

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

**June 30, 2011**



## **MANAGEMENT DISCUSSION AND ANALYSIS:**

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

This management's discussion and analysis provides our overview of the Company's operations, performance and financial condition for the quarter and six months ended June 30, 2011 and compares these unaudited quarterly results to those of the quarter and six months ended June 30, 2010. It is intended to complement and supplement financial information included in the interim and annual consolidated financial statements, related notes, other financial information found elsewhere in our annual report and in our annual information form or other documents filed on SEDAR at [www.sedar.com](http://www.sedar.com). As a result, it should be read in conjunction with such financial information. This management's discussion and analysis is current as at August 5, 2011 and as at this date 20,203,195 shares and 1,265,014 options were issued and outstanding. Reference to "Paladin" or the "Company" includes Paladin Labs Inc. and all its subsidiaries.

### **FORWARD-LOOKING STATEMENTS**

This document contains forward-looking statements for the Company and its subsidiaries. These forward looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. The Company considers the assumptions on which these forward-looking statements are based to be reasonable at the time they were prepared, but cautions the reader that these assumptions regarding future events, many of which are beyond the control of the Company and its subsidiaries, may ultimately prove to be incorrect. Factors and risks, which could cause actual results to differ materially from current expectations, are discussed in the Company's Annual Report as well as in the Company's Annual Information Form for the year ended December 31, 2010. The Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events, except as required by law. For additional information on risks and uncertainties relating to these forward-looking statements, investors should consult the Company's ongoing quarterly filings, Annual Report and Annual Information Form and other filings found on SEDAR at [www.sedar.com](http://www.sedar.com).

### **OVERVIEW & CORPORATE HIGHLIGHTS**

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

#### **Second quarter highlights:**

- Revenues reached \$35,971, an increase of 9% over the same period last year
- Net income was \$16,783, an increase of 245% over the same period last year
- Cash flows from operations reached \$17,320, a 15% increase over the same period last year
- EBITDA<sup>1</sup> was \$18,273, an increase of 34% over the same period last year
- Launched Seasonique<sup>®</sup>, a next generation extended-cycle oral contraceptive for the prevention of pregnancy
- Out-licensed the exclusive right to develop and commercialize fomepizole to Takeda Pharmaceutical Company Limited (TSE: 4502)("Takeda") for the treatment of ethylene glycol and methanol poisonings in Japan (marketed and distributed by Paladin under the trademark Antizol<sup>®</sup> in Canada and the United States)
- Acquired the exclusive Canadian rights to market and sell a controlled release hydrocodone product for the treatment of moderate to severe pain from an affiliate of Elan Corporation, plc
- Received repayment of its secured debt facility from Prostrakan Group plc ("ProStrakan") of \$86,432 (including principal, interest and break fee) for a net gain of \$8,422 in connection with the acquisition of ProStrakan by Kyowa Hakko Kirin Co., Ltd. ("KHK")
- Filed a new drug submission for Oralair<sup>™</sup> with Health Canada. Oralair<sup>™</sup> is a sublingual grass pollen immunotherapy tablet for the treatment of grass pollen rhinitis with or without conjunctivitis for patients uncontrolled with current symptomatic medications
- Received approval from the Toronto Stock Exchange on May 26, 2011 to carry out a normal course issuer bid to purchase up to 935,367 of its common shares
- Entered into an exclusive collaboration with Somaxon Pharmaceuticals, Inc. (NASDAQ:SOMX) under which Paladin will commercialize Silenor<sup>®</sup> (doxepin) for the treatment of insomnia characterized by difficulty with sleep maintenance in Canada, South America and Africa
- Launched Abstral<sup>®</sup>, a novel, rapidly-disintegrating, sublingual (under the tongue) formulation of fentanyl, a well-established opioid used for the management of breakthrough pain for cancer patients already receiving, and tolerant to opioid analgesics

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

- Acquired an additional 5,374,500 common shares of Afexa Life Sciences Inc. (TSX:FXA) ("Afexa") through market purchases on the Toronto Stock Exchange giving Paladin beneficial ownership of a total of 15,421,300 common shares of Afexa or approximately 14.95% of Afexa's total issued and outstanding common shares.
- Announced a take-over bid for any and all outstanding shares of Afexa

Paladin's revenues are principally derived from sales of pharmaceutical products to large pharmaceutical wholesalers and large chain pharmacies. The Company's expenses have been comprised primarily of cost of goods sold (including royalty payments to those companies from whom Paladin licenses its products), selling, general and administrative and research and development expenses. In addition, a substantial portion of the Company's expenses are related to the amortization of the pharmaceutical product licenses and rights the Company acquires.

Paladin's annual and quarterly operating results are primarily affected by the level of acceptance of Paladin's products by physicians and their patients, and the timing and number of product launches. The level of patient and physician acceptance of Paladin's products, the acceptance of provincial government reimbursement on such products, market access, as well as the availability of similar therapies, impact Paladin's revenues by driving the level and timing of prescriptions for its products. Each new product launch requires significant promotional investment during the first three to five years from launch.

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

The term EBITDA (earnings before interest, taxes, depreciation and amortization) does not have any standardized meaning under International Financial Reporting Standards ("IFRS") and therefore may not be comparable to similar measures presented by other companies. The Company defines EBITDA as earnings before interest expense, other finance expense (income), taxes, amortization, foreign exchange gains (losses), share of net income in associate and unusual items; such as write-downs and gains (losses) on intellectual property and investments. EBITDA is calculated and presented consistently from period to period and agrees, on a consolidated basis, with the amount disclosed as "*Earnings before under-noted items*" on the consolidated statements of income. The Company believes EBITDA to be an important measurement that allows it to assess the operating performance of its ongoing business on a consistent basis without the impact of amortization expenses. The Company excludes amortization expenses because their level depends substantially on non-operating factors such as the historical cost of intangible assets. The Company's method for calculating EBITDA may differ from that used by other issuers and, accordingly, this measure may not be comparable to EBITDA used by other issuers.

### **CRITICAL ACCOUNTING ESTIMATES**

Paladin's consolidated financial statements are prepared in accordance with IFRS, applied on a consistent basis. Paladin's significant accounting estimates and judgments include revenue recognition, inventory valuation, the useful lives and fair value of pharmaceutical product licenses and rights, income taxes and share-based compensation expense. For a more detailed discussion of the Company's critical accounting estimates, please refer to the management discussion & analysis included in the Company's 2010 Annual Report. There have been no material changes to accounting estimates since March 31, 2011.

### **ADOPTION OF IFRS**

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

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

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

#### RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

#### RESULTS OF OPERATIONS

Three months ended June 30, 2011 compared to three months ended June 30, 2010, and six months ended June 30, 2011 compared to six months ended June 30, 2010.

#### Revenues

Revenues increased \$3,035 or 9% to \$35,971 for the three months ended June 30, 2011 from \$32,936 for the three months ended June 30, 2010. For the six months ended June 30, 2011, revenues increased \$3,950 or 6% to \$67,723 from \$63,773 for the same six-month period last year.

The increase in revenues for the second quarter of 2011 is attributable to the sales growth of certain significant promoted products, including Tridural<sup>®</sup>, Trelstar<sup>®</sup>, Testim<sup>®</sup>, Metadol<sup>®</sup>, Plan B<sup>®</sup> and Abstral<sup>®</sup> which combined increased by 16% for the quarter and 17% for the six months ended June 30, 2011 compared to the same periods in 2010. Furthermore, the increase for the same quarter of 2011 is attributable to amounts previously recorded in deferred revenue and recognized into revenue in accordance with the Company's revenue recognition policy relating to an international tender contributing \$1,727 for the quarter and six months ended June 30, 2011 compared to \$nil and \$1,668 respectively in the same comparative periods last year. In addition, incremental revenues from products acquired after the comparative quarter and six months ended June 30, 2010, contributed \$951 to the quarter and \$1,615 for the six months ended June 30, 2011.

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

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

Promoted Products	Three months ended June 30, 2011		Six months ended June 30, 2011	
	Sales data per IMS Canada	% change vs. 2010	Sales data per IMS Canada	% change vs. 2010
	\$			
Tridural <sup>®</sup>	2,901	9%	5,715	13%
Metadol <sup>®</sup>	2,602	17%	5,069	14%
Plan B <sup>®</sup>	2,633	9%	5,085	9%
Trelstar <sup>®</sup>	1,839	40%	3,335	41%
Testim <sup>®</sup>	981	23%	1,957	30%
Abstral <sup>®</sup> (i)	2	n/a	2	n/a
<b>Total</b>	<b>10,958</b>	<b>16%</b>	<b>21,163</b>	<b>17%</b>

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

<sup>2</sup> The Company has chosen not to disclose detailed product by product revenues information for competitive reasons, however, does include detailed IMS Canada sales data, essentially end-user pharmacy purchase volume data, to allow the reader to better understand revenues changes from period to period on certain significant products. It is important that readers of this sales data note that IMS Canada sales data may not necessarily correspond to the Company's recording of revenue in accordance with IFRS.

### **Gross Profit**

Total gross profit increased \$2,818 or 12% to \$26,509 for the quarter ended June 30, 2011 from \$23,691 for the same comparative quarter last year. For the six months ended June 30, 2011, gross profit increased \$4,473 or 10% to \$50,221 from \$45,748 for the same period last year. Gross profit, as a percentage of revenues, increased 2% to 74% for the three and six month periods ended June 30, 2011 from 72% from the same comparative periods last year. The increase in gross profit as a percentage of revenues for the quarter and six months ended June 30, 2011 relative to the comparative periods last year is mainly the result of a favourable product mix, the divestiture of the BioEnvelop operating activities and the strengthening of the Canadian dollar relative to the US dollar.

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

Selling, general and administrative expense increased \$349 or 4% to \$8,188 for the quarter ended June 30, 2011 from \$7,839 for the same comparative period last year. For the six months ended June 30, 2011, selling, general and administrative expense decreased \$688 or 4% to \$15,228 from \$15,916. Selling, general and administrative expense, as percentage of revenues, decreased to 23% for the quarter ended June 30, 2011 compared to 24% for the same quarter last year. For the six months ended June 30, 2010, selling, general and administrative expense, as a percentage of revenues decreased to 22% from 25% for the same period last year. The slight increase in selling, general and administrative expense for the quarter ended June 30, 2011 is mainly the result of incremental promotional spend for products launched after the comparative quarter last year. The decrease in selling, general and administrative expense for the six months ended June 30, 2011 is mainly the result of certain sales and marketing streamlining efforts including the reduction of promotional spend for certain products and the Company's growth in non-promoted product revenues during the quarter and six months ended June 30, 2011, partially offset by incremental promotional spend for products launched after the comparative periods last year. The promotional activities driving selling and marketing costs primarily relate to Paladin's continued promotional activities for Tridural<sup>®</sup>, Plan B<sup>®</sup>, Trelstar<sup>®</sup> and the launch costs related to Abstral<sup>®</sup>.

### **Research and Development Expense**

Research and development expense decreased \$449 or 17% to \$2,225 for the quarter ended June 30, 2011 from \$2,674 for the same comparative quarter last year. For the six months ended June 30, 2011, research and development expense decreased \$1,121 or 21% to \$4,296 from \$5,417 for the six months ended June 30, 2010. Research and development expense, as percentage of revenues, decreased to 6% for the three and six month periods ended June 30, 2011 compared to 8% for the same periods last year. The decrease in the research and development expenses during the quarter and six months ended June 30, 2011 primarily relates to certain payments made with regard to the committed research and development efforts with respect to Isotechnika Pharma Inc. ("IsoPharma") advancements which ended during the same comparative periods last year, partially offset by incremental research and development expenses in 2011 related to certain development projects with licensors and license payments related to products not yet approved.

### **Interest Income**

Interest income increased \$1,734 or 391% to \$2,177 for the three months ended June 30, 2011 from \$443 for the three months ended June 30, 2010. For the six months ended June 30, 2011, interest income increased \$4,120 or 567% to \$4,846 from \$726 for the six months ended June 30, 2010. This increase is primarily the result of the incremental interest earned on the Company's strategic investments in partner companies, primarily ProStrakan, in the form of convertible debentures and loans acquired during and subsequent to the quarter ended March 31, 2010. Furthermore, the Company held higher average daily cash and marketable securities balances and earned a higher effective rate of return over the three and six-month periods ended June 30, 2011 compared to the same comparative periods last year.

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

Amortization expense decreased \$500 or 8% to \$5,571 for the three months ended June 30, 2011 from \$6,071 for the same period last year. For the six months ended June 30, 2011, amortization expense decreased \$1,440 or 12% to \$10,901 from \$12,341 for the same period last year. The decrease in the amortization expense is the result of certain pharmaceutical product licenses and rights having reached full amortization during and after the three and six months periods ended June 30, 2010, partially offset by incremental amortization related to the Company's recently acquired pharmaceutical product licenses and rights.

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

During the quarter ended June 30, 2011, the Company recorded a foreign exchange gain of \$75 compared to a foreign exchange gain of \$87 for the quarter ended June 30 2010, mainly as a result of the continued strengthening of the Canadian dollar relative to the US dollar and as a result of the weakening of the

Canadian dollar relative to the EURO and its impact on Company's net monetary position in these currencies during the quarters ended June 30, 2011 and June 30, 2010.

During the six months ended June 30, 2011, the Company recorded a foreign exchange gain of \$456, mainly as a result of the strengthening of the Canadian dollar relative to the US dollar and as a result of the weakening of the Canadian dollar relative to the EURO and its impact on Company's net monetary position in these currencies during the six months ended June 30, 2011.

During the six months ended June 30, 2010, the Company recorded a foreign exchange loss of \$207 on the Company's foreign operating results, mainly as a result of the weakening of the Canadian dollar relative to the US dollar and EURO and its impact on a EURO denominated investment as well as on the Company's net monetary position in these currencies for the six months ended June 30, 2010.

#### **Other Finance Income**

During the quarter ended June 30, 2011, the Prostrakan secured convertible debt facility ("Facility") was redeemed for proceeds of \$86,432, representing the aggregate of: the principal of the ProStrakan Facility of \$77,232, the interest accrued at May 17, 2011 of \$778, a break free of \$3,089, and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. In connection with the same Facility, the Company recorded a gain of \$213 on the remeasurement of the early redemption option. Furthermore, the Company recorded \$417 in interest accretion on the Company's convertible debentures, principally the Prostrakan Facility.

In addition, during the six months ended June 30, 2011 the Company disposed of certain shares held in portfolio companies for proceeds of \$3,344, representing a net gain of \$24. Furthermore, the Company recorded \$699 in interest accretion on the Company's convertible debentures, principally the Prostrakan Facility. Moreover, in accordance to applicable accounting standards, the Company re-measured the fair value of a conversion option on the Prostrakan Facility, deemed to be \$nil as at March 31, 2011, and recorded an unrealized loss of \$4,572, partially offset by the remeasurement of the early redemption option on the same Facility, deemed to be virtually certain as at March 31, 2011, and recorded an unrealized gain of \$3,354. Please refer to Significant Transaction section below for additional details on the ProStrakan Facility.

During the quarter ended June 30, 2010, the Company recorded \$50 in interest accretion on Company's loans. In addition, during the six months ended June 30, 2010, the Company disposed of certain shares held in a portfolio company for proceeds of \$27, representing a gain of \$7 and recorded \$18 in interest accretion on Company's loans.

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

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan (Pty) Ltd ("Pharmaplan"), a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. On March 1, 2011, the Company acquired an additional 10% ownership interest in Pharmaplan, increasing Paladin's ownership from 34.99% to 44.99%. The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the transaction, March 16, 2010. The investment was initially recorded at cost and adjustments are made to include the Company's share of Pharmaplan's net income. The Company's share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company's share of Pharmaplan's net identifiable assets acquired and the tax impact on the distributable earnings. The Company's share of Pharmaplan's net income for the three months ended June 30, 2011 increased \$229 or 68% to \$564 compared to \$335 for the same period last year. The Company's share of Pharmaplan's net income for the six months ended June 30, 2011 increased \$299 or 64% to \$765 compared to \$466 for the 106 day period from the acquisition date, March 16, 2010 to June 30, 2010.

#### **Provision for Income Taxes**

The provision for income taxes increased \$2,492 or 78% to \$5,692 for the quarter ended June 30, 2011 from \$3,200 for the quarter ended June 30, 2010. For the six months ended June 30, 2011, income tax expense increased \$4,371 or 85% to \$9,541 from \$5,170 for the six months ended June 30, 2010. For the three and six-month periods ended June 30, 2011, the effective tax rate was 25% and 28%, respectively, compared to 40% and 39% for the three and six months ended June 30, 2010. The decrease in effective rates in the current year is principally due to a net decrease in permanent differences as a pro-portion of net income before taxes in comparison to the previous period related to certain income amounts treated as capital for tax purposes. The Company has the following tax pools detailed below which may be applied against taxable income:

	Available \$	Recognized \$	Expires in
Non-capital tax losses			
Federal	37,382	3,659	2025-2028
Provincial	13,171	539	2025-2028
Scientific Research and Experimental Development expenditures			
Federal	74,898	62,971	N/A
Provincial	75,292	63,410	N/A
Investment tax credits			
Federal	20,177	14,874	2016-2030

The amount of the tax benefit claimed in the current and prior years is subject to audit by the taxation authorities and could be reduced by a material amount in the future.

### Net Income

Due to the factors set forth above, net income increased by \$11,920 or 245% to \$16,783 for the quarter ended June 30, 2011 compared to net income of \$4,863 for the same comparative quarter last year. For the six months ended June 30, 2011, net income increased \$16,878 or 211% to \$24,883 from \$8,005 for the six months ended June 30, 2010.

### Liquidity and Capital Resources

The Company's Investment Policy regulates the investment activities relating to cash resources. An Investment Committee composed of representatives from management and the Board of Directors monitors compliance with said policy. The Company invests in strategic investments in the form of equity or strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates.

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

Effective August 10, 2009, the Company entered into a one-year \$2,000 revolving unsecured credit facility with one of the Company's bankers. On July 29, 2010, the credit facility was renewed for an additional year and the revolving credit limit increased to \$5,000 of which, as at June 30, 2011, approximately \$1,300 is being utilized for the Company's use of forward contracts to manage certain foreign exchange exposure. The credit facility may also be used for general corporate purposes.

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

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Cash inflow from operating activities	17,320	15,111	31,206	25,494
Net cash inflow (outflow) from investing activities	2,870	(48,862)	(127,506)	(44,503)
Net cash inflow from financing activities	859	639	40,861	1,410
Foreign exchange rate loss (gain) on cash and cash equivalents	9	29	(158)	11
Increase (decrease) in cash and cash equivalents during the period	21,058	(33,083)	(55,597)	(17,588)
Cash and cash equivalents, beginning of period	19,641	46,722	96,296	31,227
Cash and cash equivalents, end of period	40,699	13,639	40,699	13,639
Marketable securities, end of period	163,368	91,899	163,368	91,899
Cash, cash equivalents and marketable securities, end of period	204,067	105,538	204,067	105,538

Paladin's cash, cash equivalents and marketable securities increased \$64,678 to \$204,067 at June 30, 2011 from \$139,389 at December 31, 2010. This increase is primarily the result of common shares issued for cash of \$40,861, cash flows generated from operating activities of \$31,206, net proceeds from disposal of financial assets of \$3,074 and dividends received from an associate of \$251, partially offset by the purchase of pharmaceutical product licenses and rights of \$7,617, the investment in an associate of \$2,936, a partial repayment of the balance of sale payable of \$250 and the purchase of property, plant and equipment of \$65. Working capital (current assets less current liabilities) increased \$60,218 to \$188,891 at June 30, 2011 from \$128,673 at December 31, 2010 primarily due to the increase in the cash, cash equivalents and marketable securities explained above.

Cash flows from operating activities increased 15% or \$2,209 to \$17,320 for the quarter ended June 30, 2011 from \$15,111 for the same comparative quarter last year. Cash flows from operating activities for the six months ended June 30, 2011 increased 22% or \$5,712 to \$31,206 compared to \$25,494 for the six months ended June 30, 2010. Cash flows from operating activities represent the cash flows from net earnings, excluding revenues and expenses not affecting cash, principally amortization, deferred taxes, share-based compensation expense, other finance expenses (income), foreign exchange (gains) losses and changes in working capital.

Cash flows from investing activities were \$2,870 compared to cash flows used in investing activities of \$48,862 for the quarters ended June 30, 2011 and 2010, respectively. During the quarter ended June 30, 2011, the Company received \$85,666 from the settlement of financial assets, principally from the reimbursement of the ProStrakan Facility and used \$5,598 to acquire long-term financial assets, \$77,138 for acquisition of marketable securities net of cash flows generated by maturing marketable securities, \$50 towards the acquisition of pharmaceutical product licenses and rights and \$10 for the purchases of property, plant and equipment. During the quarter ended June 30, 2010, the Company acquired \$48,452 marketable securities net of cash flows generated by maturing marketable securities, \$383 towards the acquisition of financial assets and \$27 towards the purchases of property, plant and equipment.

Cash flows used in investing activities were \$127,506 compared to \$44,503 for the six-month periods ended June 30, 2011 and 2010, respectively. During the six months ended June 30, 2011, the Company invested \$119,963 for the acquisition of marketable securities net of cash flows generated by maturing marketable securities, invested \$2,936 towards an addition of 10% interest in an associate, \$250 towards a partial repayment of a balance of sale payable and \$65 for the purchases of property, plant and equipment, partially offset by net proceeds from disposal of financial assets in the amount of \$3,074. During the six months ended June 30, 2010, the Company invested \$17,836 towards the acquisition of marketable securities net of the maturity of marketable securities, \$15,982 towards a 34.99% interest in an associate, \$8,986 towards the net acquisition of financial assets, \$1,650 towards the repayment of a balance of sale payable, and \$49 for the purchases of property, plant and equipment.

Cash flows from financing activities were \$859 compared to \$639 for the quarters ended June 30, 2011 and 2010, respectively, and represent proceeds from share option exercises and the issuance of common shares under the stock purchase plan for cash.

Cash flows from financing activities were \$40,861 compared to \$1,410 for the six-month periods ended June 30, 2011 and 2010, respectively. During the six months ended June 30, 2011, the Company issued 1,150,000 common shares through a bought deal share offering at a price of \$35.00 per common share for total gross proceeds to the Company in the amount of \$40,250. In conjunction with the offering, the Company incurred share issue costs of approximately \$1,643, for total net proceeds amounting to \$38,607. In addition, an amount of \$2,254 was generated from share option exercises and the issuance of common shares under the stock purchase plan for cash. During the six months ended June 30, 2010 an amount of \$1,410 was generated from share option exercises and the issuance of common shares under the stock purchase plan for cash.

#### **EQUITY INVESTMENT IN PHARMAPLAN**

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan, a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan of \$2,879 (ZAR21,000). In addition, the Company committed to additional future consideration by increasing its ownership position by 5% per year over the next 3 years to 49.99%, with such additional consideration based upon Pharmaplan's future financial results. In addition, the Company has the option to increase its ownership interest in Pharmaplan to 100% in 2013, at a purchase price determined using Pharmaplan's future financial results, payable in South African Rand ("ZAR").

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

The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the acquisition, March 16, 2010. The investments were initially recorded at cost and adjustments are made to include the Company's share of Pharmaplan's net income. The Company's share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company's share of the net identifiable assets of Pharmaplan acquired and the tax impact on the distributable earnings.

The total cost was allocated to the Company's share of net identifiable assets acquired on the basis of their fair values using the purchase method of accounting. The allocation of the cost of the investment in Pharmaplan for the March 16, 2010 and March 1, 2011 purchases is identified herein below:

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

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

	Three months ended June 30		Six months ended June 30	
	2011 \$	2010 \$	2011 \$	2010 \$
<b>Carrying values, beginning of period</b>	<b>21,915</b>	16,113	<b>15,739</b>	—
<b>Additions in the period</b>	—	—	<b>5,975</b>	15,982
Share of net income for the period before adjustments	<b>1,146</b>	625	<b>1,881</b>	826
Adjustments to net income:				
Amortization of fair value adjustments	<b>(443)</b>	(290)	<b>(879)</b>	(360)
Taxation	<b>(139)</b>	—	<b>(237)</b>	—
<b>Share of net income for the period</b>	<b>564</b>	335	<b>765</b>	466
<b>Share of dividends received in the period</b>	—	—	—	—
<b>Carrying values, end of period</b>	<b>22,479</b>	16,448	<b>22,479</b>	16,448

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

Pharmaplan's statement of income data (Unaudited)	Three months ended June 30		Six months ended June 30		106 days ended June 30	
	2011 \$	2010 \$	2011 \$	2010 \$	2011 \$	2010 \$
Revenues	<b>12,286</b>	10,131	<b>22,867</b>	12,640		
Cost of sales	<b>5,999</b>	4,518	<b>11,108</b>	5,664		
<b>Gross profit</b>	<b>6,287</b>	5,613	<b>11,759</b>	<b>6,976</b>		
Operating expenses	<b>2,807</b>	3,057	<b>5,715</b>	3,619		
<b>Earnings before under-noted items</b>	<b>3,480</b>	2,556	<b>6,044</b>	<b>3,357</b>		
Interest income, depreciation and income taxes	<b>933</b>	770	<b>1,654</b>	996		
<b>Net income for the period</b>	<b>2,547</b>	1,786	<b>4,390</b>	<b>2,361</b>		

Pharmaplan's balance sheet data (Unaudited)	June 30, 2011 \$	December 31, 2010 \$
Total assets	20,094	18,943
Total liabilities	5,602	8,281

#### **SIGNIFICANT TRANSACTION – PROSTRAKAN FACILITY**

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

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

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

On May 17, 2011, the Company received gross proceeds of \$86,432 representing the aggregate of: the principal of the ProStrakan Facility of \$77,232, the interest accrued at May 17, 2011 of \$778, a break free of \$3,089, and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. The Company has recorded interest accretion of \$361 and \$1,004 for the three and six months ended June 30, 2011, respectively in the interim consolidated income statement. Moreover, the Company has retained the rights to the products it had previously been licensed in connection with the agreement.

#### **RELATED PARTY TRANSACTIONS**

##### **Joddes Limited**

Joddes Limited ("Joddes"), a private Canadian corporation, together with its affiliates own in aggregate approximately 35% of the outstanding shares of the Company, and one director of the Company, the Company's President and CEO, is related to this group.

The Company engages a wholly-owned subsidiary of Joddes to provide logistics services including: customer service, warehousing, shipping, invoicing, collection services and certain manufacturing and selling services on behalf of the Company. The Company also engages this affiliate to perform certain research and development and selling services on a contractual pay-for-use basis. In addition, the Company leases its office facilities from another wholly-owned subsidiary of Joddes. This lease is for a period of 10 years, ending in 2013 and includes minimum annual payments for a total remaining committed amount of \$762 as at June 30, 2011 and is included in the purchase and service based commitments amount in the "Contractual Obligations and Commitments" section below.

The Company has also entered into contractual royalty agreements with a wholly-owned subsidiary of Joddes for certain legacy and over-the-counter products. The terms of these arrangements vary whereby

the Company may earn a royalty fee based on certain established terms relating to the performance of the respective products such as through a percentage of net sales, certain guaranteed minimum annual payments, or as a percentage of a defined product contribution.

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

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
	\$	\$	\$	
Revenues	1,119	1,017	1,990	2,081
Purchases	2,630	2,933	4,969	7,095
Selling, general and administrative	2,040	1,986	3,936	3,687
Research and development	168	1,124	374	2,255

As at June 30, 2011, the Company has an amount payable to a wholly-owned subsidiary of Joddes, included in Payables, accruals and provisions on the interim consolidated balance sheets, of \$1,245 (December 31, 2010: \$834).

### Pharmaplan

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

All transactions with related parties are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount. The accounts payable to related parties are on normal commercial terms and conditions and are non-interest bearing.

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

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

## QUARTERLY INFORMATION (UNAUDITED)

(In thousands of Canadian dollars except per share information)

	Q2 F2011	Q1 F2011	Q4 F2010	Q3 F2010	Q2 F2010	Q1 F2010	Q4 F2009 <sup>3</sup>	Q3 F2009 <sup>3</sup>
Revenues	35,971	31,752	32,434	31,782	32,936	30,837	29,279	28,374
EBITDA <sup>1</sup>	18,273	17,270	15,451	15,849	13,621	11,520	9,961	10,161
Net income before income taxes	22,475	11,949	16,797	11,355	8,095	5,112	2,501	4,212
Net Income	16,783	8,100	13,893	7,959	4,862	3,142	4,392 <sup>4</sup>	2,564
Earnings per share	0.83	\$0.42	\$0.74	\$0.43	\$0.26	\$0.17	\$0.24	\$0.14
Diluted earnings per share	0.80	\$0.40	\$0.72	\$0.41	\$0.25	\$0.16	\$0.23	\$0.13

Paladin's annual and quarterly operating results are primarily affected by the level of acceptance of Paladin's products by physicians and their patients, and the timing and number of product launches. The level of patient and physician acceptance of Paladin's products, the acceptance of provincial government reimbursement on such products, market access, as well as the availability of similar therapies, impact Paladin's revenues by driving the level and timing of prescriptions for its products. Each new product launch requires significant promotional investment during the first three to five years from launch.

### OFF BALANCE SHEET ARRANGEMENTS

The Company's off balance sheet arrangements consist of contractual obligations and agreements for development, sales, marketing and distribution rights to innovative drug products for the Canadian market. The effect of terminating these arrangements under normal operating circumstances consists of an effective transition of the remaining responsibilities and obligations to the licensor under agreed upon time frames and conditions. Please refer to the "Contractual Obligations and Commitments" section below for additional details. Other than these contractual obligations and commitments, the Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, changes in revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

The Company does not issue guarantees contemplated by the applicable IFRS standards.

### FINANCIAL INSTRUMENTS

The Company's Investment Policy regulates the investment activities relating to cash resources. An Investment Committee composed of representatives from management and the Board of Directors monitors compliance with said policy. The Company invests in strategic investments in the form of equity or strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates.

### CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

The Company considers its maximum credit risk from financial instruments to be \$34,887 (December 31, 2010: \$37,335) which is the total of the following financial assets: trade and other receivables, loans and other receivables and derivatives at fair value through income and loss. The Company's cash, cash equivalents, marketable securities, short-term and long-term investments are held through various institutions. Marketable securities are mainly investments in liquid, high-grade investment securities. They are subject to minimal risk of changes in value and generally have an original maturity from three months to twenty-four months from the date of purchase.

The Company is exposed to credit risk from its customers and continually monitors its customers' credit. It establishes the provision for doubtful accounts based upon the credit risk applicable to each customer. In line with other pharmaceutical companies, the Company sells its products through a small number of wholesalers and retail pharmacy chains in addition to hospitals, pharmacies, physicians and other groups. For the three months ended June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 30% and 14% of revenues, respectively (2010: 29% and 15%). For the six months

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

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

ended June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 29% and 14% of revenues, respectively (2010: 29% and 15%). As at June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 12% and 13% of trade accounts receivable, respectively (December 31, 2010: 6% and 13%). These above concentrations on the Company's customers are considered normal for the Company and its industry.

A further source of credit risk for the Company arises from its strategic investments in third-parties with whom it has commercial relationships. In connection with a licensing arrangement with Labopharm Inc. ("Labopharm"), the Company advanced Labopharm \$10,000 against future product supply, and has a balance outstanding as at June 30, 2011 of \$9,517. In connection with a license arrangement with SpePharm Holding B.V., the Company invested €4,000 (\$5,751) through a secured convertible debenture. The Company continuously monitors the risks associated with these amounts.

#### **LIQUIDITY RISK**

All financial liabilities with the exception of the long-term portion of the balances of sale payable are current. The Company generates sufficient cash from operating activities to fund its operations and fulfill its obligations as they become due. The Company has sufficient funds available through its cash, cash equivalents and marketable securities, should its cash requirements exceed cash generated from operations, to cover all financial liability obligations. As at June 30, 2011, there were no restrictions on the flow of these funds nor have any of these funds been committed in any way, except as set out in the "Contractual Obligations and Commitments" section below. All financial liabilities are short term in nature except for the long-term portion of the balance of sale payable, which is payable to the extent of future product sales.

#### **FOREIGN EXCHANGE RISK**

The Company principally operates within Canada, however, a portion of the Company's revenues, expenses, and current assets and liabilities, are denominated in United States dollars ("USD"), EURO, ZAR and Swiss francs ("CHF"). This results in financial risk due to fluctuations in the value of the USD, EURO, ZAR and CHF relative to CAD. The Company has significant monetary assets and liabilities denominated in USD, EURO, ZAR and CHF that are required to be revalued in CAD at each period end. On March 31, 2010, the Company entered into a €4,000 notional amount forward foreign exchange contract expiring on October 15, 2012 to cover the foreign exchange exposure related to a certain investment denominated in EURO. With the exception of the forward contract described above, the Company does not currently use derivative financial instruments to reduce its foreign exchange exposure and often relies on natural hedges to mitigate foreign currency risk. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results, financial position or cash flows. Based on the net exposure described in Note 3 to the condensed interim financial statements as at June 30, 2011, and assuming that all other variables remain constant, a ten-point increase or decrease on the June 30, 2011 CAD/USD, CAD/EURO, CAD/ZAR and CAD/CHF exchange rate would have an effect of \$58 (December 31, 2010: \$694) on net income. For a more detailed analysis and disclosure of the foreign exchange risk please refer to Note 3 to the condensed interim financial statements.

#### **INTEREST RATE RISK**

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

#### **EQUITY PRICE RISK**

Equity price risk arises from changes in market prices of the available-for-sale equity securities. The carrying values of investments subject to equity price risk are, in almost all instances, based on quoted market prices as of the balance sheet dates with an estimated fair value of \$9,898 at June 30, 2011 (December 31, 2010: \$7,394). The Company monitors its equity investments for impairment on a periodic basis. Market prices are subject to fluctuation and, consequently, the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

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

A hypothetical 10% adverse change in the stock prices of the Company's available-for-sale equity securities would result in an approximate \$990 other comprehensive income (loss) (December 31, 2010: \$739). The Company does not include in the analysis above investments which are subject to significant influence. The adverse change above does not reflect what could be considered the best or worst case scenarios. Indeed, results could be worse due both to the nature of equity markets and the concentrations existing in the Company's equity investment portfolio, in particular where there is less liquidity available as in the case of the small capitalization companies included in the available-for-sale equity securities.

#### RISK FACTORS

For a more detailed discussion of the risk factors that could materially affect the results of operations and the financial condition of the Company, please refer to the Company's Annual Information Form filed on SEDAR at [www.sedar.com](http://www.sedar.com).

#### INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

#### CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business, the Company secures development, sales, marketing and distribution rights to innovative drug products requiring royalties or product payments considered normal operating commitments and as such not included herein. The Company has entered into various agreements which include contractual obligations extending beyond the current year. These obligations due to their significance and being considered outside of the Company's normal course of business are separately disclosed. The Company is committed to making minimum purchases of inventory, and minimum expenditures for regulatory, selling and marketing services in the amount of \$5,522, including €3,047, to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 7 to the condensed interim financial statements is also committed to purchase an additional 5% interest in Pharmaplan's common shares in 2013, currently estimated to amount to \$2,900 (ZAR20,322) and subject to change based upon Pharmaplan's future operating results. These purchase and service-based commitments end in 2015 and annual commitments are as follows:

<b>Contractual Obligations</b> (in thousands of Canadian dollars)	<b>Total</b>	Less than 1 year	1-3 years	4-5 years	After 5 years
Purchase and service based commitments	<b>8,422</b>	694	6,749	979	—

In addition, under certain agreements, Paladin may have to pay additional consideration should the Company achieve certain sales volumes or if certain milestones are met, such as regulatory approval in Canada. The Company may have to pay up to \$19,197 including US\$10,111, €693 and GBP£500 over a maximum period of 15 years if it achieves certain product, regulatory or sales milestones on specific products in the future. The Company has the following commitments related to product license, trademark and distribution agreements:

<b>Commitments</b> (in thousands of Canadian dollars)	<b>Total</b>	Less than 1 year	1-3 years	4-5 years	After 5 years
Milestone based commitments	<b>7,433</b>	1,490	1,781	—	4,162
Revenues based commitments	<b>11,764</b>	482	482	482	10,318

## **SUBSEQUENT EVENTS**

On August 10, 2011, the Company issued a circular offering to purchase (the "Offer"), on the terms and subject to the conditions of the Offer, any and all of the issued and outstanding common shares (the "Afexa Common Shares") of Afexa Life Sciences Inc. ("Afexa"), together with any associated rights (the "SRP Rights") issued under the Shareholder Rights Plan of Afexa, which includes Afexa Common Shares that may become issued and outstanding after the date of the Offer but before the expiry time of the Offer upon the exercise of options issued under Afexa's Stock Option Plan ("Afexa Options") together with their associated SRP Rights. The Offer is open for acceptance until 8:00 p.m. (Toronto time) on September 15, 2011, unless the Offer is extended or withdrawn.

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

## INTERIM CONSOLIDATED BALANCE SHEETS

[In thousands of Canadian dollars]  
[unaudited]

	Notes	June 30, 2011	December 31, 2010
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents		40,699	96,295
Marketable securities		163,368	43,094
Trade and other receivables		20,131	21,912
Inventories		14,349	13,877
Income tax receivable		—	17
Other current assets		830	4,717
<b>Total current assets</b>		<b>239,377</b>	<b>179,912</b>
Investment in an associate	4	22,479	15,739
Financial assets		25,290	22,835
Property, plant and equipment		157	221
Pharmaceutical product licenses and rights		19,234	20,594
Investment tax credits recoverable		14,874	14,736
Deferred income tax assets		23,326	26,586
<b>Total assets</b>		<b>344,737</b>	<b>280,623</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current</b>			
Payables, accruals and provisions		30,962	36,901
Income tax payable		16,656	11,254
Deferred revenue		534	1,939
Balances of sale payable		2,334	1,145
<b>Total current liabilities</b>		<b>50,486</b>	<b>51,239</b>
Balances of sale payable		1,024	539
<b>Total liabilities</b>		<b>51,510</b>	<b>51,778</b>
<b>Shareholders' equity</b>			
Share capital	5	165,231	123,136
Other paid-in capital		4,821	4,892
Other capital reserves		(2,350)	175
Retained earnings		125,525	100,642
<b>Total shareholders' equity</b>		<b>293,227</b>	<b>228,845</b>
<b>Total liabilities and shareholders' equity</b>		<b>344,737</b>	<b>280,623</b>

Commitments [note 7]

See accompanying notes

## INTERIM CONSOLIDATED INCOME STATEMENTS

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

	Notes	Three months ended June 30		Six months ended June 30	
		2011	2010	2011	2010
Revenues	6	35,971	32,936	67,723	63,773
Cost of sales		9,462	9,245	17,502	18,025
<b>Gross profit</b>		<b>26,509</b>	23,691	<b>50,221</b>	45,748
<b>Expenses (income)</b>					
Selling, general and administrative	6	8,188	7,839	15,228	15,916
Research and development		2,225	2,674	4,296	5,417
Interest income		(2,177)	(443)	(4,846)	(726)
<b>Earnings before under-noted items</b>		<b>18,273</b>	13,621	<b>35,543</b>	25,141
Amortization of pharmaceutical product licenses and rights		5,571	6,071	10,901	12,341
Other finance income	2	(9,134)	(50)	(8,561)	(75)
Foreign exchange (gain) loss		(75)	(87)	(456)	207
Other income		—	(41)	—	(41)
Share of net income from an associate	4	(564)	(335)	(765)	(466)
<b>Income before income tax</b>		<b>22,475</b>	8,063	<b>34,424</b>	13,175
Provision for income taxes		5,692	3,200	9,541	5,170
<b>Net income for the period</b>		<b>16,783</b>	4,863	<b>24,883</b>	8,005
<b>Attributable to shareholders</b>					
Basic earnings per share		0.83	0.26	1.26	0.43
Diluted earnings per share		0.80	0.25	1.22	0.42
<b>Weighted average number of shares outstanding</b>					
Basic		20,136,525	18,668,015	19,718,663	18,632,017
Diluted		20,867,422	19,334,082	20,459,235	19,247,928

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

[In thousands of Canadian dollars]  
[unaudited]

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
<b>Net income for the period</b>	<b>16,783</b>	4,863	<b>24,883</b>	8,005
<b>Other comprehensive (loss) income:</b>				
Change in fair value of available-for-sale financial instruments [net of \$nil taxes for the three-month period [2010 – \$1] and \$34 for the six-month period [2010 – (\$1)]]	<b>(2,237)</b>	(6)	<b>(2,430)</b>	7
Reclassification adjustment for gains on available-for-sale financial instruments included in net income in the period [net of (\$3) taxes for the three-month and six-month period [2010 - \$9 and \$10, respectively]]	<b>(95)</b>	(52)	<b>(95)</b>	(62)
<b>Other comprehensive loss for the period</b>	<b>(2,332)</b>	(58)	<b>(2,525)</b>	(55)
<b>Total comprehensive income attributable to shareholders for the period</b>	<b>14,451</b>	4,805	<b>22,358</b>	7,950

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

[In thousands of Canadian dollars]  
[unaudited]

	Notes	Three months ended June 30		Six months ended June 30	
		2011	2010	2011	2010
<b>Operating activities</b>					
Net income for the period		16,783	4,863	24,883	8,005
Adjustments reconciling net income to operating cash flows					
Amortization of pharmaceutical product licenses and rights		5,571	6,071	10,901	12,341
Deferred tax		1,625	785	3,922	2,333
Share-based compensation expense	5	700	590	1,123	951
Other finance income		(9,134)	(50)	(8,561)	(75)
Unrealized foreign exchange (gain) loss		(527)	(121)	(1,014)	190
Depreciation of property, plant and equipment		24	208	129	427
Changes in working capital and other non-cash balances	8	2,842	3,100	589	1,788
Share of net income from an associate	4	(564)	(335)	(765)	(466)
<b>Cash inflow from operating activities</b>		<b>17,320</b>	<b>15,111</b>	<b>31,207</b>	<b>25,494</b>
<b>Investing activities</b>					
Purchases of financial assets		(5,598)	(383)	(85,936)	(9,013)
Purchases of marketable securities		(90,319)	(48,517)	(136,057)	(92,305)
Purchases of pharmaceutical product licenses and rights		(50)	—	(7,617)	—
Investment in an associate	4	—	—	(2,936)	(15,982)
Repayment of balances of sale payable		—	—	(250)	(1,650)
Purchases of property, plant and equipment		(10)	(27)	(65)	(49)
Proceeds from disposal of financial assets	2	85,666	—	89,010	27
Disposals and maturities of marketable securities		13,181	65	16,094	74,469
Dividends from an associate	4	—	—	251	—
<b>Net cash inflow (outflow) from investing activities</b>		<b>2,870</b>	<b>(48,862)</b>	<b>(127,506)</b>	<b>(44,503)</b>
<b>Financing activities</b>					
Common shares issued for cash, net of issue costs	5	859	639	40,861	1,410
<b>Net cash inflow from financing activities</b>		<b>859</b>	<b>639</b>	<b>40,861</b>	<b>1,410</b>
Foreign exchange rate gain (loss) on cash and cash equivalents		9	29	(158)	11
<b>Increase (decrease) in cash and cash equivalents during the period</b>		<b>21,058</b>	<b>(33,083)</b>	<b>(55,596)</b>	<b>(17,588)</b>
Cash and cash equivalents, beginning of period		19,641	46,722	96,295	31,227
<b>Cash and cash equivalents, end of period</b>		<b>40,699</b>	<b>13,639</b>	<b>40,699</b>	<b>13,639</b>
<b>Supplemental cash flow information</b>					
Interest received		3,302	947	3,587	1,437
Income taxes (paid) received		(14)	600	(59)	4,364
Cash and cash equivalents		40,699	13,639		
Marketable securities		163,368	91,899		
		<b>204,067</b>	<b>105,538</b>		

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

See accompanying notes

## INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

[In thousands of Canadian dollars]  
[unaudited]

		For the six months ended June 30, 2011 and 2010				
	Note	Share capital	Other paid-in capital	Other capital reserves (deficit)	Retained earnings	Total shareholders' equity
<b>Balance as at January 1, 2011</b>		<b>123,136</b>	<b>4,892</b>	<b>175</b>	<b>100,642</b>	<b>228,845</b>
Net income for the period					<b>24,883</b>	<b>24,883</b>
Other comprehensive loss for the period				<b>(2,525)</b>		<b>(2,525)</b>
Shares issued	5	<b>40,901</b>				<b>40,901</b>
Share-based incentive plans	5		<b>1,123</b>			<b>1,123</b>
Transfers upon exercise of share options		<b>1,194</b>	<b>(1,194)</b>			<b>—</b>
<b>Balance as at June 30, 2011</b>		<b>165,231</b>	<b>4,821</b>	<b>(2,350)</b>	<b>125,525</b>	<b>293,227</b>
<b>Balance as at January 1, 2010</b>		<b>119,652</b>	<b>4,362</b>	<b>98</b>	<b>70,786</b>	<b>194,898</b>
Net income for the period					<b>8,005</b>	<b>8,005</b>
Other comprehensive loss for the period				<b>(55)</b>		<b>(55)</b>
Shares issued	5	<b>1,427</b>				<b>1,427</b>
Share-based incentive plans	5		<b>951</b>			<b>951</b>
Transfers upon exercise of share options		<b>747</b>	<b>(747)</b>			<b>—</b>
<b>Balance as at June 30, 2010</b>		<b>121,826</b>	<b>4,566</b>	<b>43</b>	<b>78,791</b>	<b>205,226</b>

See accompanying notes

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

### 1. PRESENTATION OF FINANCIAL STATEMENTS

#### DESCRIPTION OF THE BUSINESS

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

#### BASIS OF PREPARATION

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

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

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

These condensed interim financial statements were authorised for issue by the Company’s Board of Directors on August 10, 2011.

#### RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 2. SIGNIFICANT TRANSACTION

#### Prostrakan Facility

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

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

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

On May 17, 2011, the Company received gross proceeds of \$86,432 representing the aggregate of: the principal of the ProStrakan Facility of \$77,232, the interest accrued at May 17, 2011 of \$778, a break free of \$3,089, and the outstanding balance of interest payable for the first year of \$5,333, resulting in a gain on early redemption of \$8,422. The Company has recorded interest accretion of \$361 and \$1,004 for the three and six months ended June 30, 2011, respectively, in the interim consolidated income statement. Moreover, the Company has retained the rights to the products it had previously been licensed in connection with the agreement.

### 3. FINANCIAL INSTRUMENTS

The Company's Investment Policy regulates the investment activities relating to cash resources. An Investment Committee composed of representatives from management and the Board of Directors monitors compliance with said policy. The Company invests in strategic investments in the form of equity or strictly in liquid, high-grade investment securities with varying terms to maturity, selected with regard to the expected timing of investments and expenditures for continuing operations and prevailing interest rates.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

	Carrying value		Fair Value	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
	\$	\$	\$	\$
<b>Financial assets</b>				
Cash and cash equivalents	40,699	96,295	40,699	96,295
Marketable securities	163,368	43,094	163,368	43,094
Trade and other receivables	19,495	21,894	19,495	21,894
Other current assets	197	3,480	197	3,480
Other financial assets				
Loans and other receivables	14,840	14,725	14,840	14,725
Available-for-sale financial investments	9,898	7,394	9,898 <sup>1</sup>	7,394 <sup>1</sup>
Derivatives at fair value through income and loss	552	716	552 <sup>1</sup>	716 <sup>1</sup>
<b>Total financial assets</b>	<b>249,049</b>	<b>187,598</b>	<b>249,049</b>	<b>187,598</b>
<b>Financial liabilities</b>				
Payables, accruals and provisions	30,962	36,901	30,962	36,901
Balances of sale payable	2,334	1,145	2,334	1,145
Long-term balances of sale payable	1,024	539	1,024	539
<b>Total financial liabilities</b>	<b>34,320</b>	<b>38,585</b>	<b>34,320</b>	<b>38,585</b>

#### Financial assets and liabilities – fair values

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

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

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

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

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

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

	June 30, 2011	Level 1	Level 2	Level 3
	\$	\$	\$	\$
Assets measured at fair value				
Marketable securities	163,368	163,368	—	—
Available-for-sale financial investments	9,898	9,898	—	—
Derivatives at fair value through income and loss	552	(24)	576	—
<b>Total</b>	<b>173,818</b>	<b>173,242</b>	<b>576</b>	<b>—</b>

<sup>1</sup> In accordance with existing accounting standards, certain investments in private companies included in the balance above are carried at cost, as there are no quoted market prices in an active market for such equity instruments. Fair value has not been disclosed because fair value cannot be measured reliably.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

#### LIQUIDITY RISK

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

#### CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

The Company considers its maximum credit risk from financial instruments to be \$34,887 [December 31, 2010: \$37,335] which is the total of the following financial assets: trade and other receivables, loans and other receivables and derivatives at fair value through income and loss. The Company's cash, cash equivalents, marketable securities, short-term and long-term investments are held through various institutions. Marketable securities are mainly investments in liquid, high-grade investment securities. They are subject to minimal risk of changes in value and generally have an original maturity from three months to twenty-four months from the date of purchase.

The Company is exposed to credit risk from its customers and continually monitors its customers' credit. It establishes the provision for doubtful accounts based upon the credit risk applicable to each customer. In line with other pharmaceutical companies, the Company sells its products through a small number of wholesalers and retail pharmacy chains in addition to hospitals, pharmacies, physicians and other groups. For the three months ended June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 30% and 14% of revenues, respectively [2010: 29% and 15%]. For the six months ended June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 29% and 14% of revenues, respectively [2010: 29% and 15%]. As at June 30, 2011, two customers, a major wholesale distributor and a major retail chain, represented 12% and 13% of trade accounts receivable, respectively [December 31, 2010: 6% and 13%]. These above concentrations on the Company's customers are considered normal for the Company and its industry.

Another source of credit risk for the Company arises from its strategic investments in third-parties with whom it has commercial relationships. In connection with a licensing arrangement with Labopharm Inc. ["Labopharm"], Paladin advanced Labopharm \$10,000 against future product supply, and has a balance outstanding as at June 30, 2011 of \$9,517. Moreover, in connection with a license arrangement with SpePharm Holding B.V., the Company invested €4,000 [\$5,751] through a secured convertible debenture. The Company continuously monitors the risks associated with these amounts.

#### FOREIGN EXCHANGE RISK

The Company principally operates within Canada, however, a portion of the Company's revenues, expenses, and current assets and liabilities, are denominated in United States dollars ["USD"], EURO, South African Rand ["ZAR"] and Swiss francs ["CHF"]. This results in financial risk due to fluctuations in the value of the USD, EURO, ZAR and CHF relative to CAD. The Company has significant monetary assets and liabilities denominated in USD, EURO, ZAR and CHF that are required to be revalued in CAD at each period end. On March 31, 2010, the Company entered into a €4,000 notional amount forward foreign exchange contract expiring on October 15, 2012 to cover the foreign exchange exposure related to a certain investment denominated in EURO.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

With the exception of the forward contract described above, the Company does not currently use derivative financial instruments to reduce its foreign exchange exposure and often relies on natural hedges to mitigate foreign currency risk. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results, financial position or cash flows. The significant balances in foreign currencies are as follows:

	June 30, 2011				December 31, 2010			
	USD	EURO	ZAR	CHF	USD	EURO	ZAR	CHF
Cash and cash equivalents	1,791	861	2,529	—	1,869	2,588	21,000	—
Marketable securities	—	1	3,791	—	—	—	—	—
Trade and other receivables	1,418	423	299	—	647	209	1,750	—
Other current assets	—	—	—	—	—	—	5,249	—
Payables, accruals and provisions	4,510	54	—	726	3,078	344	—	—

These four currencies are the foreign currencies in which the Company's financial instruments are denominated. The Company has considered movements in these currencies over the last three years and has concluded that a 10% movement in rates is a reasonable benchmark. Based on the aforementioned net exposure as at June 30, 2011, and assuming that all other variables remain constant, a ten-point increase or decrease on the CAD/USD, CAD/EURO, CAD/ZAR and CAD/CHF June 30, 2011 exchange rate would have an effect of \$58 [December 31, 2010: \$694] on net income.

#### EQUITY PRICE RISK

Equity price risk arises from changes in market prices of the available-for-sale equity securities. The carrying values of investments subject to equity price risk are, in almost all instances, based on quoted market prices as of the balance sheet dates with an estimated fair value of \$9,898 at June 30, 2011 [December 31, 2010: \$7,394]. The Company monitors its equity investments for impairment on a periodic basis. Market prices are subject to fluctuation and, consequently, the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

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

A hypothetical 10% adverse change in the stock prices of the Company's available-for-sale equity securities would result in an approximate \$990 other comprehensive income (loss) [December 31, 2010: \$739]. The Company does not include in the analysis above investments which are subject to significant influence. The adverse change above does not reflect what could be considered the best or worst case scenarios. Indeed, results could be worse due both to the nature of equity markets and the concentrations existing in the Company's equity investment portfolio, in particular where there is less liquidity available as in the case of the small capitalization companies included in the available-for-sale equity securities.

#### INTEREST RATE RISK

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 4. INVESTMENT IN AN ASSOCIATE

	Three months ended June 30		Six months ended June 30	
	2011 \$	2010 \$	2011 \$	2010 \$
<b>Carrying values, beginning of period</b>	<b>21,915</b>	16,113	<b>15,739</b>	—
<b>Additions in the period</b>	<b>—</b>	—	<b>5,975</b>	15,982
Share of net income for the period before adjustments	<b>1,146</b>	625	<b>1,881</b>	826
Adjustments to net income:				
Amortization of fair value adjustments	<b>(443)</b>	(290)	<b>(879)</b>	(360)
Taxation	<b>(139)</b>	—	<b>(237)</b>	—
<b>Share of net income for the period</b>	<b>564</b>	335	<b>765</b>	466
<b>Share of dividends received in the period</b>	<b>—</b>	—	<b>—</b>	—
<b>Carrying values, end of period</b>	<b>22,479</b>	16,448	<b>22,479</b>	16,448

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

On March 16, 2010, the Company entered into a strategic investment to acquire an initial 34.99% ownership interest in Pharmaplan, a privately-owned specialty pharmaceutical company based in Johannesburg, South Africa. The Company paid \$18,861 including a non-interest bearing loan of \$2,879 [ZAR21,000]. In addition, the Company committed to additional future consideration by increasing its ownership position by 5% per year over the next 3 years to 49.99%, with such additional consideration based upon Pharmaplan's future financial results. In addition, the Company has the option to increase its ownership interest in Pharmaplan to 100% in 2013, at a purchase price determined using Pharmaplan's future financial results, payable in ZAR.

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

The equity interest acquired in Pharmaplan represents an investment subject to significant influence which is accounted for using the equity method from the date of the acquisition, March 16, 2010. The investments were initially recorded at cost and adjustments are made to include the Company's share of Pharmaplan's net income. The Company's share of net income is adjusted to reflect the amortization of the fair value adjustments related to the Company's share of the net identifiable assets of Pharmaplan acquired and the tax impact on the distributable earnings.

The total cost was allocated to the Company's share of net identifiable assets acquired on the basis of their fair values using the purchase method of accounting. The allocation of the cost of the investment in Pharmaplan for the March 16, 2010 and March 1, 2011 purchases is identified herein below:

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

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

Pharmaplan's statement of income data (unaudited)	Three months ended		Six months	106 days
	June 30		ended June 30	ended June 30
	2011	2010	2011	2010
	\$	\$	\$	\$
Revenues	12,286	10,131	22,867	12,640
Cost of sales	5,999	4,518	11,108	5,664
<b>Gross profit</b>	<b>6,287</b>	<b>5,613</b>	<b>11,759</b>	<b>6,976</b>
Operating expenses	2,807	3,057	5,715	3,619
<b>Earnings before under-noted items</b>	<b>3,480</b>	<b>2,556</b>	<b>6,044</b>	<b>3,357</b>
Interest income, depreciation and income taxes	933	770	1,654	996
<b>Net income for the period</b>	<b>2,547</b>	<b>1,786</b>	<b>4,390</b>	<b>2,361</b>

  

Pharmaplan's balance sheet data (unaudited)	June 30, 2011	December 31, 2010
	\$	\$
Total assets	20,094	18,943
Total liabilities	5,602	8,281

### 5. SHARE CAPITAL

#### Authorized

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

#### Issued and outstanding

	Six months ended June 30, 2011				
	Balance beginning of year	Issued upon common share offering [i]	Exercise of share options	Employee share purchase plan	Balance end of period
Number of shares	18,803,384	1,150,000	241,839	3,746	20,198,969
Amount (\$)	123,136	38,607	3,355	133	165,231

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

#### Share option issuances and option compensation expense

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Share-based compensation expense	\$700	\$590	\$1,123	\$951
Weighted average fair value of options	\$9.70	\$7.34	\$9.97	\$6.20
Weighted average risk-free interest rate	2.34%	2.80%	2.31%	2.30%
Dividend yield	Nil	Nil	Nil	Nil
Weighted average volatility factor	31%	33%	31%	34%
Weighted average expected life	3.5 years	4 years	3.5 years	4 years

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

	2011		2010	
	#	Weighted average exercise price \$	#	Weighted average exercise price \$
Balance at January 1st	1,286,177	13.38	1,246,518	10.65
Options granted	296,539	35.62	355,701	19.98
Options exercised	(241,839)	8.93	(138,587)	9.48
Options expired/forfeited	(50,348)	20.75	(68,693)	14.09
Balance at June 30 <sup>th</sup>	1,290,529	19.03	1,394,939	12.97
Options exercisable at June 30 <sup>th</sup>	451,059	11.70	506,970	9.75

### SHARE BUYBACK

On May 26, 2011, the Company received regulatory approval from the Toronto Stock Exchange ["TSX"] to carry out a normal course issuer bid effective May 30, 2011. The Company had been authorized to purchase up to 935,367 of its common shares in the twelve-month period following the bid's effective date. During the three months ended June 30, 2011, the Company did not repurchase any of its common shares.

### 6. RELATED PARTY DISCLOSURES

#### Joddes Limited

Joddes Limited ["Joddes"], a private Canadian corporation, together with its affiliates own in aggregate approximately 35% of the outstanding shares of the Company as at June 30, 2011, and one director of the Company, the Company's President and CEO, is related to this group.

The Company engages a wholly-owned subsidiary of Joddes to provide logistics services including: customer service, warehousing, shipping, invoicing, collection services and certain manufacturing and selling services on behalf of the Company. The Company also engages this affiliate to perform certain research and development and selling services on a contractual pay-for-use basis. In addition, the Company leases its office facilities from another wholly-owned subsidiary of Joddes. This lease is for a period of 10 years, ending in 2013 and includes minimum annual payments for a total remaining committed amount of \$762 as at June 30, 2011 and is included in the purchase and service based commitments in Note 7.

The Company has also entered into contractual royalty agreements with a wholly-owned subsidiary of Joddes for certain legacy and over-the-counter products. The terms of these arrangements vary whereby the Company may earn a royalty fee based on certain established terms relating to the performance of the respective products such as through a percentage of net sales, certain guaranteed minimum annual payments, or as a percentage of a defined product contribution.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
	\$	\$	\$	
Revenues	1,119	1,017	1,990	2,081
Purchases	2,630	2,933	4,969	7,095
Selling, general and administrative	2,040	1,986	3,936	3,687
Research and development	168	1,124	374	2,255

As at June 30, 2011, the Company has a balance payable to a wholly-owned subsidiary of Joddes, included in payables, accruals and provisions on the interim consolidated balance sheets, of \$1,245 [December 31, 2010: \$834].

#### Pharmaplan

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

All transactions with related parties are carried out in the normal course of operations, and are recorded at an agreed upon exchange amount. The accounts payable to related parties are on normal commercial terms and conditions and are non-interest bearing.

### 7. COMMITMENTS

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

#### REVENUE BASED COMMITMENTS

The Company may have to pay up to \$11,764 [2010 – \$11,922] including US\$5,250 [2010 – US\$5,250] if it achieves specific sales volumes on specific products in the future, over a maximum of ten years [2010 – ten years].

#### MILESTONE BASED COMMITMENTS

The Company has also committed to fund certain research and development expenditures of third parties in the amount of \$1,470 [2010 – \$1,499] including €693 [2010 – €750] over the next three years. In addition, certain additional payments may be required under these agreements if milestones are met, such as regulatory approval in Canada. Based on the outcome of these milestones, the Company may have to pay up to \$5,963 [2010 – \$6,611], including US\$4,861 [2010 – US\$4,861] and £500 [2010 – £500], over a maximum period of 15 years [2010 – 15 years].

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 7. COMMITMENTS [CONT'D]

#### PURCHASE AND SERVICE BASED COMMITMENTS

The Company is committed to making minimum purchases of inventory, and minimum expenditures for regulatory, selling and marketing services in the amount of \$5,522 [2010 – \$17,921], including €3,047 [2010 – €3,385], to retain exclusive distribution agreements for certain products. The Company, as further discussed in note 4 is also committed to purchase an additional 5% interest in Pharmaplan's common shares in 2013, currently estimated to amount to \$2,900 [ZAR20,322] and subject to change based upon Pharmaplan's future operating results. These purchase and service based commitments end in 2015.

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

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

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Decrease in inventories	(1,821)	(143)	(472)	(1,446)
(Decrease) increase in trade and other receivables	(613)	(3,465)	1,781	(2,002)
Decrease (increase) in payables, accruals and provisions	2,065	3,901	(5,935)	(955)
Decrease in deferred revenue	(2,115)	(36)	(1,405)	(1,719)
Other working capital non-cash balances	5,329	2,843	6,623	7,910
	<b>2,845</b>	<b>3,100</b>	<b>592</b>	<b>1,788</b>

### 9. COMPARATIVE FIGURES

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

### 10. SUBSEQUENT EVENTS

On August 10, 2011, the Company issued a circular offering to purchase (the "Offer"), on the terms and subject to the conditions of the Offer, any and all of the issued and outstanding common shares (the "Afexa Common Shares") of Afexa Life Sciences Inc. ("Afexa"), together with any associated rights (the "SRP Rights") issued under the Shareholder Rights Plan of Afexa, which includes Afexa Common Shares that may become issued and outstanding after the date of the Offer but before the expiry time of the Offer upon the exercise of options issued under Afexa's Stock Option Plan ("Afexa Options") together with their associated SRP Rights. The Offer is open for acceptance until 8:00 p.m. (Toronto time) on September 15, 2011, unless the Offer is extended or withdrawn.

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

### 11. TRANSITION TO IFRS

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

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

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

#### IFRS EXEMPTION OPTIONS

##### [a] Business combinations exemption

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

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

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

#### IFRS MANDATORY EXCEPTIONS

##### [a] Estimates

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

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

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

#### RECONCILIATION OF CANADIAN GAAP TO IFRS

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

#### [a] Shareholders' equity

As of	December 31, 2010 \$	June 30, 2010 \$	January 1, 2010 \$
Shareholders' equity under Canadian GAAP	228,587	204,863	194,802
Differences increasing reported shareholders' equity:			
Income taxes	258	363	96
<b>Total shareholders' equity under IFRS</b>	<b>228,845</b>	<b>205,226</b>	<b>194,898</b>

#### [b] Comprehensive income

For the year to date periods ended	December 31, 2010 \$	June 30, 2010 \$
Comprehensive income under Canadian GAAP	29,824	7,675
Differences increasing (decreasing) reported income:		
Share-based compensation	(53)	7
Income taxes	162	268
<b>Comprehensive income under IFRS</b>	<b>29,933</b>	<b>7,950</b>

## CHANGES IN ACCOUNTING POLICIES

### SHARE-BASED COMPENSATION

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

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

#### PRESENTATION RECLASSIFICATIONS

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

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

11. TRANSITION TO IFRS [CONT'D]

Reconciliation of Consolidated Balance Sheet as of January 1, 2010

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

11. TRANSITION TO IFRS [CONT'D]

Reconciliation of Consolidated Balance Sheet as of December 31, 2010

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
Revenues	32,936			32,936	Revenues
Cost of sales	9,245			9,245	Cost of sales
<b>Gross profit</b>	<b>23,691</b>	<b>—</b>	<b>—</b>	<b>23,691</b>	<b>Gross profit</b>
<b>Expenses (income)</b>					
Selling and marketing	5,414	(14)	2,439	7,839	Selling, general and administrative
General and administrative	2,439		(2,439)	—	N/A
Research and development	2,675	(1)		2,674	Research and development
Interest income	(493)		50	(443)	Interest income
<b>Earnings before under-noted items</b>	<b>13,656</b>	<b>15</b>	<b>(50)</b>	<b>13,621</b>	<b>Earnings before under-noted items</b>
Amortization of pharmaceutical product licenses and rights	6,071			6,071	Amortization of pharmaceutical product licenses and rights
Net (gain) loss on investments	—		(50)	(50)	Other finance expense (income)
Foreign exchange loss	(119)		32	(87)	Foreign exchange (gain) loss
Other income	(41)			(41)	Other income
Share of net income in companies subject to significant influence	(335)			(335)	Share of net income of an associate
<b>Income before income tax</b>	<b>8,080</b>	<b>15</b>	<b>(32)</b>	<b>8,063</b>	<b>Income before income tax</b>
Provision for income taxes	3,395	(163)	(32)	3,200	Provision for income taxes
<b>Net income for the period</b>	<b>4,685</b>	<b>178</b>	<b>—</b>	<b>4,863</b>	<b>Net income for the period</b>
Change in fair value of available- for-sale financial instruments	(6)			(6)	Change in fair value of available-for-sale financial instruments
Reclassification adjustments for gains on available-for-sale financial instruments included in net income	(52)			(52)	Reclassification adjustments for gains on available-for-sale financial instruments included in net income
<b>Other comprehensive income for the period</b>	<b>(58)</b>	<b>—</b>	<b>—</b>	<b>(58)</b>	<b>Other comprehensive income for the period</b>
<b>Total comprehensive income for the period</b>	<b>4,627</b>	<b>178</b>	<b>—</b>	<b>4,805</b>	<b>Total comprehensive income for the period</b>
Basic earnings per share	0.25	0.01	—	0.26	Basic earnings per share
Diluted earnings per share	0.24	0.01	—	0.25	Diluted earnings per share

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

#### Reconciliation of Consolidated Income Statement and Consolidated Statement of Comprehensive Income for the six months ended June 30, 2010

Canadian GAAP accounts	Canadian GAAP balance	Adjustments	Reclassifications	IFRS Balance	IFRS accounts
Revenues	63,773			63,773	Revenues
Cost of sales	18,025			18,025	Cost of sales
<b>Gross profit</b>	<b>45,748</b>	<b>—</b>	<b>—</b>	<b>45,748</b>	<b>Gross profit</b>
<b>Expenses (income)</b>					
Selling and marketing	11,202	(12)	4,726	15,916	Selling, general and administrative
General and administrative	4,726		(4,726)	—	N/A
Research and development	5,412	5		5,417	Research and development
Interest income	(794)		68	(726)	Interest income
<b>Earnings before under-noted items</b>	<b>25,202</b>	<b>7</b>	<b>(68)</b>	<b>25,141</b>	<b>Earnings before under-noted items</b>
Amortization of pharmaceutical product licenses and rights	12,341			12,341	Amortization of pharmaceutical product licenses and rights
Net (gain) loss on investments	(7)		(68)	(75)	Other finance expense (income)
Foreign exchange loss	201		6	207	Foreign exchange (gain) loss
Other income	(41)			(41)	Other income
Share of net income in companies subject to significant influence	(466)			(466)	Share of net income of an associate
<b>Income before income tax</b>	<b>13,174</b>	<b>7</b>	<b>(6)</b>	<b>13,175</b>	<b>Income before income tax</b>
Provision for income taxes	5,444	(268)	(6)	5,170	Provision for income taxes
<b>Net income for the period</b>	<b>7,730</b>	<b>275</b>	<b>—</b>	<b>8,005</b>	<b>Net income for the period</b>
Change in fair value of available- for-sale financial instruments	7			7	Change in fair value of available-for-sale financial instruments
Reclassification adjustments for gains on available-for-sale financial instruments included in net income	(62)			(62)	Reclassification adjustments for gains on available-for-sale financial instruments included in net income
<b>Other comprehensive income for the period</b>	<b>(55)</b>	<b>—</b>	<b>—</b>	<b>(55)</b>	<b>Other comprehensive income for the period</b>
<b>Total comprehensive income for the period</b>	<b>7,675</b>	<b>275</b>	<b>—</b>	<b>7,950</b>	<b>Total comprehensive income for the period</b>
Basic earnings per share	0.41	0.02	—	0.43	Basic earnings per share
Diluted earnings per share	0.40	0.02	—	0.42	Diluted earnings per share

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

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

### Reconciliation of Consolidated Statement of Cash Flows the Six Months ended June 30, 2010

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

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