



QUARTERLY REPORT

FORM 61

INSTRUCTIONS

This report is to be filed by Exchange Issuers within 60 days of the end of their first, second and third fiscal quarters and within 140 days of the end of their fourth fiscal quarter. Three schedules (typed) are to be attached to this report as follows:

SCHEDULE A: FINANCIAL INFORMATION

Financial information prepared in accordance with generally accepted accounting principles for the fiscal year-to-date, with comparative information for the corresponding period of the preceding fiscal year. This financial information should consist of the following:

For the first, second and third fiscal quarters:

An interim financial report presented in accordance with Section 1750 of the C.I.C.A. Handbook. This should include a summary income statement (or a statement of deferred costs) and a statement of changes in financial position. A summary balance sheet is also to be provided.

For the fourth fiscal quarter (year end):

Annual audited financial statements.

SCHEDULE B: SUPPLEMENTARY INFORMATION

The supplementary information set out below is to be provided when not included in Schedule A.

1. *For the current fiscal year-to-date:*

Breakdown, by major category, of those expenditures and costs which are included in the deferred costs, exploration and development expenses, cost of sales or general and administrative expenses set out in Schedule A. State the aggregate amount of expenditures made to parties not at arm's length from the issuer.

2. *For the quarter under review:*

(a) Summary of securities issued during the period, including date of issue, type of security (common shares, convertible debentures, etc.), type of issue (private placement, public offering, exercise of warrants, etc.) number, price, total proceeds, type of consideration (cash, property, etc.) and commission paid.

(b) Summary of options granted, including date, number, name of optionee, exercise price and expiry date.

3. *As at the end of the quarter:*

- (a) Particulars of authorized capital and summary of shares issued and outstanding.
- (b) Summary of options, warrants and convertible securities outstanding, including number or amount, exercise or conversion price and expiry date.
- (c) Total number of shares in escrow or subject to a pooling agreement.
- (d) List of directors.

SCHEDULE C: MANAGEMENT DISCUSSION

Review of operations in the quarter under review and up to the date of this report, including brief details of any significant event or transaction which occurred during the period. The following list can be used as a guide but is not exhaustive:

Acquisition or abandonment of resource properties, acquisition of fixed assets, financings and use of proceeds, management changes, material contracts, material expenditures, transactions with related parties, legal proceedings, contingent liabilities, default under debt or other contractual obligations, special resolutions passed by shareholders.

Specifically, the management discussion must include:

- (a) disclosure of and reasons for any material differences in the actual use of proceeds from the previous disclosure by the issuer regarding its intended use of proceeds; and
- (b) a brief summary of the investor relations activities undertaken by or on behalf of the issuer during the quarter and disclosure of the material terms of any investor relation arrangements or contracts entered into by the issuer during the quarter.

Freedom of Information and Protection of Privacy Act

The personal information requested on this form is collected under the authority of and used for the purpose of administering the Securities Act. Questions about the collection or use of this information can be directed to the Supervisor, Statutory Filings (604-660-4890), 1100 - 855 Hornby Street, Vancouver, British Columbia V6Z 2H4.

ISSUER DETAILS

NAME OF ISSUER

PALADIN LABS INC.

FOR QUARTER ENDED

Dec 31/97

DATE OF REPORT

98 05 14

ISSUER'S ADDRESS

8400 DARNLEY ROAD

CITY

MONTRÉAL

PROVINCE

QUÉBEC

POSTAL CODE

H4T 1M4

ISSUER FAX NO.

(514) 342-7764

ISSUER TELEPHONE NO.

(514) 340-1114

CONTACT PERSON

JONATHAN GOODMAN

CONTACT'S POSITION

PRESIDENT

CONTACT TELEPHONE NO.

(514) 340-5032

CERTIFICATE

The three schedules required to complete this Quarterly Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Quarterly Report will be provided to any shareholder who requests it.

DIRECTOR'S SIGNATURE

Jonathan Goodman

PRINT FULL NAME

Jonathan Goodman

DATE SIGNED

98 05 19

DIRECTOR'S SIGNATURE

Marc Beaudet

PRINT FULL NAME

MARC BEAUDET

DATE SIGNED

98 05 19

PALADIN LABS INC.
FINANCIAL STATEMENTS
DECEMBER 31, 1997

PALADIN LABS INC.
FINANCIAL STATEMENTS
DECEMBER 31, 1997

AUDITOR'S REPORT

To the Shareholders of
Paladin Labs Inc.

We have audited the balance sheet of Paladin Labs Inc. as at December 31, 1997 and December 31, 1996 and the statements of operations, deficit and changes in financial position 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 upon our audit.

We have conducted our audit in accordance with 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 misstatement. An audit includes examination, on a test basis, of 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, 1997 and December 31, 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

BESSNER GALLAY SCHAPIRA KREISMAN /s/

Bessner Gallay Schapira Kreisman
CHARTERED ACCOUNTANTS

Montreal, Quebec
February 5, 1998

**PALADIN LABS INC.
BALANCE SHEET
AS AT DECEMBER 31, 1997**

	1997 \$	1996 \$
ASSETS		
CURRENT		
Cash	8,985	9,255
Marketable securities - at cost which approximates market value	553,696	749,430
Accounts receivable - Parent company	178,677	-
- Other	52,938	39,949
Income taxes recoverable	95,662	30,859
	<u>889,958</u>	<u>829,493</u>
OTHER ASSETS (Note 2)	<u>1,535,053</u>	<u>2,651,008</u>
	<u><u>2,425,011</u></u>	<u><u>3,480,501</u></u>
LIABILITIES		
CURRENT		
Accounts payable - Parent company	-	321,769
- Other	35,021	12,729
	<u>35,021</u>	<u>334,498</u>
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 3)	8,866,390	8,616,390
CONTRIBUTED SURPLUS	86,513	86,513
DEFICIT	<u>(6,562,913)</u>	<u>(5,556,900)</u>
	<u>2,389,990</u>	<u>3,146,003</u>
	<u><u>2,425,011</u></u>	<u><u>3,480,501</u></u>

COMMITMENTS (Note 8)

CONTINGENT LIABILITY (Note 9)

APPROVED ON BEHALF OF THE BOARD:

Jonathan Goodman (signed) Director

Mark Beudet (signed) Director

**PALADIN LABS INC.
STATEMENT OF DEFICIT
FOR THE YEAR ENDED DECEMBER 31, 1997**

	1997	1996
	\$	\$
Balance, beginning of year	(5,556,900)	(3,688,945)
Net loss	<u>(1,006,013)</u>	<u>(1,867,955)</u>
BALANCE, END OF YEAR	<u>(6,562,913)</u>	<u>(5,556,900)</u>

PALADIN LABS INC.
STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 1997

	1997 \$	1996 \$
REVENUES		
Income from distribution of pharmaceutical products	830,166	40,703
Interest earned	19,035	37,586
	<u>849,201</u>	<u>78,289</u>
EXPENSES		
Amortization	118,027	283,162
Interest and bank charges	2,399	2,516
Investor relations	6,726	10,109
Office expenses	2,638	554
Professional and consulting fees	61,230	26,295
Regulatory fees	3,543	2,795
Salaries and wage levies	232,599	57,327
Taxes and licences	1,176	28,795
Travel and promotion	-	1,620
	<u>428,338</u>	<u>413,173</u>
Expenses recovered	111,913	-
	<u>316,425</u>	<u>413,173</u>
Research and development expense (Note 4)	536,860	258,877
	<u>853,285</u>	<u>672,050</u>
LOSS BEFORE UNDERNOTED ITEMS	(4,084)	(593,761)
Write-down of pharmaceutical product rights and license (Note 5)	997,929	1,257,340
LOSS BEFORE INCOME TAXES	(1,002,013)	(1,851,101)
Provision for large corporation tax	4,000	16,854
NET LOSS	<u>(1,006,013)</u>	<u>(1,867,955)</u>
LOSS PER SHARE	(0.25)	(0.50)

**PALADIN LABS INC.
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE YEAR ENDED DECEMBER 31, 1997**

	1997 \$	1996 \$
OPERATING ACTIVITIES		
Net loss for the year	(1,006,013)	(1,867,955)
Add items not affecting cash:		
Amortization	118,027	283,162
Write-down of pharmaceutical product rights and license	<u>997,929</u>	<u>1,257,340</u>
	109,943	(327,453)
Changes in working capital non-cash items relating to operations	<u>(555,947)</u>	<u>50,195</u>
	<u>(446,004)</u>	<u>(277,258)</u>
INVESTING ACTIVITIES		
Additions to other assets	-	(1)
Acquired through issuance of common shares	-	1
Common shares issued for cash	<u>250,000</u>	<u>-</u>
	<u>250,000</u>	<u>-</u>
DECREASE IN CASH	(196,004)	(277,258)
Cash, beginning of year	<u>758,685</u>	<u>1,035,943</u>
CASH, END OF YEAR	<u><u>562,681</u></u>	<u><u>758,685</u></u>
CASH COMPRISES THE FOLLOWING:		
Cash	8,985	9,255
Marketable securities	<u>553,696</u>	<u>749,430</u>
	<u><u>562,681</u></u>	<u><u>758,685</u></u>

1. Accounting Policies

The company is incorporated under the B.C. Companies Act and is in the business of developing, producing and marketing pharmaceuticals on a worldwide basis. The financial statements are prepared on the basis of generally accepted accounting principles and the most significant accounting policies followed by the company are described below:

Use of Estimates

The presentation of financial statements, in accordance with generally accepted accounting principles, requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the period reported. Actual results could differ from these estimates.

Pharmaceutical Product Rights and Licences

Rights and licences, pertaining to pharmaceutical products, which were purchased by the company, are valued at cost except for the acquisition during the prior year from the company's parent which is recorded at a value of \$1, the parent company's carrying amount, pursuant to generally accepted accounting principles for related party transactions applicable to fiscal periods commencing after October 1, 1995. The amortization expense and the related accumulated amortization is computed by the straight-line method for reporting purposes based upon their useful lives of thirteen to fifteen years.

Research and Development Expense

Research and development costs are expensed in the year incurred.

Loss Per Share

Net loss per common share has been computed by dividing the loss applicable to common shareholders by the weighted average number of shares of common stock outstanding during the respective years. The result for the year ended December 31, 1996 has been adjusted to reflect the 1 for 10 share consolidation during that year. Fully diluted loss per share is not presented as this calculation has an anti-dilutive effect on the loss per share.

PALADIN LABS INC.
NOTES TO THE FINANCIAL STATEMENTS
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2. Other Assets

Other assets consist of the following:

	Cost \$	Accumulated Amortization \$	1997 Net \$	1996 Net \$
Pharmaceutical product rights	1,770,401	235,348	1,535,053	2,517,902
Licence	-	-	-	133,106
	<u>1,770,401</u>	<u>235,348</u>	<u>1,535,053</u>	<u>2,651,008</u>

During the prior year, the company acquired from its parent, the exclusive rights to develop and further commercialize certain pharmaceutical products, in exchange for newly issued common shares of the company as described in Note 3d. The non-monetary exchange value of \$386,879 attributed to the transaction was arrived at based upon the fair market value as determined by management, which consisted of the parent company's original development costs.

3. Capital Stock

a) The capital stock consists of the following:

Authorized:

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

Issued and fully paid:

	1997		1996	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Balance, beginning of year	3,823,991	8,616,390	36,692,390	8,616,389
Consolidation of shares, 1 for 10	-	-	(33,023,151)	-
	3,823,991	8,616,390	3,669,239	8,616,389
Issued during the year				
Exercise of warrants (c)	166,667	250,000	-	-
For product rights (d)	-	-	154,752	1
BALANCE, END OF YEAR	<u>3,990,658</u>	<u>8,866,390</u>	<u>3,823,991</u>	<u>8,616,390</u>

PALADIN LABS INC.
NOTES TO THE FINANCIAL STATEMENTS
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3. **Capital Stock** - cont'd.

- b) Of the issued and outstanding shares, 7,500 are held in escrow.
- c) The 666,667 common shares issued by way of private placement in a prior year had attached to each share a purchase warrant entitling the holder to purchase one additional share at \$1.50 until January 4, 1997 and at \$1.80 thereafter until January 5, 1998.

During the year, a shareholder exercised 166,667 of these warrants, resulting in the issue of 166,667 common shares for a total consideration of \$250,000.

These shares were subject to a holding period of one year throughout which they could not be traded, of which the restriction expired on January 3, 1998.

- d) The 154,752 common shares issued in the prior year for pharmaceutical product rights were subject to a holding period of one year throughout which they could not be traded, of which the restriction expired during 1997.
- e) The company has outstanding stock options entitling directors and an employee to purchase up to 83,058 common shares at a price of \$1.21 for a period ending December 10, 2001 and 10,000 common shares at a price of \$2.43 for a period ending January 31, 2002.

4. **Research and Development**

The research and development expense consists of the following:

	1997	1996
	\$	\$
Research and development costs	593,382	281,086
Less: investment tax credits claimed	56,522	22,209
	<u>536,860</u>	<u>258,877</u>

5. **Write-Down of Pharmaceutical Product Rights and License**

The Directors of the company have ascertained that the values of certain pharmaceutical product rights and license, acquired in prior years, have been significantly reduced due to market changes and regulatory issues. As a result, these rights, having an original cost of \$1,116,700 and an unamortized value of \$997,929 have been written off in the current fiscal period.

PALADIN LABS INC.
NOTES TO THE FINANCIAL STATEMENTS
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6. Related Party Transactions

The company entered into transactions with its parent which resulted in the following:

	1997	1996
	\$	\$
Purchase of pharmaceutical product rights (notes 1, 2, 3)	-	1
Research and development expenses	593,382	281,086
Income from distribution of pharmaceutical products	830,165	40,703
Expenses recovered	111,913	-

7. Income Taxes

- a) As at December 31, 1997 the company had available income tax losses of approximately \$1.9 million which may be applied against the taxable income of future years. These losses expire between 1998 and 2003.
- b) As at December 31, 1997, the company had available for Federal income tax purposes, investment tax credits, related to Scientific Research and Experimental Development expenditures amounting to approximately \$1.2 million of which the potential income tax benefit applicable thereto may be applied against income taxes payable in future years.

8. Commitments

During prior periods, the company entered into agreements with its parent, granting the parent the exclusive right to manufacture and distribute certain pharmaceutical products in Canada for a period of five years, commencing from the date of first commercial sale. Under the terms of these agreements, the company is entitled to receive the net profits from the sale of the products after deduction of all costs inclusive of a manufacturing and distribution fee.

9. Contingent Liability

The company is the defendant in a lawsuit alleging infringement of the Plaintiff's process patent. It is the opinion of management that this claim is unfounded as the Company's supplier is not using a process protected by patent. The plaintiff has frustrated the company's attempts to have the claim struck by repeatedly adjourning the matter. Consequently, no provision has been made for any ultimate loss which may be realized by the company as a result of this litigation. Such a loss, if any, will be reflected in the period in which it occurs.

10. Subsequent Event

On January 5, 1998 a shareholder exercised 416,666 warrants, resulting in the issue of 416,666 common shares for a total consideration of \$750,000 cash. These shares are subject to a holding period of one year during which they may not be traded.