

1ST QUARTER RESULTS 2002

RELENTLESS
EXECUTION OF
STRATEGY





Q1 2002 PRESIDENT'S MESSAGE

Dear Shareholders,

In the first quarter of 2002 Paladin continued its relentless execution of strategy as our enhanced portfolio of products drove revenues and net income higher. Paladin's business model of growth through selective acquisitions and strategic marketing continues unabated with our new products complementing our already strong portfolio. We are impressed by the results thus far in 2002 and confident that, with the added funds from both increased net income and our recently completed special warrant offering, positive momentum will continue to build.

First quarter 2002 revenues totalled \$6.0 million, a 73% increase over the first quarter of 2001. This growth was derived from sales of existing products and new revenue streams from strategic acquisitions made previously including Androderm[®], Dostinex[®], Estring[®], Dalacin[®] Vaginal Cream, Plan B[™], MUSE[®], and Propyl-Thyracil[®]. Gross profit as a percentage of revenues improved to 73% in the current quarter from 63% in the same period of last year. Net income for the quarter increased 172% to \$1.4 million, compared to \$0.5 million in the same period last year.

This quarter, Paladin strengthened its portfolio and position in the growing Canadian endocrinology market by entering into an agreement with Pharmacia Canada Inc. to be the exclusive Canadian distributor of a portfolio of endocrinology and women's health brands. The products include Dostinex[®], Estring[®], and Dalacin[®] Vaginal Cream. The other brands included in this agreement are formulations of the prostaglandin, dinoprostone, indicated for cervical ripening in pregnant women at or near term, and the induction of labour. All products are currently being sold in Canada, with combined sales of approximately \$5.0 million in 2001.

During the quarter, on behalf of Women's Capital Corporation, Paladin submitted an application to Health Canada to change Plan B[™], its emergency contraceptive pill, from prescription-only to non-prescription status. Plan B[™] is the first progestin-only pill indicated to prevent pregnancy after a contraceptive failure or unprotected sex. Plan B[™] is highly effective and produces significantly less nausea and vomiting than



other emergency contraceptive regimens. This submission could potentially improve access to Plan B™ by enabling Canadian women to obtain the product directly from their pharmacist, without a physician's prescription.

Paladin also announced that the Therapeutic Products Directorate of Health Canada has accepted United Therapeutics Corporation's New Drug Submission for Remodulin™ (treprostinil sodium) Injection and confirmed that it will receive Priority Review. Paladin acquired the exclusive Canadian distribution rights for Remodulin™ from United Therapeutics in February 1999. Formerly referred to as UNIPROST™, Remodulin™ is indicated for the treatment of pulmonary arterial hypertension. United Therapeutics recently announced that the U.S. Food and Drug Administration (FDA) issued an approvable letter for Remodulin™, usually the final step before FDA clearance for marketing in the United States.

Finally in the first quarter of fiscal 2002, Paladin improved its financial strength with the successful completion of a special warrant offering, raising \$21 million in gross proceeds at \$9.50 per share. This offering solidly positions us with resources to execute our strategy of acquiring additional innovative pharmaceuticals for the Canadian market and to continue to build our pipeline of promising therapeutics.

Our future has never been stronger, as funds from both increased revenues and our recently completed special warrant financing will continue to fuel growth and further reward those who share our vision.

On behalf of the Board of Directors, thank you for your continued support.

"Jonathan Ross Goodman"
(signed)

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



MANAGEMENT'S DISCUSSION AND ANALYSIS

(All numbers are in thousands of Canadian dollars)

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 interim and annual financial statements and the related notes to these financial statements.

Overview

Paladin is a specialty 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.

First quarter highlights:

- Revenues reached \$6,038, an increase of 73% over the same period last year.
- Net income reached \$1,401, an increase of 172% over the same period last year.
- Entered into an agreement with Pharmacia Canada Inc. for a portfolio of five endocrinology and women's health products.
- Therapeutic Products Directorate ("TPD") of Health Canada accepted the New Drug Submission for Remodulin™ (trerostinil sodium) Injection and confirmed that it will receive PRIORITY REVIEW.
- Submitted an application to Health Canada to change Plan B™, an emergency contraceptive pill, from prescription-only to non-prescription status.
- Closed a \$21 million special warrant private placement at a price of \$9.50 per share.

As is common in the specialty drug industry, Paladin's revenue and profitability growth may vary from one quarter to another. These fluctuations result from, among other things, the timing of TPD approvals, the timing of new product launches and the timing of the listing of the new drugs on Formularies.

Results of Operations

Three-month periods ended March 31, 2002 and 2001

Revenues: Revenues increased \$2,553 or 73% to \$6,038 for the three-month period ended March 31, 2002 from \$3,485 for the three-month period ended March 31, 2001. This increase was due primarily to new and recently launched products. The recently launched products include Androderm®, Plan B™, MUSE®, Tapazole®, and Propyl-Thyralil®. The newly launched products include Locacorten® – Vioform® line of products and Rogitine®, licensed from Novartis Pharmaceuticals Canada Inc. in the



fourth quarter of 2001 and the portfolio of products acquired from Pharmacia Canada Inc. in January 2002. The addition of these products strengthened the Company's product offering 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 effectively market and promote these products.

Gross Profit: Total gross profit increased \$318 or 25% to \$1,609 for the three-month period ended March 31, 2002 from \$1,291 for the three-month period ended March 31, 2001. Gross profit, as a percentage of revenues, improved to 73% for the three-month period ended March 31, 2002 from 63% for the three-month period ended March 31, 2001.

Selling and Administrative Expense: Selling and administrative expense increased \$465 or 29% to \$2,060 for the three-month period ended March 31, 2002 from \$1,595 for the three-month period ended March 31, 2001. This increase was primarily due 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 2001 and 2002. Selling and administrative expense, as a percentage of revenues, decreased to 34% for the three-month period ended March 31, 2002 from 46% for the three-month period ended March 31, 2001. 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 \$258 or 206% to \$383 for the three-month period ended March 31, 2002 from \$125 for the three-month period ended March 31, 2001. 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 \$273 or 177% to \$427 for the three-month period ended March 31, 2002 from \$154 for the three-month period ended March 31, 2001. This increase reflects the impact of amortization expense related to the Company's acquisition of licenses, rights and intellectual property during the year ended December 31, 2001, as well as the impact of amortization expense related to the Company's acquisitions of licenses, rights and intellectual property during the three-month period ended March 31, 2002.



Interest Income: Interest income decreased \$217 or 74% to \$77 for the three-month period ended March 31, 2002 from \$294 for the three-month period ended March 31, 2001, reflecting primarily the effect of lower interest rates.

Income Tax Expense: Income tax expense increased \$136 or 137% to \$235 for the three-month period ended March 31, 2002 from \$99 for the three-month period ended March 31, 2001. The effective tax rate was 14% for the three-month period ended March 31, 2002 compared to 16% for the three-month period ended March 31, 2001.

Net Income: As a result of the factors set forth above, net income increased \$886 or 172%, to \$1,401 for the three-month period ended March 31, 2002 from \$515 for the three-month period ended March 31, 2001.

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 operations, working capital needs and future product acquisitions. At present, the Company is actively pursuing product acquisitions that may require substantial capital resources. There are no present agreements or commitments with respect to any acquisitions.

Cash flows from operating activities were \$1,823 and \$778 for the three-month period ended March 31, 2002 and 2001, respectively. Cash flows from operating activities represent the cash flows from earnings, excluding revenues and expenses not affecting cash, principally amortization, future income taxes, and imputed interest. The Company believes these cash flows are sufficient to meet existing commitments.

The increase in cash flows from operating activities for the first quarter of 2002 was mainly the result of increase in net income, amortization and net change in non-cash balances relating to working capital offset by a decrease in future income taxes. For the three-month period ended March 31, 2001 the increase in cash flows from operating activities was mainly due to increase in net income, amortization and net change in non-cash balances relating to operations.

The Company's investing activities used cash of \$12,206 for the three-month period ended March 31, 2002. For the three-month period ended March 31, 2001 cash flows from investing activities were \$8,512. During the three-month period ended March 31, 2002, the Company invested \$2,089 in acquisitions of pharmaceutical product licenses and rights and intellectual property. This decrease was offset by \$1,179 in accounts payable related to the above-mentioned acquisitions. In addition, the Company had a \$11,285 reduction in temporary investments. For the three-month



period ended March 31, 2001, the Company invested \$2,569 in pharmaceutical products licenses and rights and intellectual property and had a \$11,088 increase in temporary investments.

Cash flows from financing activities were \$19,986 for the three-month period ended March 31, 2002. For the three-month period ended March 31, 2002, \$19,895 was provided from the issuance of special warrants less related issuance costs. In addition, \$91 was provided from common stock option exercises and the issuance of shares under the stock purchase plan.

On March 21, 2002, Paladin received the net proceeds of the sale of the special warrants, after payment of the Agents' fee of \$1,152 in the amount of \$19,800, of which \$10,476 is being held in escrow to be released upon obtaining final receipts for the Final Prospectus from the Securities Commissions in the Provinces of Quebec, Ontario and British Columbia. On May 3, 2002, Paladin filed a long form prospectus to qualify the common shares which will be issued in exchange for the special warrants and received final receipts from the Securities Commissions in the above-mentioned provinces.

Forward Looking Statements

This report includes "forward looking statements" that are subject to risks and uncertainties. For information identifying legislative or regulatory, economic, climatic, currency, technological, competitive and other important factors that could cause actual results to differ materially from those anticipated in the forward looking statements, see Paladin Labs Inc. Annual Report under the heading Risk Factors in the Management's Discussion and Analysis section.

BALANCE SHEET

[In thousands of Canadian dollars]

	March 31 2002 \$ (unaudited)	December 31 2001 \$
ASSETS		
Current		
Cash and cash equivalents <i>[notes 4 and 5]</i>	11,581	1,978
Temporary investments <i>[notes 4 and 5]</i>	31,755	20,470
Accounts receivable	2,209	2,067
Inventories	50	50
Income tax credits receivable	512	487
Future income tax assets	2,275	2,275
Total current assets	48,382	27,327
Capital assets	14,203	12,530
Investments, at cost	2,771	2,771
Future income tax credits receivable	347	347
Future income tax assets	2,221	2,216
	67,924	45,191
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	5,678	3,924
Income taxes payable	142	181
Deferred credit	1,638	1,638
Total current liabilities	7,458	5,743
Balance of sale payable	557	544
Deferred credit	553	935
Future income tax liability	133	133
	8,701	7,355
Shareholders' equity		
Capital stock <i>[note 4]</i>	37,245	37,154
Special warrants <i>[note 4]</i>	19,895	-
Contributed surplus	87	87
Other paid-in capital	23	23
Retained earnings	1,973	572
Total shareholders' equity	59,223	37,836
	67,924	45,191

See accompanying notes

STATEMENTS OF INCOME AND RETAINED EARNINGS

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

	Three month period ended March 31	
	2002	2001
	\$	\$
	(unaudited)	(unaudited)
Revenues	6,038	3,485
Cost of Sales	1,609	1,291
Gross profit	4,429	2,194
Selling and administrative	2,060	1,595
Research and development	383	125
Amortization	427	154
Interest income, net	(77)	(294)
Income before income taxes	1,636	614
Provision for income taxes		
Current	21	5
Future	214	94
	235	99
Net income	1,401	515
Retained earnings (deficit), beginning of period	572	(913)
Retained earnings (deficit), end of period	1,973	(398)
Earnings per share		
Basic	0.11	0.04
Diluted	0.11	0.04
Weighted average number of shares outstanding		
Basic	12,549,760	12,394,038
Diluted	12,833,496	12,459,373

See accompanying notes

STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]

	Three month period ended March 31	
	2002	2001
	\$	\$
	(unaudited)	(unaudited)
Operating activities		
Net income	1,401	515
Add items not affecting cash		
Amortization	427	154
Future income taxes	(387)	70
Imputed interest on balance of sale	13	12
	1,454	751
Net change in non-cash balances relating to operations	369	27
Cash flows from operating activities	1,823	778
Investing activities		
Additions to pharmaceutical product licenses and rights and intellectual property	(2,089)	(2,569)
Accounts payable related to the acquisition of intellectual property	1,179	-
Acquisition of capital assets	(11)	(7)
Net increase (decrease) in temporary investments	(11,285)	11,088
Cash flows from investing activities	(12,206)	8,512
Financing activities		
Issuance of common shares	91	-
Issuance of special warrants	20,952	-
Share issue costs	(1,057)	-
Cash flows from financing activities	19,986	-
Net change in cash and cash equivalents during period	9,603	9,290
Cash and cash equivalents, beginning of period	1,978	2,858
Cash and cash equivalents, end of period	11,581	12,148
Cash and cash equivalents	11,581	12,148
Temporary investments	31,755	10,394
	43,336	22,542

See accompanying notes



NOTES TO FINANCIAL STATEMENTS

Three month period ended March 31

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

1. BASIS OF PRESENTATION

Information with respect to the December 31, 2001 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, 2001 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, 2001, except, as outlined below, effective January 1, 2002 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants regarding intangible assets and stock – based compensation plans.

3. CHANGES IN ACCOUNTING POLICIES

i) Intangible Assets

Effective January 1, 2002, the Company prospectively adopted the new recommendation published by the Canadian Institute of Chartered Accountants relating to the method of valuation and the presentation and disclosure requirements for intangible assets. The new recommendations require recognized intangible assets to be amortized over their useful life to an enterprise, unless the life is determined to be indefinite. When an intangible asset is determined to have an indefinite useful life, it should not be amortized until its life is determined to be no longer indefinite. The amortization method and estimate of the useful life of an intangible asset should be reviewed annually. Intangible assets which are subject to amortization are tested for impairment by comparing the net carrying amount with the net recoverable amount whereas for intangible assets not subject to amortization, the net carrying amount is compared to the asset's fair value. The impact of the adoption of the new recommendations will not result in any change to the recognized intangible assets of the Company because its intangible assets are not considered to have an indefinite life. However, the Company will have additional disclosure requirements relating to its intangible assets.



ii) Stock-Based Compensation

Effective January 1, 2002, the Company prospectively adopted the new recommendation published by the Canadian Institute of Chartered Accountants relating to stock – based compensation and other stock – based payments. The Company has chosen to recognize no compensation when stock options are granted to employees and directors under stock option plan with no cash settlement features. However, direct awards of stock to employees and stock options awards granted to non-employees will continue to be accounted for in accordance with the fair value method of accounting for stock – based compensation.

4. CAPITAL STOCK

Authorized: 100,000,000 common shares without nominal or par value

Issued and outstanding:

	Number of shares	Amount
Balance at December 31, 2001	12,539,247	\$37,154
Issued on exercise of stock options	13,419	80
Issued under employee share purchase plan	1,133	11
Employee share purchase loan repayment	–	20
Balance at March 31, 2002	12,553,799	\$37,245

Special warrants:

	Number of shares	Stated capital
Issued for cash	2,205,500	\$20,952
Issuance costs	–	(1,057)
	2,205,500	\$19,895

On March 20, 2002, the Company signed an agency agreement to issue 2,205,500 special warrants for a cash consideration of \$20,952 less issue costs of \$1,057. Each warrant will be exercisable, without additional consideration, into one common share after the necessary regulatory approval.



Pursuant to the terms of the Special Warrant Indenture, 50% of the gross proceeds of the offering less the agency fee of \$1,152 shall be held in escrow pending the earlier of (i) the clearance of the final prospectus; or (ii) the election to repurchase or not to repurchase the Special Warrants by holding thereof in the event clearance of the final prospectus does not occur prior to July 21, 2002. In the event that the final prospectus is not cleared on or prior to June 19, 2002, each holder of Special Warrant will be entitled to receive 1.1 common shares of the corporation.

On May 3, 2002 the Company filed a long form prospectus to qualify the common shares which will be issued in exchange for the special warrants.

Stock option plan

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

	2002		2001	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance, beginning of period	694,833	5.71	484,344	4.90
Granted	68,258	9.86	130,867	5.23
Exercised	(13,419)	6.00	—	—
Expired or forfeited	(5,000)	6.35	(300)	5.00
Balance, end of period	744,672	6.08	614,911	4.97
Options exercisable at end of period	274,244	5.53	289,352	4.22

5. CASH AND TEMPORARY INVESTMENTS

Cash and temporary investments increased by \$20,888 during the three-month period ended March 31, 2002.



6. 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 \$4,860 [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 \$2,179 [US\$1,368] and \$100.

Purchase and service based commitments

The Company is committed to making minimum spending relating to inventory purchases, regulatory, sales and marketing expenditures in the amount of \$17,025 in order to retain exclusive distribution agreements for certain products. These commitments end in 2011 and annual amounts are as follows:

	\$
April 1, 2002 to December 31, 2002	2,740
2003	3,485
2004	3,295
2005	1,786
2006	1,792
2007	851
2008-2011	3,076

Stock Exchange Listing

Toronto Stock Exchange

Trading Symbol: PLB

Transfer Agent

Computershare Trust Company of Canada

1500 University St.

Suite 700

Montreal, Quebec

H3A 3S8

Investor Relations

Samira Sakhia

Chief Financial Officer

Tel.: (514) 340-5067

Fax: (514) 344-4675

E-mail: info@paladin-labs.com

Joanna Longo

Investor Relations

Tel.: (416) 815-0700

Fax: (416) 815-0080

E-mail: jlongo@equicomgroup.com



Paladin Labs Inc., 6111 Royalmount Suite 102, Montreal, QC, Canada H4P 2T4
www.paladinlabs.com