

1 st QUARTER RESULTS

2001



# PRESIDENT'S REPORT

## Dear Shareholders,

It has been a productive quarter at Paladin Labs, as we pursued our in-licensing strategy and acquired three new products to add to our portfolio. Financially, we continue to experience strong sales growth from our products. In short, Paladin is pleased with the results of the quarter and believes that the Company is well positioned to leverage its financial strength to profit from new opportunities.

### Product Acquisitions

In February the Company obtained the Canadian rights to Oesclim® (estradiol 17- $\beta$  transdermal system) from Groupe Fournier. Oesclim® is an estrogen patch indicated for the relief of menopausal and post-menopausal symptoms. Oesclim® represents a new generation of twice-weekly matrix patches, capable of delivering estradiol conveniently, effectively, and unobtrusively, to those women who are prescribed hormone replacement therapy. Hormone therapy is a proven option for those women seeking relief from symptoms associated with menopause, a demographic group that is projected to increase by 15% over the next five years.

According to IMS Canada, as of September 2000, 12-month sales figures for Oesclim® exceeded \$1.5 million and grew 150% when compared to the previous year during which the product was launched. The promotion of Oesclim® also complements the sales and marketing efforts behind our other hormone related products such as Plan B™ (a next-generation emergency contraceptive), Androderm® (the first testosterone patch approved for sale in Canada) and Tapazole® (an established treatment for hyperthyroidism). The overall market for transdermal patches and gels exceeds \$30 million in Canada and has grown at a compounded rate of 8% over the past four years. We are naturally excited to be in this market space and expect it to contribute significantly to shareholder value.

In March, Paladin announced that it signed an agreement with Novartis Pharmaceuticals Canada Inc. for the exclusive Canadian marketing and distribution rights to Fiorinal® and Fiorinal-C®, two drugs frequently prescribed to treat migraines and tension headaches. This agreement is again consistent with one of Paladin's strategic objectives, namely the licensing of non-promoted brands from multinational pharmaceutical companies.

### Financial Highlights

Revenues for the quarter ended March 31, 2001 were \$3,484,749, representing an increase of 29.9% compared with the corresponding quarter in 2000. Revenues were driven by sales of new or recently launched products including Tapazole®, Oesclim®, MUSE®, and Plan B™.

Net income for the three months ended March 31, 2001 climbed 72.6% over the first quarter of 2000 to \$515,483. Our solid financial results are not only evidence of the value our business model can deliver but demonstrate our commitment to profitability and sound fiscal management.

On behalf of the Board, I thank everyone at Paladin for continuing to enhance the value of this Company through hard work, talent and dedication. I would also like to thank our shareholders for their continued support. We maintain our commitment to build Paladin into Canada's premier specialty Pharmaceutical company. We look forward to reporting to you our progress in the months ahead.

Sincerely,



Jonathan Goodman  
President & CEO

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Overview

Paladin experienced another successful quarter, continuing to augment its product line while reporting improved financial results. Revenues for the quarter increased by 29.9% over the first quarter of 2000, while net income rose by 72.6%. In February 2001, the Company licensed the Canadian rights to Oesclim<sup>®</sup>, an estrogen patch indicated for the relief of menopausal and post-menopausal symptoms. In March 2001, an agreement was signed with Novartis Pharmaceuticals Canada Inc. for the exclusive Canadian marketing and distribution rights to Fiorinal<sup>®</sup> and Fiorinal-C<sup>®</sup>. Fiorinal was launched in 1971 and is prescribed frequently by physicians for the treatment of migraines and tension headaches.

## Three months ended March 31, 2001 compared to the three months ended March 31, 2000

Revenues for the first quarter of 2001 increased by \$801,674 or 29.9% to \$3,484,749 due primarily to the sales of new or recently launched products such as Tapazole<sup>®</sup>, Oesclim<sup>®</sup>, MUSE<sup>®</sup> and Plan B<sup>™</sup>. Gross profit as a percentage of revenues improved to 62.9% in the current quarter from 60.9% in the corresponding quarter in 2000.

Selling and administrative expenses increased to \$1,594,720 from \$1,044,903 in the first quarter of last year, primarily as a result of the significant increase in staffing costs related to the expanded infrastructure necessitated by the Company's product line growth over the past year.

Research and development expenses at \$124,786 were \$198,761 lower than in the same quarter in 2000. This reflected the significant spending in the first quarter of last year on the development of the Company's sustained release version of Statex<sup>®</sup> (sustained release morphine sulfate), which is expected to complete Phase III clinical testing in the current year.

Amortization expense was \$154,063 in the quarter compared to \$23,536 in the corresponding quarter last year. This increase reflected the Company's success in acquiring new products during the past year.

Interest income increased to \$294,539 in the current quarter from \$91,632 in the first quarter of 2000 as a result of the investment of the unused portion of the proceeds from the equity issue in April 2000.

Net income for the three months ended March 31, 2001 amounted to \$515,483 or \$0.04 per share compared to \$298,662 or \$0.03 per share in the corresponding period last year.

## Financial Condition

Cash flow generated by operating activities in the current quarter amounted to \$778,714 compared to cash utilized by operations of \$1,873,010 in the same quarter in 2000. The 2000 period reflected an increase of \$2,230,934 in non-cash working capital, primarily due to an increase of \$1,099,676 in accounts receivable, together with decreases in accounts payable (\$761,484) and income taxes payable (\$415,036).

Expenditures on patents, pharmaceutical product licenses and rights amounted to \$2,569,265 in the quarter, up significantly from \$363,998 in the first quarter of 2000. The current quarter spending was for the purchase of the Canadian license to Oesclim<sup>®</sup>.

The decrease in temporary investments in the current quarter of \$11,087,770 reflected the transfer of marketable securities into bankers' acceptances with maturities of three months or less, which are classified on the balance sheet as cash equivalents.

# BALANCE SHEET

	<b>March 31 2001</b>	December 31 2000
	\$	\$
	(unaudited)	
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	<b>12,148,219</b>	2,857,528
Temporary investments	<b>10,393,666</b>	21,481,436
Accounts receivable	<b>1,383,295</b>	1,494,527
Inventories	<b>49,785</b>	410,885
Income tax credits receivable	<b>457,460</b>	1,036,374
Future income tax assets	<b>1,520,000</b>	1,520,000
<b>Total current assets</b>	<b>25,952,425</b>	28,800,750
Capital assets, net of accumulated amortization	<b>8,565,500</b>	6,143,770
Investments, at cost	<b>2,366,016</b>	2,366,016
Future income tax assets	<b>3,908,321</b>	4,118,321
	<b>40,792,262</b>	41,428,857
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	<b>773,253</b>	1,802,581
Income taxes payable	<b>103,413</b>	98,413
Deferred credit	<b>977,760</b>	977,760
<b>Total current liabilities</b>	<b>1,854,426</b>	2,878,754
Balance of sale payable	<b>507,250</b>	495,000
Deferred credit	<b>2,146,594</b>	2,286,594
	<b>4,508,270</b>	5,660,348
<b>Shareholders' equity</b>		
Capital stock	<b>36,595,379</b>	36,595,379
Contributed surplus	<b>86,513</b>	86,513
Deficit	<b>(397,900)</b>	(913,383)
<b>Total shareholders' equity</b>	<b>36,283,992</b>	35,768,509
	<b>40,792,262</b>	41,428,857

See accompanying notes

# STATEMENT OF INCOME

(Unaudited)

<b>Three months ended March 31</b>	<b>2001</b>	<b>2000</b>
	\$	\$
Revenues	<b>3,484,749</b>	2,683,075
Cost of sales	<b>1,291,236</b>	1,048,333
<b>Gross profit</b>	<b>2,193,513</b>	1,634,742
Selling and administrative	<b>1,594,720</b>	1,044,903
Research and development	<b>124,786</b>	323,547
Amortization	<b>154,063</b>	23,536
Interest income	<b>(294,539)</b>	(91,632)
<b>Income before income taxes</b>	<b>614,483</b>	334,388
Provision for income taxes		
Current	<b>5,000</b>	-
Future	<b>94,000</b>	35,726
	<b>99,000</b>	35,726
<b>Net Income</b>	<b>515,483</b>	298,662
<b>Earnings per share</b>		
Basic	<b>\$ 0.04</b>	\$ 0.03
Diluted	<b>\$ 0.04</b>	\$ 0.03

*See accompanying notes*

# STATEMENT OF DEFICIT

(Unaudited)

<b>Three months ended March 31</b>	<b>2001</b>	<b>2000</b>
	\$	\$
		(restated - see note 3)
<b>Balance, beginning of period</b>	<b>(913,383)</b>	(3,710,637)
Net income for the period	<b>515,483</b>	298,662
<b>Balance, end of period</b>	<b>(397,900)</b>	(3,411,975)

*See accompanying notes*

# STATEMENT OF CASH FLOWS

(Unaudited)

<b>Three months ended March 31</b>	<b>2001</b>	<b>2000</b>
	<b>\$</b>	<b>\$</b>
<b>Operating activities</b>		
Net income	<b>515,483</b>	298,662
Add items not affecting cash		
Amortization	<b>154,063</b>	23,536
Future income taxes	<b>70,000</b>	35,726
Imputed interest on balance of sale	<b>12,250</b>	-
	<b>751,796</b>	357,924
Net change in non-cash balances relating to operations	<b>26,918</b>	(2,230,934)
Cash flows from (used in) operating activities	<b>778,714</b>	(1,873,010)
<b>Investing activities</b>		
Acquisition of capital assets	<b>(6,528)</b>	-
Additions to patents, pharmaceutical product licenses and rights	<b>(2,569,265)</b>	(363,998)
Net decrease (increase) in temporary investments	<b>11,087,770</b>	(2,499,076)
Cash flows from (used in) investing activities	<b>8,511,977</b>	(2,863,074)
<b>Financing activities</b>		
Share issue costs	-	(115,622)
Cash flows used in financing activities	-	(115,622)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>9,290,691</b>	(4,851,706)
Cash and cash equivalents, beginning of period	<b>2,857,528</b>	4,885,528
<b>Cash and cash equivalents, end of period</b>	<b>12,148,219</b>	33,822

*See accompanying notes*

# NOTES TO FINANCIAL STATEMENTS

## 1. BASIS OF PRESENTATION

Information with respect to the December 31, 2000 balance sheet is derived from the Company's complete audited financial statements. These unaudited interim financial statements should be read in conjunction with the notes appearing in the Company's audited financial statements for the year ended December 31, 2000 and the accompanying notes.

## 2. ACCOUNTING POLICIES

The accounting policies underlying these interim financial statements are those set forth in note 2 of the audited financial statements for the year ended December 31, 2000, except that effective January 1, 2001 the Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants regarding the preparation of interim financial statements. The adoption of the new recommendations did not have a significant effect on the Company's financial position or results of operations.

## 3. RESTATEMENT

As reported in note 3 of the audited financial statements for the year ended December 31, 2000, the Company changed its accounting policy for share issue costs retroactively, resulting in a restatement of capital stock and the deficit.

### **Stock Exchange Listing**

Toronto Stock Exchange  
Trading Symbol: PLB

### **Transfer Agent**

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