtan
Vice President, Business Development

Business Development Activity in 2001	
Total number of new agreements:	6*
Total number of products acquired or in-licensed:	11*
Total number of brands launched to market:	8

*includes Pharmacia agreement January 2002



SELECTED PRODUCTS IN DEVELOPMENT

Remodulin™

The Next-Generation Treatment for Pulmonary Hypertension

Pulmonary hypertension is a vascular disease which affects the pulmonary blood vessels between the heart and lungs. Blockage of blood flow through the circulatory system causes elevated pulmonary blood pressure, increasing the strain on the right side of the heart as it tries to pump blood to the lungs. Pulmonary hypertension is primarily caused by reduced production of the natural compound prostacyclin in the pulmonary blood vessels.

Remodulin™ (triprostenol) is a synthetic variation of the prostacyclin molecule being developed by United Therapeutics Corp. As the next-generation treatment, Remodulin™ is more stable than the current standard of care, which must be administered intravenously via a cumbersome pump. Instead, Remodulin™ is delivered by subcutaneous infusion with a pager-sized MiniMed microinfusion device, improving the mobility of the patient, eliminating the risk of sepsis infection associated with an intravenous catheter and the related hospitalization.

In 2001, the Advisory Committee of the FDA recommended the approval of Remodulin™ in the United States, while in early 2002, Health Canada awarded Remodulin™ NDS priority review in Canada.

Circadin®

Canada's First Melatonin Product for the Management of Sleep Disorders

Circadin® (controlled release melatonin tablets) contains 2 mg of melatonin in a controlled-release formulation. Unlike the United States, where the FDA considers melatonin a health food supplement, the TPD in Canada regards melatonin as a new chemical entity and, as such, requires the filing of a full NDS. As a result, there is currently no melatonin being sold legally in Canada, despite estimated sales of over US\$80 million in the United States. Circadin® has the potential to be the first melatonin product approved for sale in Canada.

An NDS for Circadin® is being prepared for Canada by Neurim Pharmaceuticals (1991) Ltd., an Israeli company affiliated with Tel Aviv University.

Statex®SR

A Twice-Daily Morphine

Statex®SR (sustained-release morphine sulphate) is a twice-daily morphine product used in the palliation of pain of various degrees. The product was developed by Amarin Corporation plc and licensed from Drug Royalty Corporation in November 1996. Paladin has recently completed a Phase III trial designed to demonstrate clinical equivalence to the market leading product, and is currently reviewing the outcome.

According to IMS Canada, the sustained-release, non-injectable morphine market exceeds \$30 million. If Paladin successfully completes the development of Statex®SR, it stands to gain a competitive entry in this growing market.

DHEA

For Diseases Associated with Ageing and Adrenal Insufficiency

DHEA (dehydroepiandrosterone) is a prevalent neurosteroid that decreases with ageing. Literature suggests that if exogenous DHEA is administered to older patients or patients suffering from depression, there may be beneficial effects on mood and general well being. Additionally, a recent paper in the New England Journal of Medicine revealed that in a Phase II trial, women with Addison's Disease (adrenal insufficiency) had a statistically significant improvement in well-being and sexual function after taking 50 mg of DHEA daily.

Like Circadin®, DHEA is not regulated as a drug in the United States, and as a result, there is a healthy over-the-counter market estimated to be in excess of US\$50 million in that country. In Canada, however DHEA is a controlled substance and the TPD regards it as a new chemical entity, requiring the filing of a full NDS.

In 1999, Paladin acquired NPI, a company focused on the discovery and development of novel therapeutics relating to DHEA. Paladin is continuing the development of this product in order to gain regulatory approval in Canada, and to make the product available to Canadian specialty physicians. In 2001, Paladin advanced its clinical program by focusing its efforts on furthering the study of the use of DHEA for the treatment of Addison's Disease, and exploring how to collaborate with international companies in order to expedite the clinical development. Paladin anticipates being in clinical trials with DHEA in 2002.



MANAGEMENT DISCUSSION AND ANALYSIS:

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

The following analysis explains the variations in the results of operations, financial position and cash flows for Paladin Labs Inc. ("Paladin" or the "Company"). This discussion should be read in conjunction with the information contained in the Company's financial statements and the related notes to the financial statements.



Samira Sakhia, CA
Chief Financial Officer

Overview

Paladin is a speciality pharmaceutical company focused on acquiring or in-licensing innovative pharmaceutical products for the Canadian market. Through a national sales force, the Company markets its pharmaceutical products to Canadian specialists in its key therapeutic areas.

Paladin's strategy is to acquire promotion sensitive products with existing sales and to increase sales of these products through focused marketing and promotion. The Company also in-licenses late stage development products, obtains regulatory approval for them and then launches them in the Canadian market. This strategy allows Paladin to take advantage of the consolidation in the pharmaceutical industry. Furthermore, this strategy provides emerging biotechnology companies with a proven Canadian partner with both regulatory and marketing expertise.

Paladin achieved record results in 2001 and signed five product license and acquisition agreements. In addition, the Company launched eight products during 2001 and signed a significant agreement in early 2002.

Paladin's revenues reached \$17,795 for the year ended December 31, 2001. Income before write-down of intellectual property and income taxes was \$4,330, an increase of 61% over fiscal 2000. For the year ended December 31, 2001, the Company's net income after write-down of intellectual property was \$1,485 or \$0.12 per share compared to \$2,797 or \$0.24 per share for the year ended December 31, 2000.

As at December 31, 2001, the Company's total assets were \$45,191 and shareholders' equity was \$37,836. The Company's cash and cash equivalents, and temporary investments amounted to \$22,448 as at December 31, 2001.

Quarterly Information

(In thousands of Canadian dollars except per share information)

	Q1 F2001	Q2 F2001	Q3 F2001	Q4 F2001	Q1 F2000	Q2 F2000	Q3 F2000	Q4 F2000
Sales	3,485	4,515	4,859	4,936	2,683	3,064	3,045	3,815
Income before write-down of intellectual property and income taxes	614	1,151	1,578	987	334	926	921	514
Net Income (loss)	515	995	1,473	(1,498)	299	832	819	847
Basic and fully diluted EPS	\$0.04	\$0.08	\$0.12	\$(0.12)	\$0.03	\$0.07	\$0.07	\$0.07

Results of Operations

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Revenues

Revenues increased \$5,188 or 41%, to \$17,795 for the year ended December 31, 2001 from \$12,607 for the year ended December 31, 2000. This increase was due primarily to the new or recently launched products, including Androderm®, Plan B™, MUSE®, Tapazole®, Propyl-Thyracil® and Oesclim®. The addition of these products strengthened the Company's product offerings in its key therapeutic areas of urology, endocrinology and women's health. The Company has been able to leverage its existing relationships with key physicians in these therapeutic areas to market and promote these products effectively.

Gross Profit

Total gross profit increased \$3,625 or 43%, to \$12,007 for the year ended December 31, 2001 from \$8,382 for the year ended December 31, 2000. Gross profit, as a percentage of revenues, improved to 67% for the year ended December 31, 2001 from 66% for the year ended December 31, 2000.

Selling and Administrative Expense

Selling and administrative expense increased \$1,256 or 22%, to \$7,031 for the year ended December 31, 2001 from \$5,775 for the year ended December 31, 2000. This increase was primarily attributed to increased marketing spending associated with new product launches and to higher staffing costs related to expanded infrastructure necessitated by the Company's product line growth during the past year. Selling and administrative expense, as a percentage of revenues, decreased to 40% for the year ended December 31, 2001 from 46% for the year ended December 31, 2000. The decrease in selling and administrative expense, as a percentage of revenues, is a result of efficiencies realized from in-licensing and launching brands in the Company's key therapeutic areas. This strategy has allowed the Company to leverage its existing sales and marketing infrastructure to launch new products.

Research and Development Expense

Research and development expense increased \$137 or 16%, to \$994 for the year ended December 31, 2001 from \$857 for the year ended December 31, 2000. This increase was primarily due to higher staffing costs and associated costs required to support products in various stages of development including further Canadian regulatory expenses for currently marketed products.

Amortization Expense

Amortization expense increased \$496 or 301%, to \$661 for the year ended December 31, 2001 from \$165 for the year ended December 31, 2000. This increase reflected the full-year impact of amortization expense related to the Company's acquisition of licenses, rights and intellectual property during the year ended December 31, 2000, as well as the impact of amortization expense related to the Company's acquisitions of licenses, rights and intellectual property during the year ended December 31, 2001.

Interest Income

Interest income decreased \$101 or 9%, to \$1,009 for the year ended December 31, 2001 from \$1,110 for the year ended December 31, 2000, reflecting primarily the effect of lower interest rates during the year ended December 31, 2001.

Write-Down of Intellectual Property

During the year ended December 31, 2001, the Company recorded a write-down of intellectual property associated with ConXn™ (relaxin), SYNSORB Cd®, and DepoCyt™.

The Company entered into a Development, Commercialization and License Agreement with Connetics Corporation ("Connetics") on July 7, 1999 relating to the development of relaxin. The Company has licenses of \$1,875, of which a total of \$200 had been amortized as at December 31, 2001.

On May 23, 2001, Connetics announced that it would pursue licensing or other strategic alternatives for its relaxin program. Since Connetics has been unable to conclude a satisfactory arrangement for the continuing development of relaxin, the Company wrote off the unamortized balance of \$1,675 relating to this license.

The Company entered into a License, Distribution, and Supply Agreement with SYNSORB Biotech Inc. ("Synsorb") on September 29, 1999 relating to the development of SYNSORB Cd®. The Company has licenses of \$100, of which a total of \$15 had been amortized as at December 31, 2001.

On December 10, 2001 Synsorb announced that it had decided to terminate further development of SYNSORB Cd®. Consequently, the Company wrote off the unamortized balance of \$85 relating to this license.

The Company entered into a Marketing and Distribution agreement with SkyePharma, Inc. on June 30, 2001 relating to DepoCyt™. The Company has licenses of \$1,500, of which a total of \$112 had been amortized at December 31, 2001.

Paladin recorded its first sale of DepoCyt™ in 2000. During 2001, management reviewed the valuation of the license for DepoCyt™ and determined that there was an impairment in the carrying value of this license. Consequently, the Company recorded a write-down of \$750.

Income Tax Expense

Income tax expense increased \$249 or 128%, to \$443 for the year ended December 31, 2001 from \$194 for the year ended December 31, 2000. The effective tax rate was 23% for the year ended December 31, 2001 compared to 7% for the year ended December 31, 2000. For the year ended December 31, 2001, the Company recorded a charge of \$168 in tax expense for the impact of expected changes in tax rates related to loss carryforwards.

Net Income

As a result of the factors set forth above, net income decreased \$1,312 or 47%, to \$1,485 for the year ended December 31, 2001 from \$2,797 for the year ended December 31, 2000.

LIQUIDITY AND CAPITAL RESOURCES

The Company believes that its existing cash and cash equivalents, and temporary investments, as well as cash generated from operations are sufficient to finance its current and future operations and working capital needs. However, in the event that the Company makes significant acquisitions in the future, the Company may wish to raise funds through the issuance of debt or equity securities.

At present, the Company is actively pursuing product acquisitions that may require the use of substantial capital resources. There are no present agreements or commitments with respect to any such acquisitions.

Cash flows from operating activities were \$5,154 and \$1,507 for the years ended December 31, 2001 and 2000, respectively. Cash flows from operating activities represent the cash flows from net earnings, excluding revenues and expenses not affecting cash, principally amortization, write-down of intellectual property, future income taxes and imputed interest.

The increase in cash flows from operating activities for fiscal 2001 was mainly the result of increase in income before write-downs of intellectual property and income taxes. For the year ended December 31, 2000 the increase in cash flows from operating activities was mainly due to increase in net income less a decrease in net change in non-cash balances relating to operations.

The Company's investing activities used cash of \$6,593 and \$21,976 for the years ended December 31, 2001 and 2000, respectively. During the year ended December 31, 2001, the Company invested \$9,627 in acquisitions of patents, pharmaceutical product licenses and rights and intellectual property. This decrease was offset by \$2,250 in accounts payable related to the above mentioned acquisitions. In addition, the Company had a \$1,011 reduction in temporary investments. The principle uses of cash in fiscal 2000 were acquisitions of patents, pharmaceutical product licenses and rights and intellectual property of \$5,497 and purchases of temporary investments of \$16,481.

Cash flows from financing activities were \$559 and \$18,441 for the years ended December 31, 2001 and 2000, respectively. For the year ended December 31, 2001, cash was provided from common stock option exercises and the issuance of shares under the stock purchase plan. For the year ended December 31, 2000, cash flows from financing activities was primarily from proceeds from the issuance of 2,900,000 in common shares in an offering which was completed in April 2000 less related issuance costs.

EVENT SUBSEQUENT TO THE END OF THE FISCAL YEAR

On January 17, 2002, the Company entered into a ten-year distribution agreement and related service agreements with Pharmacia Canada Inc. The distribution agreement adds five marketed products to the Company's existing portfolio of products. Under the agreements, Paladin is required to pay an aggregate of \$8,093 over the next five years.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2001, the Company retroactively adopted the new recommendations relating to the method of calculation and the presentation and disclosure requirements for earnings per share, as outlined in note 3(i) to the financial statements. The change in accounting policy had no impact on the Company's previously reported earnings per share for the year ended December 31, 2000.

During 2000, the Company changed its accounting policy for share issue costs as outlined in note 3(ii) to the financial statements. The impact of this change, which was applied retroactively, was to decrease capital stock and the deficit for 2000 and prior periods.

RECENT PRONOUNCEMENTS

The Canadian Institute of Chartered Accountants approved a new Handbook Section 3062 - Goodwill and Other Intangible Assets. Intangible assets other than goodwill acquired in a business combination or other transaction for which the acquisition date is after June 30, 2001, are to be amortized based on the useful life to an enterprise, unless the life is determined to be indefinite in which case the intangible asset will not be amortized. Section 3062 will be effective for the Company's fiscal year beginning January 1, 2002. The Company does not believe the adoption of this section will have a material impact on the financial statements.

The Canadian Institute of Chartered Accountants approved a new Handbook Section 3870 - Stock Based Compensation and Other Stock - Based Payments. Section 3870 will be effective for the Company's fiscal year beginning January 1, 2002. The Company does not believe the adoption of this rule will have a material impact on the financial statements.

RISK FACTORS

Volatility of Share Price

The market price of Paladin's shares is subject to volatility. Deviations in actual financial results as compared to the expectations of securities analysts who follow the Company can have a significant effect on the trading of Paladin's shares. Changes in accounting standards could or could not have an impact on the financial statements' presentation.

Interest Rate Risk

The Company's temporary investments are subject to interest rate risks. As outlined in note 4 to the financial statements, the Company holds discount notes and corporate bonds for periods less than one year. The purpose of these temporary investments is to fund acquisitions of patents, pharmaceutical product licenses and rights and intellectual property.

Product Commercialization Risk

The Company's strategy includes in-licensing late-stage development products. This strategy entails external and environmental risks including: the uncertainties involved in clinical testing, the cost and time involved in obtaining regulatory approvals, the uncertainties related to obtaining commercially viable pricing as well as appropriate reimbursement levels. While Management strives to have a portfolio of products that are in late-stage clinical development and believes that these products offer revenue generating potential, there can be no assurance that this will prove correct.

Generic Product Risk

Although most of the Company's revenue is generated by products not subject to competition from generic products, there is no proprietary protection for many of our branded pharmaceutical products. The entrance into the market of a generic pharmaceutical product may have a material adverse effect on the Company's business, financial condition and results of operations.

Dependence on Affiliate

The Company outsources several business activities to an affiliated company, Pharmascience Inc., including: laboratory studies, product formulation, clinical data analysis, product manufacturing and product distribution. Although all such transactions are at arm's length, should Pharmascience Inc. terminate these contracts, the Company's business may be adversely affected by the interruption in services.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING 2001

The accompanying financial statements of Paladin Labs Inc. and all of the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

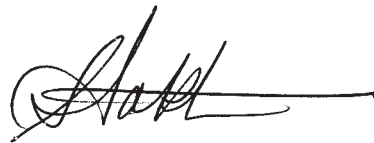
The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The most significant of these accounting principles are described in Note 2 to the financial statements. The financial statements include some amounts that are based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects. The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. The financial information elsewhere in this Annual Report is consistent with the information presented in the financial statements.

The Board of Directors has appointed an Audit Committee consisting of three outside directors. The committee meets periodically during the year to review with management and the external auditors any significant accounting, internal control and auditing matters. They review and finalize the annual financial statements of the Company along with the external auditors' report prior to the submission of the financial statements to the Board of Directors for final approval.

The Company's external auditors, Ernst & Young LLP, Chartered Accountants, conduct an independent audit on behalf of the shareholders, in accordance with Canadian generally accepted auditing standards, and express their opinion on the financial statements. Their report outlines the scope of their audit and their opinion on the financial statements of the Company. The external auditors have full access to management and the Audit Committee of the Board.



Jonathan Ross Goodman, B.A., LL.B., M.B.A.
President & CEO



Samira Sakhia, CA
Chief Financial Officer

AUDITORS' REPORT

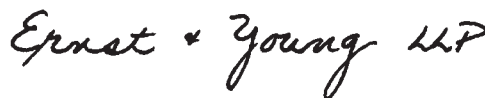
To the Shareholders of
Paladin Labs Inc.

We have audited the balance sheets of **Paladin Labs Inc.** as at December 31, 2001 and 2000 and the statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Montreal, Canada,
January 31, 2002



Chartered Accountants

BALANCE SHEETS

As at December 31
[In thousands of Canadian dollars]

	2001	2000
	\$	\$
ASSETS		
Current		
Cash and cash equivalents	1,978	2,858
Temporary investments [note 4]	20,470	21,481
Accounts receivable [note 5]	2,067	1,495
Inventories	50	411
Income tax credits receivable	487	1,036
Future income tax assets [note 13]	2,275	1,520
Total current assets	27,327	28,801
Capital assets [note 6]	12,530	6,144
Investments, at cost [note 7]	2,771	2,366
Future income tax credits receivable [note 13]	347	187
Future income tax assets [note 13]	2,216	4,026
	45,191	41,524
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	3,924	1,803
Income taxes payable	181	98
Deferred credit [note 13]	1,638	978
Total current liabilities	5,743	2,879
Balance of sale payable [note 8]	544	495
Deferred credit [note 13]	935	2,286
Future income tax liability [note 13]	133	95
	7,355	5,755
Shareholders' equity		
Capital stock [note 9]	37,154	36,595
Contributed surplus	87	87
Other paid-in capital [note 9]	23	—
Retained earnings (deficit)	572	(913)
Total shareholders' equity	37,836	35,769
	45,191	41,524

See accompanying notes

On behalf of the Board:



Director



Director

STATEMENTS OF INCOME AND RETAINED EARNINGS

Years ended December 31

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

	2001 \$	2000 \$
Revenues <i>[note 11]</i>	17,795	12,607
Cost of sales <i>[note 11]</i>	5,788	4,225
Gross profit	12,007	8,382
Selling and administrative <i>[note 11]</i>	7,031	5,775
Research and development <i>[notes 11 and 12]</i>	994	857
Amortization	661	165
Interest income, net	(1,009)	(1,110)
Income before undernoted items	4,330	2,695
Gain on disposal of investment	—	(296)
Net loss on disposition and write-downs of intellectual property <i>[note 10]</i>	2,402	—
Income before income taxes	1,928	2,991
Provision for income taxes <i>[note 13]</i>		
Current	41	20
Future	402	174
	443	194
Net income	1,485	2,797
Deficit, beginning of year as previously reported	(913)	(3,866)
Cumulative impact of restatement of prior year <i>[note 3]</i>	—	156
Deficit, beginning of year as restated	(913)	(3,710)
Retained earnings (deficit) end of the year	572	(913)
Earnings per share		
Basic	0.12	0.24
Diluted	0.12	0.24
Weighted average number of shares outstanding <i>[note 14]</i>		
Basic	12,428,188	11,506,636
Diluted	12,496,356	11,632,798

See accompanying notes

STATEMENTS OF CASH FLOWS

Years ended December 31
[In thousands of Canadian dollars]

	2001	2000
	\$	\$
OPERATING ACTIVITIES		
Net income	1,485	2,797
Add items not affecting cash		
Amortization	661	165
Write-down of intellectual property	2,402	—
Future income taxes	242	(13)
Gain on disposal of investment	—	(296)
Imputed interest on balance of sale	49	45
Expenses related to options issued to consultants	23	—
	4,862	2,698
Net change in non-cash balances relating to operations	292	(1,191)
Cash flows from operating activities	5,154	1,507
INVESTING ACTIVITIES		
Additions to patents, pharmaceutical product licenses and rights and intellectual property	(9,627)	(5,497)
Accounts payable related to the acquisition of intellectual property	2,250	—
Acquisition of capital assets	(16)	(31)
Net increase (decrease) in temporary investments	1,011	(16,481)
Investments <i>[note 7]</i>	(211)	(565)
Proceeds from disposal of investment	—	598
Cash flows from investing activities	(6,593)	(21,976)
FINANCING ACTIVITIES		
Common shares issued for cash	559	20,337
Share issue costs	—	(1,896)
Cash flows from financing activities	559	18,441
Net change in cash and cash equivalents during the year	(880)	(2,028)
Cash and cash equivalents, beginning of year	2,858	4,886
Cash and cash equivalents, end of year	1,978	2,858
Supplemental cash flow information		
Interest paid	2	31
Income taxes paid	31	462

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

December 31, 2001

[In thousands of Canadian dollars

except for share and per share amounts]

1. Nature of operations

Paladin Labs Inc. [the "Company"] is a Canadian public company continued under the *Canada Business Corporations Act*. The Company's shares are traded on the Toronto Stock Exchange. The Company's business consists of in-licensing or acquiring, marketing, developing and distributing innovative pharmaceutical products in Canada. On January 1, 2000, the Company and its wholly-owned subsidiary Neuroscience Pharma Inc. ["NPI"] were amalgamated and continued operations under the name Paladin Labs Inc. The December 31, 2001 and December 31, 2000 financial statement include the accounts of NPI on a continuity of interest basis of accounting.

2. Basis of presentation and significant accounting policies

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles, the most significant of which are described below:

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Cash and cash equivalents

Cash consists of bank deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value, and consist primarily of bankers' acceptances with maturities of three months or less.

Inventories

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

Temporary investments

Temporary investments are recorded at the lower of cost and market value on a portfolio basis.

Investments

Investments in common shares of private and public companies, where the Company does not exercise significant influence, are accounted for by the cost method whereby earnings are recognized only to the extent that dividends are declared. Annually, the Company performs a review of its investments to determine if there has been other than temporary impairment in value.

Capital assets

Capital assets are recorded at cost. Amortization is provided on a basis and at rates assigned to amortize the cost of the assets over their estimated useful lives as follows:

Computer equipment	30% declining balance
Patents, pharmaceutical product licenses and rights and intellectual property	Up to 20 years

In the normal course of business, the Company secures Canadian development, sales and marketing rights to innovative drug products. Intellectual property acquired is recorded at cost and consists primarily of process know-how covered by certain patented and non-patented information. Patents, licenses, rights and intellectual property are amortized on a straight-line basis over the lesser of the term of the agreement, the life of the patent or twenty years. The terms generally range from 10 to 20 years. On an ongoing basis, management reviews the recoverability based on projected future results. Whenever there is an impairment in the value, the carrying amount is accordingly written down.

Revenue recognition

Product revenues are recognized as products are shipped to customers and title to the property passes to the customer and when there is reasonable expectation of collection. Appropriate allowances for returned goods are estimated and recorded by management.

Government assistance

Amounts received or receivable resulting from government assistance programs, including grants and investment tax credits for research and development, are reflected as reductions of the cost of the assets or expenses to which they relate at the time the eligible expenditures are incurred, provided there is reasonable assurance the benefits will be realized.

Research and development

Research costs are charged against income in the year of expenditure. Development costs are charged against income in the year of expenditure unless a development project meets the criteria under generally accepted accounting principles for deferral and amortization. The Company has not deferred any such development costs to date.

Interest income

Interest income is recognized as it accrues to the Company.

Income taxes

The Company provides for income taxes using the liability method. Under this method, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the period in which the future tax assets or liabilities are expected to be realized or settled. Future income tax assets are recognized to the extent that it is more likely than not that they will be realized.

Deferred credit

The deferred credit results from the acquisition of future income tax benefits through a business combination and is amortized to income tax expense in proportion to the realization of these benefits.

Stock-based compensation plans

The Company has a stock-based compensation plan, which is described in Note 9. No compensation expense is recognized for this plan when stock or stock options are issued to employees and directors. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. If stock or stock options are repurchased from employees, the excess of the consideration paid over the carrying amount of the stock or stock options canceled is charged to retained earnings. Options issued to consultants are recognized as an expense in the period they are granted using the Black-Scholes option pricing model.

Earnings per share

Basic earnings per share are calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method, giving effect to the exercise of all dilutive factors. The treasury stock method assumes that any proceeds that could be obtained upon the exercise of options would be used to purchase common shares at the average market price during the period.

Foreign currency translation

Transactions arising in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the transaction dates. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the year-end rates of exchange. Exchange gains and losses arising from the translation of foreign currency items are included in the determination of net income.

3. Change in accounting policies**i) Earnings per share**

Effective January 1, 2001, the Company retroactively adopted the new recommendations published by the Canadian Institute of Chartered Accountants relating to the method of calculation and the presentation and disclosure requirements for earnings per share. The new recommendations require the use of the treasury stock method instead of the imputed earnings method for calculating diluted earnings per share. The change in accounting policy has had no impact on the Company's previously reported earnings per share for the year ended December 31, 2000.

ii) Share issue costs

The Company changed its accounting policy for share issue costs in 2000. Share issue costs are accounted for as a reduction of capital stock, whereas previously, they had been recorded in the statement of deficit. This change has been applied retroactively, and the prior period statement of deficit has been restated. The effect of this change was to decrease capital stock and the deficit by \$1,196 for the year ended December 31, 2000, to decrease capital stock and the deficit by \$17 for the year ended December 31, 1999 and to decrease opening deficit of 1999 by \$139.

4. Temporary investments

	2001		2000	
	Cost	Market Value	Cost	Market Value
	\$	\$	\$	\$
Corporate bond, 4.30%, due February 2002	903	922	—	—
Corporate bond, 4.20%, due February 2002	6,657	6,799	—	—
Corporate bond, 3.86%, due February 2002	6,500	6,638	—	—
Corporate bond, 2.30%, due September 2002	2,401	2,406	—	—
Discount note, 2.00%, due April 2002	2,030	2,030	—	—
Corporate bond, 1.90%, due September 2002	754	756	—	—
Corporate bond, 5.40%, due on September 2002	575	519	—	—
Discount note, 2.00%, due June 2002	650	650	—	—
Discount note, 5.69%, due January 2001	—	—	10,001	10,197
Corporate bond, 5.65%, due on March 2001	—	—	5,284	5,361
Discount note, 5.68%, due February 2001	—	—	1,708	1,741
Corporate bond, 5.68%, due March 2001	—	—	1,133	1,150
Corporate bond, 6.00%, due December 2006	—	—	1,021	1,023
Corporate bond, 6.45%, due October 2006	—	—	948	940
Discount note, 5.66%, due February 2001	—	—	879	900
Corporate bond, 5.85%, due March 2001	—	—	507	500
	20,470	20,720	21,481	21,812

5. Accounts receivable

	2001 \$	2000 \$
Receivable from an affiliated company <i>[note 11]</i>	1,213	871
Interest receivable	339	354
Other receivables	515	270
	2,067	1,495

Other receivables consist primarily of commodity taxes of \$105 [2000 - \$72] and trade receivables of \$317 [2000 - \$151].

6. Capital assets

	2001		2000	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Computer equipment	47	14	31	5
Patents, pharmaceutical product licenses and rights, and intellectual property	13,103	606	6,295	177
Total	13,150	620	6,326	182
Less: accumulated amortization	620		182	
Net carrying value	12,530		6,144	

7. Investments

	2001 \$	2000 \$
Investment in common shares of Connetics Corporation, a public corporation in the United States [US\$200] [market value - \$414 [2000 - \$221]]	304	304
Investment in shares of Anthra Pharmaceuticals Inc. ["Anthra"], a private corporation based in the United States [US\$1,000] [market value - see note [i] below]	1,497	1,497
Investment in common shares of BioSante Pharmaceuticals Inc., a public company in the United States [US\$636] [2000 - US\$375] [see [ii] below] [market value \$1,136 [2000 - \$643]]	970	565
	2,771	2,366

In all these investments, the Company has no more than 5% of the outstanding common shares.

[i] It is not practicable within constraints of timeliness or cost to determine the fair value of Anthra common shares.

[ii] On September 1, 2000, the Company acquired a convertible debenture in the amount of US\$500 pursuant to a 10-year license agreement with BioSante Pharmaceuticals Inc. ["BioSante"]. The debenture was non-interest bearing and on August 13, 2001, BioSante exercised its option to convert the debenture into 476,190 common shares of BioSante.

On August 29, 2001, the Company licensed an additional product from BioSante for \$193 [US\$125], for which the Company received 157,828 shares of BioSante. BioSante also achieved certain milestones for which the Company made an additional investment of \$39 [US\$25] and received 31,566 shares of BioSante. The total investment component has been given a value of \$211 [US\$137] and the difference of \$21 [US\$13] has been allocated to patents, pharmaceutical product licenses and rights.

In connection with this agreement, the Company may also be required to make additional investments in common shares of BioSante for a maximum amount of US\$168 based on the outcome of certain milestones.

8. Balance of sale payable

In 1999, the Company acquired all of the outstanding common shares of NPI for a total consideration of \$750 consisting of \$100 cash and a \$650 non-interest bearing balance of sale due on December 21, 2003. NPI focuses on the discovery and development of novel therapeutics relating to dehydroepiandrosterone [DHEA]. Given the non-interest bearing nature of the \$650 balance of sale, the amount has been recorded in these financial statements at its

discounted net present value of \$450 which will be accreted over the repayment term. As at December 31, 2001, the Company had recorded \$49 [\$45 in 2000] of interest expense and had \$544 [\$495 in 2000] in balance of sale payable.

9. Capital stock

Authorized

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

Issued and outstanding

	2001		2000	
	Number of shares	Amount \$	Number of shares	Amount \$
Balance, beginning of year	12,394,038	36,595	9,466,338	17,454
Issued during the year:				
Exercise of warrants	1,450	12	27,700	137
Exercise of stock options	143,412	525	—	—
Employee share purchase plan	347	2	—	—
Public offering	—	—	2,900,000	20,300
Share issue costs, net of income taxes	—	—	—	(1,196)
Employee share purchase loan	—	20	—	(100)
Balance, end of year	12,539,247	37,154	12,394,038	36,595

Employee share purchase plan

In 2000, \$100 was advanced to a key employee to purchase common shares. This loan is secured by a pledge of the common shares. During 2001, pursuant to the resignation of the above key employee, the Company entered into a repayment agreement requiring annual payments of \$20 commencing June 8, 2001.

Stock option plan

The Company has a Stock Option Plan [the "Plan"] in place for the benefit of key employees, directors, officers and consultants of the Company to purchase an aggregate maximum of 900,000 common shares. The number of common share options granted to a beneficiary and the vesting period will be determined at the discretion of the Board of Directors and is not to exceed 5% of the outstanding common shares.

The exercise price of any option granted under the Plan shall be fixed by the Board of Directors and will not be less than the average closing price per common share on the date of grant. The term of an option and vesting period was five years from the date of the grant. On December 6, 2001, the Board amended the stock option plan to extend the term to seven years and the vesting period to four years. All options granted on and after December 6, 2001 are subject to this amendment.

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

	2001		2000	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance, beginning of year	484,344	4.90	327,894	3.98
Granted	399,233	5.94	157,198	6.85
Exercised	(143,412)	3.66	—	—
Expired or forfeited	(45,332)	5.56	(748)	6.35
Balance, end of year	694,833	5.71	484,344	4.90
Options exercisable at end of year	235,500	4.98	252,625	4.07

Additional information concerning stock options outstanding as at December 31, 2001 is as follows:

Exercise price	Options outstanding		Options exercisable
	Number	Weighted average months to expiry	Number
\$4.30	132,000	26	132,000
\$4.50	5,205	29	2,080
\$4.78	57,600	31	23,040
\$6.85	5,000	32	5,000
\$6.35	25,227	37	5,040
\$7.00	121,700	43	38,340
\$5.00	158,735	51	30,000
\$5.05	8,000	58	-
\$6.75	181,366	83	-
	694,833		235,500

Stock purchase plan

The Company has a stock purchase plan with 200,000 common shares reserved for purchase by full-time employees at fair market value. During 2001, 347 [nil in 2000] shares were issued at fair market value under this plan.

Under this plan, the Company will contribute 25% of employees' contributions to a maximum of 6% of the employees' salary in the form of common shares. The Company will make its contribution if the employee remains employed by the Company and has held the original shares for two years from the original purchase date.

Other paid-in capital

During the year, the Company granted 15,000 options to consultants at a price of \$7.00. These options have a five-year vesting period. Management has estimated the fair value of these options using Black-Scholes option pricing model using a volatility factor of 0.71 and a risk free rate of 2.65% to be approximately \$23. This amount of \$23 has been recorded as an expense and credit to other paid-in capital.

10. Other expenses

	\$
Relaxin [i]	(1,675)
SYNSORB Cd® [ii]	(85)
DepoCyt™ [iii]	(750)
E2-NETA and E2 Patch [iv]	108
	<u>2,402</u>

During 2001, the Company recorded write-downs and a gain associated with the intellectual property described below.

[i] In a license agreement with Connetics Corporation [“Connetics”] for relaxin, the Company recorded licenses of \$1,875, of which a total of \$200 had been amortized as at December 31, 2001.

On May 23, 2001, Connetics announced that it would no longer continue its relaxin program and would investigate other strategic alternatives. Connetics has been unable to conclude a satisfactory arrangement for the continuing development of relaxin and the Company wrote-off the unamortized balance of \$1,675 relating to this license on December 31, 2001.

[ii] The Company entered into a License, Distribution, and Supply Agreement with Synsoorb Biotech Inc. [“Synsoorb”] for SYNSORB Cd®. The Company has licenses of \$100, of which a total of \$15 had been amortized. On December 10, 2001, Synsoorb announced that it decided to terminate further development of SYNSORB Cd® and the Company wrote-off the unamortized balance of \$85 relating to this license.

[iii] The Company entered into a Marketing and Distribution agreement with SkyePharma Inc. relating to DepoCyt™. The Company has a license of \$1,500, of which a total of \$112 had been amortized.

During 2001, management reviewed the valuation of the license for DepoCyt™ and determined that there was an impairment in the carrying value of this license. Consequently, the Company recorded a write-down of \$750.

[iv] In 2001, the Company surrendered its right to the E2 Patch and BioSante withdrew E2-NETA and provided consideration of 173,611 shares of BioSante. The Company recorded a gain of \$108 representing the difference between the value of the consideration received and the write-off of the intellectual property related to these products of \$94 less the accumulated amortization of \$10.

11. Related party transactions

In June of 1998, the Company entered into a number of ten-year agreements each with five-year renewal options with an affiliated company, Pharmascience Inc. [“Pharmascience”], a company under common control and formerly the Company’s parent. Pharmascience provides manufacturing and logistics services including, customer service, warehousing and shipping on behalf of the Company. Pharmascience also performs invoicing and collection services on behalf of the Company. The services rendered by Pharmascience and the method of charging varies depending upon the agreement and products. The table below, reflects the transactions with Pharmascience.

	2001 \$	2000 \$
Sales to Pharmascience	2,387	2,026
Purchases	4,873	3,878
Research and development expenses	819	936
Distribution fees	773	592
Selling and administrative expenses	290	347

During 2001, the Company sold a license for 5% Amlexanox Paste to Pharmascience. The Company originally obtained this license with a commitment to royalty and milestone payments based on future sales and through payments to obtain regulatory approval, which were previously expensed. Future royalty and milestone payments have been assigned to Pharmascience for a cash payment of \$250.

12. Research and development and government assistance

The Company incurred research and development expenditures which are eligible for investment tax credits. The investment tax credits recorded are based on management’s estimates of amounts expected to be recovered and are subject to audit by taxation authorities. The amounts can be summarized as follows:

	2001 \$	2000 \$
Research and development expenditures	1,259	1,167
Investment tax credits	(265)	(310)
	<u>994</u>	<u>857</u>

13. Income taxes

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax assets and liabilities are as follows:

	2001 \$	2000 \$
Future income tax assets		
Current		
Loss carryforwards	1,671	1,358
Temporary differences related to capital assets	464	—
Tax benefit of share issue costs	140	162
	2,275	1,520
Long-term		
Loss carryforwards	—	2,160
Temporary differences related to capital assets	422	95
Scientific Research and Experimental Development expenditures not claimed for tax purposes	1,541	1,305
Tax benefit of share issue costs	253	466
	2,216	4,026
Total future income tax assets	4,491	5,546
Future income tax liabilities		
Future income tax credit liabilities	133	95
Total future income tax liabilities	133	95
Net future income tax assets	4,358	5,451

The Company's income tax expense consists of the following:

	2001 \$	2000 \$
Provision at Canadian statutory rates [37.12%] [2000 - 38.12%]	716	1,140
Decrease resulting from:		
Drawdown of deferred credit	(409)	(898)
Impact of change in expected tax rate	168	—
Other	(32)	(48)
	443	194

As at December 31, 2001, the Company has Scientific Research and Experimental Development expenditures available for Federal and Provincial income tax purposes, amounting to approximately \$4,736 and \$4,469, respectively, which may be applied against taxable income of future years. The Company also has Federal investment tax credits from Scientific Research and Experimental Development expenditures amounting to \$347 which expire in 2011.

In addition, at December 31, 2001, the Company has available, for Federal and Provincial income tax purposes, loss carryforwards which may be applied against the taxable income of future years and which expire as follows:

	Federal \$	Provincial \$
2004	2,546	2,308
2005	2,284	2,276
	4,830	4,584

The tax benefits of the above items have been recorded as future tax assets subject to the expiration periods noted above. The Company also recorded a reduction of current tax expense of \$1,707 reflecting the claiming of Federal and Provincial losses carryforward in the current year for approximately \$4,432 and \$5,125 respectively. There is measurement uncertainty with respect to the realization of \$2,477 of the future tax assets relating to scientific research and experimental development expenditures and loss carryforwards. Management believes it is more likely than not that these future tax assets will be realized. The amount of the future tax assets considered realizable, and the tax benefit claimed in the current year, however, could be reduced by a material amount in the future.

14. Earnings per share

The following summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding used in the diluted earnings per share calculations:

	2001	2000
Basic weighted average number of shares outstanding	12,428,188	11,506,636
Dilutive effect of stock options	68,168	126,162
Diluted weighted average number of shares outstanding	12,496,356	11,632,798

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

15. Commitments

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

Revenue based commitments

The pharmaceutical product license agreements require that the Company make royalty payments ranging from 2.5% to 15% of sales, or require payments for products at rates ranging from 26% to 50% of the net selling price, or 60% of the net profit on sales. In addition, the Company will have to pay \$4,867 [US\$3,050] and \$250 if the Company achieves specific sales volumes on specific products in the future.

Milestone based commitments

The Company has also committed to fund certain research and development expenditures of third parties of \$399 [US\$250] over the next two years. In addition, specific payments are required under these agreements if milestones are met, such as regulatory approval in Canada. Based on the outcome of these milestones, the Company may have to pay up to \$2,182 [US\$1,368] and \$100.

Purchase based commitments

The Company is committed to making minimum purchases in the amount of \$1,710 in order to retain exclusive distribution agreements for certain products. These commitments end in 2009 and annual amounts are as follows:

	\$
2002	190
2003	190
2004	190
2005	190
2006	190
2007 - 2009	760

16. Financial instruments

[i] Fair values

Short-term financial assets and liabilities

The carrying amounts of cash and cash equivalents, temporary investments, accounts receivable and accounts payable are a reasonable estimate of their fair values because of the short maturity of these instruments.

The effective rate of return on cash equivalents and temporary investments is approximately 4.7% [2000 - 5.5%].

Long-term financial liabilities

The carrying amount of the balance of sale is presented at fair value as it has been discounted using the estimated borrowing rate.

[ii] Concentration of credit risk

Investment tax credits recoverable and research and development tax credits receivable are due from the Federal and Provincial governments. Cash and cash equivalents and temporary investments consist of bonds or commercial paper in a number of large corporations, one of which, a provincial government corporation represents 68.7% of the total and as such the related credit risk is limited.

17. Enterprise wide disclosures

Substantially all of Company's revenues are generated from sales and distribution of pharmaceutical products in Canada and only one customer, an affiliated company [see note 11], accounts for 12% [2000 - 16%] of sales. All of the Company's assets are located in Canada.

18. Comparative figures

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

19. Subsequent event

On January 17, 2002, the Company entered into a ten-year distribution agreement with related service agreements which require an aggregate payment of \$8,093 over a period of five years.

BOARD OF DIRECTORS

Ted Wise
Chairman
Co-founder of Pharmascience Inc.

Jonathan Ross Goodman
President & CEO
Paladin Labs Inc.

Mark A. Beaudet
Vice President, Marketing & Sales
Paladin Labs Inc.

Ger van Amersfoort*
Former President of
Novartis Pharmaceuticals Canada Inc.
& SmithKline Beecham Pharma Inc.

Robert Lande▲
Chief Financial Officer
Telecom Américas Ltd.

Michael Tarnow*
President & CEO Huntington Venture, LLC
Former President of
Merck Frosst Canada & Co.

Dr. Brad Thompson*▲
President & CEO
Oncolytics Biotech

Tom Wiggins▲
President & CEO
Connetics Corp.

* member of the Audit Committee

▲ member of the Compensation Committee

OFFICERS

Jonathan Ross Goodman
President & CEO

Mark A. Beaudet
Vice President, Marketing & Sales

David MacNaughtan
Vice President, Business Development

Samira Sakhia
Chief Financial Officer

Correspondence

Paladin Labs Inc.
6111 Royalmount Avenue
Suite 102
Montreal QC H4P 2T4
Canada

Tel: (514) 340-1112
Web site: www.paladinlabs.com
E-mail: info@paladin-labs.com

Stock Exchange Listing

Toronto Stock Exchange
Trading symbol: PLB

Transfer Agent

Computershare Investor Services
Place Montreal Trust
1800 McGill College Avenue
Montreal QC H3A 3K9
Canada

Auditors

Ernst & Young, LLP
1 Place Ville Marie
Suite 2400
Montreal QC H3B 3M9
Canada

Annual General Meeting

May 1st, 2002, 4 p.m.
6111 Royalmount Avenue
Suite 102
Montreal QC H4P 2T4
Canada

Ce document est aussi disponible en français

Glossary

- CIS** (*carcinoma in situ*) – a neoplastic entity wherein the tumour cells are confined to the surface epithelium of origin, without invasion of the basement membrane i.e., a surface tumour
- DHEA** – a natural hormone that is the most abundant steroid in the body and which serves as a precursor to sex hormones, amongst other functions
- Endocrinology** – a medical science dealing with disorders of the endocrine glands
- Etiology** – a branch of medical science concerned with the origins and causes of diseases
- FDA** – the acronym for Food & Drug Administration, this is the American government body that oversees the manufacture, use and sale of drugs in the U.S.
- Galactorrhea** – excessive or spontaneous flow of milk; persistent secretion of milk irrespective of nursing
- Intravesical Instillation** – administration of a liquid drop by drop within the bladder
- Melatonin** – a natural hormone thought to be responsible for the regulation of circadian rhythms
- Microadenoma** – an adenoma (a benign epithelial tumour) as of the anterior pituitary gland, less than 10mm in diameter
- NDS** – the acronym for New Drug Submission, this is a document which contains the pre-clinical data submitted to the TPD, and which serves as the basis for approval to market the drug in Canada
- Pituitary** – a gland which lies immediately beneath the hypothalamus and is responsible for the regulation of other endocrine glands; of or relating to the pituitary gland
- Prolactin** – a hormone produced in the pituitary gland that is responsible for signalling the body to produce breast milk
- Prostacyclin** – a natural molecule that is responsible for dilation of the pulmonary artery
- Resectable** – referring to the surgical removal of part of an organ or structure
- TPD** – the acronym for the Therapeutic Products Directorate, this is the national authority that regulates, evaluates and monitors the safety, efficacy and quality of therapeutic and diagnostic products and vaccines available to Canadians
- Transdermal** – delivery of a drug through the surface of the skin
- Urology** – a medical science dealing with disorders of the urinary tract

