

PATHEON INC  
Form 10-Q  
September 13, 2012  
Table of Contents

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q

---

**S** QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended July 31, 2012

OR

**£** TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-54283

---

PATHEON INC.

(Exact name of registrant as specified in its charter)

---

Canada

(State or other jurisdiction of  
incorporation or organization)

Not Applicable  
(I.R.S. Employer  
Identification No.)

c/o Patheon Pharmaceuticals Services Inc.

4721 Emperor Boulevard, Suite 200

Durham, NC

(Address of principal executive offices)

919-226-3200

(Registrant's telephone number, including area code)

27703

(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of September 11, 2012, the registrant had 129,167,926 restricted voting shares outstanding.



Table of Contents

Patheon Inc.

TABLE OF CONTENTS

PART I - Financial Information	
Item 1. <u>Financial Statements</u>	
<u>Unaudited Consolidated Balance Sheets as of July 31, 2012 and October 31, 2011</u>	<u>1</u>
<u>Unaudited Consolidated Statements of Operations for the Three and Nine Months Ended July 31, 2012 and 2011</u>	<u>2</u>
<u>Unaudited Consolidated Statement of Changes in Shareholders' Equity for the Nine Months Ended July 31, 2012</u>	<u>3</u>
<u>Unaudited Consolidated Statements of Cash Flows for the Nine Months Ended July 31, 2012 and 2011</u>	<u>4</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>5</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>18</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>31</u>
Item 4. <u>Controls and Procedures</u>	<u>31</u>
PART II - <u>Other Information</u>	<u>32</u>
Item 1. <u>Legal Proceedings</u>	<u>32</u>
Item 1A. <u>Risk Factors</u>	<u>32</u>
Item 6. <u>Exhibits</u>	<u>32</u>
<u>Signatures</u>	<u>33</u>
<u>Exhibit Index</u>	<u>34</u>

Table of Contents

## Item 1. Financial Statements

Patheon Inc.  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

	As of July 31, 2012	As of October 31, 2011
(in millions of U.S. dollars)	\$	\$
Assets		
Current		
Cash and cash equivalents	35.4	33.4
Accounts receivable	138.1	158.0
Inventories	90.3	81.8
Income taxes receivable	1.9	3.1
Prepaid expenses and other	16.3	10.7
Deferred tax assets - short-term	13.3	8.1
Total current assets	295.3	295.1
Capital assets	399.2	474.2
Deferred financing costs	5.1	6.2
Deferred tax assets	36.0	39.1
Goodwill	3.4	3.5
Investments	5.8	5.3
Long-term assets held for sale	—	0.2
Other long-term assets	10.0	1.0
Total assets	754.8	824.6
Liabilities and shareholders' equity		
Current		
Short-term borrowings	6.6	6.1
Accounts payable and accrued liabilities	175.3	181.5
Income taxes payable	3.3	—
Deferred revenues - short-term	8.7	8.8
Current portion of long-term debt	—	1.1
Total current liabilities	193.9	197.5
Long-term debt	310.4	280.1
Deferred revenues	34.6	27.7
Deferred tax liabilities	30.4	27.9
Other long-term liabilities	41.1	53.7
Total liabilities	610.4	586.9
Shareholders' equity		
Restricted voting shares	572.0	571.9
Contributed surplus	16.0	13.5
Deficit	(455.4	) (371.9
Accumulated other comprehensive income	11.8	24.2
Total shareholders' equity	144.4	237.7
Total liabilities and shareholders' equity	754.8	824.6
see accompanying notes		



Table of Contents

Patheon Inc.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended July 31,		Nine months ended July 31,	
	2012	2011	2012	2011
(in millions of U.S. dollars, except per share information)	\$	\$	\$	\$
Revenues	203.7	172.7	539.1	518.4
Cost of goods sold	148.2	146.9	435.2	420.1
Gross profit	55.5	25.8	103.9	98.3
Selling, general and administrative expenses	29.9	31.7	99.0	84.3
Repositioning expenses	0.1	1.9	6.9	3.4
Impairment charge	—	—	57.9	—
(Gain) loss on sale of capital assets	—	(0.1)	) —	) 0.1
Operating income (loss)	25.5	(7.7)	) (59.9)	) 10.5
Interest expense, net	6.8	6.3	19.8	19.0
Foreign exchange loss (gain), net	0.4	(3.6)	) 0.6	) 3.2
Other income, net	(0.5)	) (6.3)	) (0.6)	) (5.8)
Income (loss) from continuing operations before income taxes	18.8	(4.1)	) (79.7)	) (5.9)
Provision for (benefit from) income taxes	3.3	(4.7)	) 3.6	) 0.1
Income (loss) before discontinued operations	15.5	0.6	(83.3)	) (6.0)
Loss from discontinued operations	—	(0.2)	) (0.2)	) (0.5)
Net income (loss) attributable to restricted voting shareholders	15.5	0.4	(83.5)	) (6.5)
Basic income (loss) per share				
From continuing operations	\$0.120	\$0.005	(\$0.645)	) (\$0.046)
From discontinued operations	—	(\$0.002)	) (\$0.002)	) (\$0.004)
Net income (loss) per share, basic	\$0.120	\$0.003	(\$0.647)	) (\$0.050)
Diluted income (loss) per share				
From continuing operations	\$0.120	\$0.005	(\$0.645)	) (\$0.046)
From discontinued operations	—	(\$0.002)	) (\$0.002)	) (\$0.004)
Net income (loss) per share, diluted	\$0.120	\$0.003	(\$0.647)	) (\$0.050)
Average number of shares outstanding (in thousands)				
Basic	129,168	129,168	129,168	129,168
Diluted	129,200	129,168	129,168	129,168
see accompanying notes				

Table of Contents

Patheon Inc.

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(unaudited)

(in millions of U.S. dollars)	Restricted Voting Shares	Contributed Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at October 31, 2011	\$571.9	\$13.5	\$ (371.9 )	\$ 24.2	\$ 237.7
Stock-based compensation	—	2.5	—	—	2.5
Comprehensive income (loss):	—	—	—	—	—
Net loss attributable to restricted voting shareholders	—	—	(83.5 )	—	(83.5 )
Foreign currency translation adjustments	0.1	—	—	—	0.1
Change in foreign currency gains on investments in subsidiaries, net of hedging activities	—	—	—	(20.5 )	(20.5 )
Change in value of derivatives designated as foreign currency cash flow hedges	—	—	—	1.2	1.2
Losses on foreign currency hedges reclassified to consolidated statement of operations	—	—	—	0.6	0.6
Amortization of pension related costs, net of tax	—	—	—	0.3	0.3
Curtailed impact and plan asset remeasurement, net of tax	—	—	—	6.0	6.0
Subtotal	0.1	2.5	(83.5 )	(12.4 )	(93.3 )
Balance at July 31, 2012 see accompanying notes	\$572.0	\$16.0	\$ (455.4 )	\$ 11.8	\$ 144.4

Table of Contents

Patheon Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine months ended July	
	31,	
	2012	2011
(in millions of U.S. dollars)	\$	\$
Operating activities		
Loss before discontinued operations	(83.3	) (6.0
Adjustments to reconcile net loss to net cash provided by operating activities		)
Depreciation and amortization	30.8	41.0
Impairment charge	57.9	—
Non-cash interest	0.9	0.8
Change in other long-term assets and liabilities	(1.7	) (5.3
Deferred income taxes	(0.3	) 5.9
Amortization of deferred revenues	(7.6	) (42.6
Loss on sale of capital assets	—	0.1
Stock-based compensation expense	2.5	2.6
Other	(0.8	) (0.3
	(1.6	) (3.8
Net change in non-cash working capital balances related to continuing operations	(9.9	) (11.2
Increase in deferred revenues	18.7	27.2
Cash provided by operating activities of continuing operations	7.2	12.2
Cash used in operating activities of discontinued operations	(0.4	) (0.5
Cash provided by operating activities	6.8	11.7
Investing activities		
Additions to capital assets	(32.9	) (31.2
Proceeds on sale of capital assets	0.1	0.3
Cash used in investing activities of continuing operations	(32.8	) (30.9
Cash provided by investing activities of discontinued operations	0.1	—
Cash used in investing activities	(32.7	) (30.9
Financing activities		
Increase in short-term borrowings	0.9	1.3
Increase in long-term debt	35.5	6.0
Repayment of long-term debt	(6.1	) (7.4
Cash provided by (used in) financing activities	30.3	(0.1
Effect of exchange rate changes on cash and cash equivalents	(2.4	) 5.3
Net increase (decrease) in cash and cash equivalents during the period	2.0	(14.0
Cash and cash equivalents, beginning of period	33.4	53.5
Cash and cash equivalents, end of period	35.4	39.5
see accompanying notes		



Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

1. Accounting policies

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared by Patheon Inc. (the “Company” or “Patheon”) in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). Operating results for the three and nine months ended July 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending October 31, 2012 (“fiscal 2012”). These consolidated financial statements do not include all the information and footnotes required by U.S. GAAP for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and notes for the fiscal year ended October 31, 2011 (“fiscal 2011”) contained in the Company’s Annual Report on Form 10-K for the year so ended. The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect: the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amounts of revenue and expenses in the reporting period. Management believes that the estimates and assumptions used in preparing its consolidated financial statements are reasonable and prudent, however, actual results could differ from those estimates.

Changes in accounting policy

The Company historically prepared its consolidated financial statements in conformity with accounting principles generally accepted in Canada and provided a supplemental reconciliation to U.S. GAAP. Effective November 1, 2011, the Company adopted U.S. GAAP as the reporting standard for its consolidated financial statements. These unaudited consolidated interim financial statements, including related notes, have therefore been prepared in accordance with U.S. GAAP. All comparative financial information contained herein has been recast to reflect the Company’s results as if the Company had historically reported in accordance with U.S. GAAP. These unaudited interim financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the interim periods presented.

Effective February 1, 2012, the Company adopted ASU 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” This ASU modifies the existing standards to include disclosure of all transfers between Level 1 and Level 2 asset and liability fair value categories. In addition, the ASU provides guidance on measuring the fair value of financial instruments managed within a portfolio and the application of premiums and discounts on fair value measurements. The ASU requires additional disclosure for Level 3 measurements regarding the sensitivity of fair value to changes in unobservable inputs and any interrelationships between those inputs. The adoption of this guidance had no material impact to the Company’s financial statements.

Recently issued accounting pronouncements

In April 2012, the Jumpstart Our Business Startups Act (the “JOBS Act”) was enacted. Section 107 of the JOBS Act provides that an “emerging growth company” can utilize the extended transition period that is typically available only for private companies for implementing new or revised accounting standards. In other words, as an “emerging growth company,” the Company can delay the adoption of certain new or revised accounting standards until such time as those standards apply to private companies. The Company has elected not to avail itself of this exemption and, therefore, will be implementing new or revised accounting standards at the same time as other public companies that are not “emerging growth companies.”

In June 2011, the Financial Accounting Standards Board (“FASB”) issued ASU 2011-05, “Comprehensive Income (Topic 220): Presentation of Comprehensive Income in U.S. GAAP” (“ASU 2011-05”). ASU 2011-05 requires that comprehensive income and the related components of net income and of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 also requires reclassification adjustments from other comprehensive income to net income be presented on

the face of the financial statements. The amendments are effective for annual reporting periods beginning on or after December 15, 2011, and interim periods within those annual periods. However, in December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05" to defer the requirement to present reclassification adjustments from other comprehensive income on the face of the financial statements and allow entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the requirements in effect before ASU 2011-05. Other than a change in presentation, the Company does not expect the adoption of this guidance will have a material impact on the Company's consolidated financial statements.

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

In December 2011, the FASB issued ASU 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities," which requires enhanced disclosures about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. The amendments are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The amendments should be applied retrospectively for all prior periods presented. The Company does not expect adoption of this guidance will have a material impact on its consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment," which amends U.S. GAAP ASC 350, "Intangible Assets-Goodwill and Other." Under this new ASU, an entity may elect the option to assess qualitative factors to determine whether it is necessary to perform the first step in the two-step impairment testing process. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect adoption of this guidance will have a material impact on its consolidated financial statements.

## 2. Discontinued operations, plant consolidations and asset impairments

### Puerto Rico

The Company announced on December 10, 2009 its plan to consolidate its Puerto Rico operations into its manufacturing site located in Manati and ultimately close or sell its plant in Caguas. As a result of additional time required to transition manufacturing operations from Caguas to Manati due to longer than expected customer regulatory time lines and increased product demand, an offer received in the fiscal year ended October 31, 2010 ("fiscal 2010") to purchase the facility was rescinded. The transition will continue beyond the end of calendar year 2012, and the Company now estimates the total project repositioning expenses to be \$13.2 million, of which an additional \$0.1 million and \$1.5 million was recorded in the three and nine months ended July 31, 2012, respectively. The consolidation also results in additional accelerated depreciation of Caguas assets of approximately \$12.0 million over the life of the project. Because the business in the Caguas facility is being transferred within the existing site network, its results of operations are included in continuing operations.

The results of discontinued operations for the Company's Carolina facility (which the Company closed effective January 31, 2009) for the three and nine months ended July 31, 2012 and 2011 are as follows:

	Three months ended July 31,		Nine months ended July 31,	
	2012	2011	2012	2011
	\$	\$	\$	\$
Revenues	—	—	—	—
Cost of goods sold	—	—	—	—
Gross loss	—	—	—	—
Selling, general and administrative expenses	—	0.2	0.3	0.5
Gain on sale of capital assets	—	—	(0.1	) —
Operating loss	—	(0.2	) (0.2	) (0.5
Loss before income taxes	—	(0.2	) (0.2	) (0.5
Net loss for the period	—	(0.2	) (0.2	) (0.5

On February 17, 2012, the Company finalized the sale of our Carolina, Puerto Rico facility for a nominal amount.

### United Kingdom

The Company determined to make certain adjustments over the next 24 to 36 months to the scale and scope of business conducted at its Swindon, U.K., facility. These adjustments include winding down or transferring

non-cephalosporin commercial production to other facilities and, to the extent possible and commercially appropriate, directing pharmaceutical development services (“PDS”) projects that require commercialization activities to other facilities. The Company will work with each of its affected commercial customers to develop plans to maintain supply chain continuity to the extent possible and commercially appropriate.

As a result of the above, the Company conducted an impairment analysis on long-term assets at the Company's Swindon, U.K. facility, during the second quarter of fiscal 2012, and concluded that a non-cash impairment charge of \$57.9 million was

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

required to bring the assets down to the fair value of \$9.5 million. The impairment charges reduce assets in the commercial manufacturing outsourcing services (“CMO”) segment by \$55.1 million and PDS assets by \$2.8 million. The impairment analysis included fair value (Level 3) measurements resulting from future cash flows from operations, as well as market value approach of land and buildings, internal transfer of assets, and expected salvage value on equipment. Cash inflows were based on current customer expectations and future contract expiry dates. Cash outflows were based on expenses needed to run the facility in each period including on-going maintenance and capital expenditures. It was also determined that, in light of certain restrictive covenants that require use as a business industrial site, the best use of the asset is to continue using it in the pharmaceutical business. The corporate weighted average cost of capital was used for discounting future cash flows.

### 3. Supplemental balance sheet information

#### Inventories

Inventories consisted of the following as of July 31, 2012 and October 31, 2011:

	July 31, 2012	October 31, 2011
	\$	\$
Raw materials, packaging components and spare parts	52.0	53.0
Work-in-process	38.3	28.8
	90.3	81.8

#### Accounts payable and accrued liabilities

The following is the breakdown of accounts payable and accrued liabilities:

	July 31, 2012	October 31, 2011
	\$	\$
Trade payables	89.7	102.2
Interest payable	7.0	1.0
Accrued salaries and related expenses	46.2	44.0
Customer deposits	16.9	17.9
Other accruals	15.5	16.4
	175.3	181.5

### 4. Preferred shares and restricted voting shares

The following table summarizes information regarding the Company’s outstanding preferred shares, restricted voting shares and restricted voting share stock options as of July 31, 2012:

	Outstanding	Exercisable
Class I preferred shares series D	150,000	N/A
Restricted voting shares	129,167,926	N/A
Restricted voting share stock options	13,028,718	3,876,783

### 5. Segmented information

The Company is organized and managed in two business segments: CMO and PDS. These segments are organized around the service activities provided to the Company’s customers.



Edgar Filing: PATHEON INC - Form 10-Q

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	Three months ended July 31, 2012			
	Commercial	PDS	Corp. & Other	Total
	\$	\$	\$	\$
Revenues	168.3	35.4	—	203.7
Adjusted EBITDA	36.2	7.9	(9.5	) 34.6
Depreciation and amortization	7.9	1.2	0.2	9.3
Capital expenditures	14.7	0.5	0.1	15.3

	Three months ended July 31, 2011			
	Commercial	PDS	Corp. & Other	Total
	\$	\$	\$	\$
Revenues	138.7	34.0	—	172.7
Adjusted EBITDA	11.5	7.7	(8.9	) 10.3
Depreciation and amortization	10.9	1.4	0.3	12.6
Capital expenditures	8.3	1.7	0.2	10.2

	As of and for the nine months ended July 31, 2012			
	Commercial	PDS	Corp. & Other	Total
	\$	\$	\$	\$
Revenues	438.1	101.0	—	539.1
Adjusted EBITDA	48.8	16.9	(30.5	) 35.2
Total assets	587.9	68.0	98.9	754.8
Depreciation and amortization	26.3	3.8	0.7	30.8
Goodwill	3.4	—	—	3.4
Impairment charge	55.1	2.8	—	57.9
Capital expenditures	29.4	2.5	1.0	32.9

	As of and for the nine months ended July 31, 2011			
	Commercial	PDS	Corp. & Other	Total
	\$	\$	\$	\$
Revenues	425.8	92.6	—	518.4
Adjusted EBITDA	64.1	16.1	(28.3	) 51.9
Total assets	671.1	75.9	78.4	825.4
Depreciation and amortization	36.0	4.2	0.8	41.0
Goodwill	3.6	—	—	3.6
Capital expenditures	25.4	5.3	0.5	31.2

Cash and cash equivalents as well as deferred tax assets are considered to be part of “Corp. & Other” in the breakout of total assets shown above. The Company evaluates the performance of its segments based on segment Adjusted EBITDA, which is defined as income (loss) before discontinued operations before repositioning expenses, interest expense, foreign exchange losses reclassified from other comprehensive loss, refinancing expenses, gains and losses on sale of capital assets, gain on extinguishment of debt, income taxes, asset impairment charges, depreciation and amortization and other income and expenses. Readers are cautioned that Adjusted EBITDA should not be construed as

an alternative to income (loss) before discontinued operations determined in accordance with U.S. GAAP as an indicator of performance. Adjusted EBITDA is used by management as an internal measure of profitability. The Company has also included Adjusted EBITDA because it believes that this measure is used by certain investors to assess the Company's financial performance before non-cash charges and certain costs that it does not believe are reflective of its underlying business. The Company's presentation of Adjusted EBITDA may not be comparable to similar measures presented by other issuers.

Below is a reconciliation of Adjusted EBITDA to its closest U.S. GAAP measure.

8

---



Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	Three months ended July 31,	
	2012	2011
	\$	\$
Total Adjusted EBITDA	34.6	10.3
Depreciation and amortization	(9.3	) (12.6
Repositioning expenses	(0.1	) (1.9
Interest expense, net	(6.8	) (6.3
Gain on sale of capital assets	—	0.1
(Provision for) benefit from income taxes	(3.3	) 4.7
Other	0.4	6.3
Income before discontinued operations	15.5	0.6
	Nine months ended July 31,	
	2012	2011
	\$	\$
Total Adjusted EBITDA	35.2	51.9
Depreciation and amortization	(30.8	) (41.0
Repositioning expenses	(6.9	) (3.4
Interest expense, net	(19.8	) (19.0
Impairment charge	(57.9	) —
Loss on sale of capital assets	—	(0.1
Provision for income taxes	(3.6	) (0.1
Other	0.5	5.7
Loss before discontinued operations	(83.3	) (6.0

In the table below, revenues are attributed to countries based on the location of the customer's billing address, capital assets are attributed to the country in which they are located and goodwill is attributed to the country in which the entity to which the goodwill pertains is organized:

	Three months ended July 31, 2012				
	Canada	US*	Europe	Other	Total
	\$	\$	\$	\$	\$
Revenues	4.3	109.4	79.8	10.2	203.7

\* Includes Puerto Rico

	Three months ended July 31, 2011				
	Canada	US*	Europe	Other	Total
	\$	\$	\$	\$	\$
Revenues	3.6	88.9	69.6	10.6	172.7

\* Includes Puerto Rico

	As of and for the nine months ended July 31, 2012				
	Canada	US*	Europe**	Other	Total
	\$	\$	\$	\$	\$
Revenues	9.1	310.8	191.5	27.7	539.1
Capital assets	112.5	144.5	140.7	1.5	399.2
Goodwill	3.4	—	—	—	3.4

\* Includes Puerto Rico

\*\* European assets in current year reflect the impairment of Swindon assets.

9

---

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	As of and for the nine months ended July 31, 2011				Total
	Canada	US*	Europe	Other	
	\$	\$	\$	\$	\$
Revenues	8.9	246.2	237.2	26.1	518.4
Capital assets	118.8	132.9	229.1	1.6	482.4
Goodwill	3.6	—	—	—	3.6

\* Includes Puerto Rico

#### 6. Stock-based compensation

The Company has an incentive stock option plan in which directors, officers and key employees of the Company and its subsidiaries, as well as other persons engaged to provide ongoing management or consulting services to Patheon, are eligible to participate. On March 10, 2011, the Company's shareholders approved an amendment to the stock option plan, which, among other things, provides that the maximum number of shares that may be issued under the plan is 15,500,151, which currently represents 12% of the issued and outstanding restricted voting shares. As of July 31, 2012 and 2011, the total number of restricted voting shares issuable under the plan was 15,500,151 shares, respectively, of which there were stock options outstanding to purchase 13,028,718 shares and 12,725,924 shares, respectively, under the plan. Before the March 2011 amendments, the plan provided that the exercise prices of options were determined at the time of grant and could not be less than the weighted-average market price of the restricted voting shares of Patheon on the Toronto Stock Exchange (the "TSX") during the two trading days immediately preceding the grant date. Following the March 2011 amendments, the exercise prices of the options may not be less than the closing price of the restricted voting shares on the TSX (or on such other stock exchange in Canada or the United States on which restricted voting shares may be then listed and posted) on the date of the grant. Options generally expire in no more than 10 years after the grant date and are subject to early expiry in the event of death, resignation, dismissal or retirement of an optionee. Options generally have vesting periods of either three years or five years, with either one-third or one-fifth vesting on each anniversary of the grant date, respectively.

On June 18, 2012 the Company granted 1,291,750 options to its executive committee members with a vesting based upon the parameters that all granted options will have cliff performance vesting which will vest at the earlier of the achievement of an adjusted EBITDA target or five years after date of grant.

For the purposes of calculating the stock-based compensation expense in connection with the Company's incentive stock option plan, the fair value of stock options is estimated at the date of the grant using the Black-Scholes option pricing model and the cost is amortized over the vesting period.

Stock-based compensation expense recorded in the three and nine months ended July 31, 2012 was \$0.7 million and \$2.5 million, respectively. Stock-based compensation expense recorded in the three and nine months ended July 31, 2011 was \$1.3 million and \$2.6 million, respectively.

A summary of the plan activity during the nine months ended July 31, 2012 is as follows:

(Dollar amounts in Canadian dollars)	July 31, 2012			
	Shares Number	Weighted-Average Exercise Price	Weighted Average Contractual Term	Aggregate Intrinsic Value
		\$		\$
Outstanding as of October 31, 2011	12,628,458	2.88		
Granted	2,793,502	2.01		
Exercised	—	—		
Forfeited	(2,344,942 )	3.55		26,600
Expired	(48,300 )	12.27		

Edgar Filing: PATHEON INC - Form 10-Q

Outstanding as of July 31, 2012	13,028,718	2.53	8.0	2,117,071
Exercisable as of July 31, 2012	3,876,783	2.94	6.2	48,024

The total fair value of shares that vested during the three months ended July 31, 2012 and 2011 was \$2.4 million and \$1.7 million, respectively. As of July 31, 2012, the total unrecognized compensation cost related to the nonvested stock options was \$6.3 million, which is expected to be recognized through fiscal 2017, with a weighted average remaining vesting period of 2.53 years.

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

## 7. Pension and post-retirement benefits

## Employee future benefits

The components of net periodic benefit cost for the defined benefit plans and other benefit plans for the nine months ended July 31, 2012 and 2011 were as follows:

	Nine months ended July 31,		2011	
	2012	2011	2011	2010
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
	\$	\$	\$	\$
Service cost	1.7	—	2.7	—
Interest cost	3.8	0.3	3.9	0.3
Expected return on plan assets	(4.0	) —	(3.6	) —
Amortization of actuarial loss	0.8	—	0.6	—
Net periodic benefit costs	2.3	0.3	3.6	0.3

Based on current information available from actuarial estimates, the Company anticipates that contributions required under its defined benefit pension plans and other benefit plans for fiscal 2012 will be approximately \$6.4 million compared to contributions of \$11.8 million that were made in fiscal 2011. Included in the fiscal 2011 contributions is a voluntary catch-up contribution of \$4.9 million for the benefit plans in the United Kingdom, which was made during the third quarter of fiscal 2011. Required contributions to defined benefit pension plans in future years will be dependent upon a number of variables, including the long-term rate of return on plan assets. The amounts that the Company will be required to contribute to such plans in the future may vary.

Not included in the defined benefit and other benefit plans estimates above are the unfunded termination indemnities related to the employees of the Company's Italian subsidiary. In accordance with Italian severance pay statutes, an employee benefit is accrued for service to date and is payable when the employee's employment with the Company ceases. The termination indemnity liability is calculated in accordance with local civil and labor laws based on each employee's length of service, employment category and remuneration. The termination liability is adjusted annually by a cost-of-living index provided by the Italian government. Although there is no vesting period, the Italian government has established private accounts for these benefits and has required the Company to contribute \$3.2 million and \$3.4 million in fiscal 2012 and 2011, respectively, to these accounts, with additional contributions in the future. The liability recorded in the consolidated balance sheets is the amount to which the employees would be entitled if their employment with the Company ceased. The related expenses for the nine months ended July 31, 2012 and 2011 was \$2.3 million and \$2.2 million, respectively.

The employee future benefit expense in connection with defined benefit pension plans, other post retirement benefit plans and the unfunded termination indemnities for the nine months ended July 31, 2012 and 2011 was \$4.9 million and \$6.1 million, respectively.

The Company amended its U.K. Pension Plan to freeze the accrual of additional benefits related to future service and allow the employees to enter into a defined contribution plan effective February 1, 2012. All current and future U.K. employees will be eligible to participate in the defined contribution plan. Any pension benefits accrued in the U.K. Pension Plan will be retained in that plan until retirement unless the plan participant chooses to transfer the benefits to another arrangement. The curtailment impact reduced the projected benefit obligation by \$7.9 million. This resulting gain was applied against the accumulated unrecognized net actuarial losses in other comprehensive (loss) income.

8. Repositioning expense

On May 9, 2012, the Company announced a plan of termination (the “Plan of Termination”) that is expected to result in a workforce reduction of approximately 91 employees across the Company's global PDS and CMO segments. In the U.K., the statutory consultation process with the works council in Swindon has now been completed and the Company expects to complete the Plan of Termination across all affected sites by the end of fiscal 2012. In connection with the Plan of Termination, the Company recorded approximately \$5.4 million of estimated expenses associated with employee termination benefits during

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

the second quarter of fiscal 2012. The Company anticipates that it may further adjust the size of the workforce at the Swindon facility as it continues its transformation process, with a total of approximately 400 jobs at risk of redundancy.

During the three and nine months ended July 31, 2012, the Company incurred \$0.1 million and \$6.9 million, respectively, in repositioning expenses, which related to the Plan of Termination and the shutdown of the Caguas facility. During the three and nine months ended July 31, 2011, the Company incurred \$1.9 million and \$3.4 million, respectively, in repositioning expenses, all of which related to the shutdown of the Caguas facility.

The following is a summary of these expenses and other charges associated with operational improvements (collectively "repositioning expenses") as of and for the three and nine months ended July 31, 2012 and 2011:

	As of and for the three months ended July 31, 2012			
	Commercial	PDS	Corporate	Total
	\$	\$	\$	\$
Total repositioning liabilities at April 30, 2012				9.2
Employee-related expenses	0.1	—	—	0.1
Consulting, professional and project management costs	—	—	—	—
Total expenses	0.1	—	—	0.1
Repositioning expenses paid				(0.9 )
Foreign exchange				(0.4 )
Total repositioning liabilities at July 31, 2012				8.0
	As of and for the three months ended July 31, 2011			
	Commercial	PDS	Corporate	Total
	\$	\$	\$	\$
Total repositioning liabilities at April 30, 2011				2.9
Employee-related expenses	1.1	—	—	1.1
Consulting, professional and project management costs	0.8	—	—	0.8
Total expenses	1.9	—	—	1.9
Repositioning expenses paid				(1.0 )
Total repositioning liabilities at July 31, 2011				3.8
	As of and for the nine months ended July 31, 2012			
	Commercial	PDS	Corporate	Total
	\$	\$	\$	\$
Total repositioning liabilities at October 31, 2011				6.7
Employee-related expenses	4.4	1.3	—	5.7
Consulting, professional and project management costs	1.2	—	—	1.2
Total expenses	5.6	1.3	—	6.9
Repositioning expenses paid				(5.6 )
Total repositioning liabilities at July 31, 2012				8.0

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	As of and for the nine months ended July 31, 2011			
	Commercial	PDS	Corporate	Total
	\$	\$	\$	\$
Total repositioning liabilities at October 31, 2010				3.2
Employee-related expenses	1.2	—	—	1.2
Consulting, professional and project management costs	2.2	—	—	2.2
Total expenses	3.4	—	—	3.4
Repositioning expenses paid				(2.8 )
Total repositioning liabilities at July 31, 2011				3.8

## 9. Other information

## Foreign exchange

During the three and nine months ended July 31, 2012, the Company recorded foreign exchange losses of \$0.4 million and \$0.6 million, respectively. The losses during the three and nine months ended July 31, 2012 were primarily from hedge losses, partially offset by operating gains. During the three months ended July 31, 2011, the Company recorded foreign exchange gains of \$3.6 million, from operating and hedge gains. During the nine months ended July 31, 2011, the Company recorded foreign exchange losses of \$3.2 million, primarily from operating exposures, partially offset by hedge gains.

## Contingencies

In the fourth quarter of fiscal 2011, a customer gave notice of its intent to seek indemnification against the Company pursuant to a manufacturing service agreement (“MSA”) for all costs associated with a recall of an allegedly defective product. The Company recorded an expense of \$1.7 million, net of expected insurance proceeds, to cover recall costs and costs to replace returned products. During the first quarter of fiscal 2012, the customer gave further notice of its intent to seek indemnification pursuant to the MSA for all actual and potential third-party claims that have been or may be filed against it in connection with the recall and the alleged product defects, as well as all costs and expenses of the defense and settlement of such claims. During the second quarter of fiscal 2012, the Company accrued an additional \$2.4 million, for additional returned products from the customer. To date, three putative class actions and four single plaintiff actions have been commenced in the United States against the customer in connection with the allegedly defective products, and the Company has also been named in one of the putative class actions. As these cases are at an early stage, the Company is unable to estimate the number of potential claimants or the amount of potential damages for which the Company may be directly or indirectly liable in the above actions.

## 10. Financial instruments and risk management

The Company has determined the estimated fair values of its derivative financial instruments using a replacement cost model, with inputs based on observed market rates; however, considerable judgment is required to develop these estimates. The fair values of the Company’s financial instruments are not materially different from their carrying values.

As of July 31, 2012 and October 31, 2011, the carrying amount of the financial assets that the Company has pledged as collateral for its long-term debt facilities was \$110.7 million and \$106.7 million, respectively.

## Fair value measurements

The fair value under ASC 820, “Fair Value Measurement,” is principally applied to financial assets and liabilities such as derivative instruments consisting of embedded call options and foreign exchange contracts. The following table provides a summary of the financial assets and liabilities that are measured at fair values as of July 31, 2012 and



October 31, 2011:

13

---

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

## Assets measured at fair value

	Fair Value measurement at July 31, 2012 using:				Fair Value measurement at October 31, 2011 using:			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Derivatives designated as hedging instruments:								
Foreign exchange forward contracts	—	2.0	—	2.0	—	1.2	—	1.2
Total assets	—	2.0	—	2.0	—	1.2	—	1.2

## Liabilities measured at fair value

	Fair Value measurement at July 31, 2012 using:				Fair Value measurement at October 31, 2011 using:			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Derivatives designated as hedging instruments:								
Foreign exchange collars	—	0.8	—	0.8	—	1.7	—	1.7
Total liabilities	—	0.8	—	0.8	—	1.7	—	1.7

Level 1 - Based on quoted market prices in active markets.

Level 2 - Inputs, other than quoted prices in active markets, that are observable, either directly or indirectly.

Level 3 - Unobservable inputs that are not corroborated by market data.

The following table presents the fair value of the Company's derivative financial instruments and their classifications on the consolidated balance sheets as of July 31, 2012 and October 31, 2011:

## Fair values of derivative instruments

	Asset derivatives as of July 31, 2012		Asset derivatives as of October 31, 2011	
	Balance sheet location	Fair Value \$	Balance sheet location	Fair Value \$
Derivatives designated as hedging instruments:				
Foreign exchange forward contracts	Prepaid expenses and other	1.5	Prepaid expenses and other	0.2
Foreign exchange forward contracts	Other long-term assets	0.5	Other long-term assets	1.0
Total designated derivatives		2.0		1.2
	Liability derivatives as of July 31, 2012		Liability derivatives as of October 31, 2011	
	Balance sheet location	Fair Value \$	Balance sheet location	Fair Value \$
Derivatives designated as hedging instruments:				
Foreign exchange forward contracts	Accounts payable and accrued liabilities	—	Accounts payable and accrued liabilities	1.4
	Accounts payable and accrued liabilities	0.7	Accounts payable and accrued liabilities	—

Foreign exchange collars				
Foreign exchange collars	Other long-term liabilities	0.1	Other long-term liabilities	0.3
Total designated derivatives		0.8		1.7

Foreign exchange forward contracts and other hedging arrangements

The Company utilizes financial instruments to manage the risk associated with fluctuations in foreign exchange rates.

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The hedges are valued using a replacement cost model, with inputs based on observed market rates.

As of July 31, 2012, the Company's Canadian operations had entered into foreign exchange forward contracts to sell an aggregate amount of US\$69.4 million. These contracts hedge the Canadian operations' expected exposure to U.S. dollar denominated receivables and mature at the latest on April 2, 2014, at an average exchange rate of \$1.0373 Canadian. The mark-to-market value of these financial instruments as of July 31, 2012 was an unrealized gain of \$1.8 million, which has been recorded in accumulated other comprehensive income in shareholders' equity, net of associated income tax.

As of July 31, 2012, the Company's Canadian operations had entered into foreign exchange forward contracts to sell an aggregate amount of €2.0 million. These contracts hedge the Canadian operations' expected exposure to Euro denominated receivables and mature at the latest on October 5, 2012, at an average exchange rate of \$1.3400 Canadian. The mark-to-market value of these financial instruments as of July 31, 2012 was an unrealized gain of less than \$0.2 million, which has been recorded in accumulated other comprehensive income in shareholders' equity, net of associated income tax.

As of July 31, 2012, the Company's Canadian operations had entered into foreign exchange collars to sell an aggregate amount of US\$58.9 million. These contracts hedge the Canadian operations' expected exposure to U.S. dollar denominated receivables and mature at the latest on December 31, 2013, at an average exchange rate of \$0.9849 Canadian. The mark-to-market value of these financial instruments as of July 31, 2012 was an unrealized loss of \$0.8 million, which has been recorded in accumulated other comprehensive income in shareholders' equity, net of associated income tax.

Risks arising from financial instruments and risk management

The Company's activities expose it to a variety of financial risks: market (including foreign exchange and interest rate) risk, credit risk and liquidity risk. The Company's overall financial risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures. The Company does not purchase any derivative financial instruments for speculative purposes.

Financial risk management is the responsibility of the Company's corporate finance team. The corporate finance team works with the Company's operational personnel to identify, evaluate and, where appropriate, hedge financial risks. The Company's corporate finance team also monitors material risks and discusses them with the audit committee of the board of directors.

Foreign exchange risk

The Company operates in Canada, the United States, Puerto Rico, Italy, France, the United Kingdom and Japan. Foreign exchange risk arises because the value of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rates ("transaction exposures") and because the non-U.S. dollar denominated financial statements of the Company may vary on consolidation into the reporting currency of U.S. dollars ("translation exposures").

The Company's most significant transaction exposures arise in its Canadian operations. Approximately 90% of the revenues of the Canadian operations and approximately 10% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience transaction exposures because of volatility in the exchange rate between the Canadian and U.S. dollar. Based on the Company's current U.S. denominated net inflows, as of July 31, 2012, fluctuations of +/-10% would, everything else being equal, have an annual effect on (loss) income from continuing operations before income taxes of approximately +/- \$17.1 million, prior to hedging activities.

The objective of the Company's foreign exchange risk management activities is to minimize transaction exposures and the resulting volatility of the Company's earnings. The Company manages this risk by entering into foreign exchange contracts. As of July 31, 2012, the Company has entered into foreign exchange contracts to cover approximately 80%

of its Canadian-U.S. dollar cash flow exposures for fiscal 2012. The Company does not currently hedge any translation exposures.

Translation gains and losses related to certain foreign currency denominated intercompany loans are included as part of the net investment in certain foreign subsidiaries, and are included in accumulated other comprehensive income in shareholders' equity.

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

Credit risk

Credit risk arises from cash and cash equivalents held with banks and financial institutions, derivative financial instruments (foreign exchange contracts with positive fair values), and credit exposure to customers, including outstanding accounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets.

The objective of managing counterparty credit risk is to prevent losses in financial assets. The Company regularly assesses the credit quality of the counterparties, taking into account their financial position, past experience and other factors. Management also regularly monitors the utilization of credit limits. In cases where the credit quality of a customer does not meet the Company's requirements, a cash deposit is received before any services are provided. As of July 31, 2012 and October 31, 2011, the Company held deposits of \$16.9 million and \$17.9 million, respectively.

Liquidity risk

Liquidity risk arises when financial obligations exceed financial assets available at a particular point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at all times. The Company mitigates liquidity risk by maintaining cash and cash equivalents on-hand and through the availability of funding from credit facilities. As of July 31, 2012, the Company was holding cash and cash equivalents of \$35.4 million and had undrawn lines of credit available to it of \$63.0 million.

11. Related party transactions

Revenues for contract manufacturing from a company controlled by Joaquin B. Viso (the "Viso Affiliate"), a director and significant shareholder of the Company, were \$0.2 million and \$0.3 million for the three and nine months ended July 31, 2012, respectively, and were less than \$0.1 million for each of the three and nine months ended July 31, 2011. These transactions were conducted in the normal course of business and are recorded at the exchanged amounts. Accounts receivable at July 31, 2012 and October 31, 2011 were \$0.1 million and nil, respectively, resulting from these transactions. In addition, Patheon manufactures a product for a third party for which the product's intellectual property is owned by the Viso Affiliate. The manufacturing agreement was originally contracted between the third party and the Viso Affiliate, but has been administered directly between Patheon and the third party on normal commercial terms since 2003.

As of July 31, 2012 and October 31, 2011, the Company had an investment of \$2.9 million and \$3.3 million, respectively, representing an 18% interest in two Italian companies (collectively referred to as "BSP Pharmaceuticals") whose largest investor was previously an officer of the Company until December 31, 2009. These companies specialize in the manufacture of cytotoxic pharmaceutical products. As a result of the shareholders' agreement with the other investors in BSP Pharmaceuticals that provides the Company with significant influence over BSP Pharmaceuticals' operations, the Company accounts for its investment in BSP Pharmaceuticals using the equity method. Accordingly, for the nine months ended July 31, 2012 and 2011, the Company recorded investment income of approximately \$0.4 million and losses of less than \$0.1 million, respectively.

In connection with its investment in BSP Pharmaceuticals, the Company has a management services agreement with BSP Pharmaceuticals that provides on-going sales and marketing services, and provided engineering and operational services during the construction of the BSP facility which was completed in 2008. There were no management fees recorded under this agreement for the three and nine months ended July 31, 2012 and 2011, respectively. Accounts receivable at October 31, 2011 include a balance of \$1.2 million in connection with the management services agreement, with no balance at July 31, 2012, respectively. These services were conducted in the normal course of business and are recorded at the exchanged amounts.

In connection with certain of BSP Pharmaceuticals' bank financing, the Company had made commitments that it would not dispose of its interest in BSP Pharmaceuticals prior to January 1, 2011, and if needed, irrevocably inject

equity (pro-rata) in order to ensure BSP complies with certain specific bank covenants.

12. Income taxes

The Company accounts for income taxes under FASB ASC 740, Income Taxes (“ASC 740”). The Company calculates its quarterly tax provision consistent with the guidance provided by ASC 740-270, whereby the Company forecasts its estimated annual effective tax rate then applies that rate to its year-to-date pre-tax book (loss) income. The effective tax rate may be subject to fluctuations during the year as new information is obtained, which may affect the assumptions used to estimate the annual effective rate, including factors such as the valuation allowances against deferred tax assets, the recognition or de-recognition of tax benefits related to uncertain tax positions, or changes in or the interpretation of tax laws in jurisdictions where the Company conducts business. There is no tax benefit recognized on certain of the net operating losses incurred in

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

foreign jurisdictions due to insufficient evidence supporting the Company's ability to use these losses in the future. For the nine months ended July 31, 2012 and 2011, the Company recorded a tax expense of \$3.6 million and \$0.1 million, respectively.

There were no material changes in uncertain tax positions for the nine months ended July 31, 2012 and 2011. The Company does not reasonably expect any change to the amount of uncertain tax positions within the next 12 months.

## 13. Comprehensive income (loss)

	Three months ended July 31,		Nine months ended July 31,	
	2012	2011	2012	2011
	\$	\$	\$	\$
Net income (loss) attributable to restricted voting shareholders	15.5	0.4	(83.5 )	(6.5 )
Other comprehensive (losses) income, net of income taxes				
Change in foreign currency (losses) gains on investments in subsidiaries, net of hedging activities	(13.6 )	(11.8 )	(20.5 )	24.7
Change in value of derivatives designated as foreign currency cash flow hedges	(0.7 )	0.2	1.2	4.2
Gains (losses) on foreign currency cash flow hedges reclassified to consolidated statement of loss	0.5	(1.1 )	0.6	(2.5 )
Amortization of pension related costs, net of tax	—	—	0.3	—
Curtailed impact and plan asset remeasurement, net of tax	—	—	6.0	—
Other comprehensive (loss) income for the period	(13.8 )	(12.7 )	(12.4 )	26.4
Comprehensive income (loss) attributable to restricted voting shareholders	1.7	(12.3 )	(95.9 )	19.9

## 14. Basic and diluted income (loss) per share

Shares used in basic earnings per share are computed using the weighted average number of common shares outstanding during each period. Shares used in diluted earnings per share include the dilutive effect of unvested restricted voting share stock options under the incentive stock option plan using the treasury stock method. For the three months ended July 31, 2012, 32,302 weighted average restricted voting shares options had a grant price that was less than the average market price. The computation of net income per share did not include 12,996,416 and 12,725,924 outstanding options in the three months ended July 31, 2012 and 2011, respectively, because such options were anti-dilutive in nature. The computation of net loss per share did not include 13,028,718 and 12,725,924 outstanding options in the nine months ended July 31, 2012 and 2011, respectively, because such options were anti-dilutive in nature.

The components of basic and diluted earnings per share for the three and nine months ended July 31, 2012 and 2011 are as follows:

	Three months ended July 31,		Nine months ended July 31,	
	2012	2011	2012	2011
Numerator:				
Income (loss) from continuing operations	\$ 15.5	\$ 0.6	\$(83.3 )	\$(6.0 )
Income (loss) from discontinued operations	—	(0.2 )	(0.2 )	(0.5 )
Net income (loss)	\$ 15.5	\$ 0.4	\$(83.5 )	\$(6.5 )
Denominator: (in thousands of shares)				
Average number of shares outstanding - Basic	129,168	129,168	129,168	129,168



Edgar Filing: PATHEON INC - Form 10-Q

Dilutive effect of restricted voting shares options 32	—	—	—
Average number of shares outstanding - Diluted 129,200	129,168	129,168	129,168

17

---

Table Of Contents

Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2012  
(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

15. Subsequent events

On August 13, 2012 the Company announced that Mark J. Kontny, Ph.D., President, Global Pharmaceutical Development Services and Chief Scientific Officer was no longer with the Company. In connection with Mr. Kontny's employment agreement, the Company expects to incur a severance charge of approximately \$0.4 million in the fourth quarter of fiscal 2012.

On September 5, 2012, the Company announced that it sold its global secondary clinical packaging and clinical distribution services business to Bellwyck Packaging Solutions, a private company with 20 years experience providing clinical trial and contract services for secondary packaging.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is designed to provide a better understanding of our consolidated financial statements, including a brief discussion of our business, key factors that impact our performance and a summary of our operating results. You should read the following discussion and analysis of financial condition and results of operations together with our unaudited consolidated financial statements and the related notes beginning on page 1 of this quarterly report on Form 10-Q and our audited financial statements and related notes beginning on page F-1 of our annual report on Form 10-K filed December 19, 2011 (our "2011 Form 10-K"). We historically prepared our consolidated financial statements and management's discussion and analysis of financial condition and results of operations ("MD&A") in conformity with accounting principles generally accepted in Canada and provided a supplemental reconciliation to accounting principles generally accepted in the United States ("U.S. GAAP"). Effective November 1, 2011, we adopted U.S. GAAP as the reporting standard for our consolidated financial statements and MD&A. In addition to historical information, the following discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results could differ materially from those anticipated by the forward-looking statements due to important factors including, but not limited to, those set forth under "Item 1A. Risk Factors" of our 2011 Form 10-K. See "Forward Looking Statements."

Executive Overview

We are a leading provider of commercial manufacturing outsourcing services ("CMO") and outsourced pharmaceutical development services ("PDS") to the global pharmaceutical industry, offering a wide range of services from developing drug candidates at the pre-formulation stage through the launch, commercialization and production of approved drugs. We have established our position as a market leader by leveraging our scale, global reach, specialized capabilities, broad service offerings, scientific expertise and track record of product quality and regulatory compliance to provide cost-effective solutions to our customers.

We have two reportable segments, CMO and PDS. Our CMO business manufactures prescription products in sterile dosage forms as well as solid and liquid conventional dosage forms, and we differentiate ourselves by offering specialized manufacturing capabilities relating to high potency, controlled substance and sustained release products. Our PDS business provides a broad range of development services, including early development services, finished dosage formulation of sterile and solid dosage forms, clinical trial packaging, clinical trial material manufacturing and associated analytical services. Additionally, our PDS business serves as a pipeline for future commercial manufacturing opportunities.

Recent Business Highlights

The following is a summary of certain key financial results and non-financial events that occurred during and subsequent to the three and nine months ended July 31, 2012:

Edgar Filing: PATHEON INC - Form 10-Q

Revenues for the three months ended July 31, 2012 increased \$31.0 million, or 18.0%, to \$203.7 million, from \$172.7 million for the three months ended July 31, 2011.

Gross profit for the three months ended July 31, 2012 increased \$29.7 million, or 115.1%, to \$55.5 million from \$25.8 million for the third quarter of fiscal 2011.

Income before discontinued operations for the three months ended July 31, 2012 was \$15.5 million, compared to \$0.6 million for the same period of the prior year.

Adjusted EBITDA for the three months ended July 31, 2012 increased \$24.3 million to \$34.6 million, from \$10.3

million for the three months ended July 31, 2011.

On September 5, 2012, we announced that we sold our global secondary clinical packaging and clinical distribution services business to Bellwyck Packaging Solutions, a private company with 20 years experience providing clinical trial and contract services for secondary packaging.

On August 13, 2012, we announced that Mark J. Kontny, Ph.D., President, Global Pharmaceutical Development Services and Chief Scientific Officer was no longer with the Company. In connection with Mr. Kontny's employment agreement, we expect to incur a severance charge of approximately \$0.4 million in the fourth quarter of fiscal 2012. We recorded a \$57.9 million impairment charge for the impairment of long-term assets at our Swindon, U.K. facility during the second quarter of fiscal 2012. The impairment charge will not result in any current or future cash expenditures.

On May 9, 2012, we announced a plan of termination (the "Plan of Termination") that is expected to result in a workforce reduction of approximately 91 employees across our global PDS and CMO segments. In the U.K., we have begun the consultative process with the works councils representing the employees at the Swindon and Milton Park facilities. Subject to these consultations, we expect to complete the Plan of Termination across all affected sites by the end of fiscal 2012. In connection with the Plan of Termination, we recorded approximately \$5.4 million of estimated expenses associated with employee termination benefits during the second quarter of fiscal 2012. We anticipate that we may further adjust the size of the workforce at the Swindon facility as we continue our transformation process, with a total of approximately 400 jobs at risk of redundancy.

On February 15, 2012, we appointed Stuart Grant as our Executive Vice President, Chief Financial Officer.

On February 13, 2012, Ramsey Frank resigned as Chairman of the Board and a director of our company. The Board appointed Paul S. Levy, Managing Director, JLL Partners Inc. ("JLL Partners"), as our new Chairman and appointed Nicholas O'Leary, Senior Associate, JLL Partners, to our Board of Directors, filling the vacant seat left by the departure of Mr. Frank. The Board also appointed Michel Lagarde, an existing member of the Board, as Chair of our Corporate Governance Committee and Daniel Agroskin, Managing Director at JLL Partners, and also an existing member of the Board, to our Corporate Governance Committee, filling the positions vacated by Mr. Frank.

On January 19, 2012, we and PROCAPS S.A. announced an agreement to provide a line of prescription pharmaceutical soft-gel product development and manufacturing services. The capabilities we gain via this new offering include large scale commercial supply of prescription soft gel capsules for the North American, European and Asian markets.

On December 15, 2011, our Board appointed Michel Lagarde, Principal, JLL Partners as a director of our company. Mr. Lagarde replaced Thomas S. Taylor, Managing Director, JLL Partners, who left our Board effective December 15, 2011. Mr. Lagarde replaced Mr. Taylor as the Chairman of our Compensation and Human Resources Committee ("CHR Committee") and is a member of our Audit and Corporate Governance Committees.

On November 1, 2011, Eric W. Evans, our then Chief Financial Officer, resigned. In connection with Mr. Evans's employment agreement, we incurred a severance charge of approximately \$0.4 million in the three months ended January 31, 2012.

#### Opportunities and Trends

Our target markets include the highly fragmented global market for the manufacture of finished pharmaceutical dosage forms and for PDS. According to PharmSource, a provider of pharmaceutical outsourcing business information, the CMO market totaled \$11.7 billion in 2010, and could experience marginal growth of roughly 1% (in conservative scenarios) to as much as 3% - 5% annually during 2011 to 2015. PharmSource also estimates that the outsourced PDS market totaled approximately \$1.3 billion in 2010, with growth projections in the 2011 to 2015 period approaching 3% annually. We are one of only a few industry participants that can provide a broad range of CMO and PDS services.

Pharmaceutical outsourcing service providers have faced challenges in recent years due to the uncertain economic environment. In the research and development area, emerging pharmaceutical companies have faced funding uncertainties due to limited access to capital, and many larger companies have decreased or delayed product development spending due to uncertainties surrounding industry consolidation, overall market weakness and the regulatory approval environment. As a result, decision-making related to the awarding of new outsourcing projects has slowed during recent years for similar reasons.



### Puerto Rico Operations

We closed our Carolina facility in Puerto Rico effective January 31, 2009. We completed the sale of this property on February 17, 2012 for a nominal amount. The results of the Carolina operations have been reported in discontinued operations in the nine months ended July 31, 2012 and the three and nine months ended July 31, 2011.

In December 2009, we announced our plan to consolidate our Puerto Rico operations into our manufacturing site located in Manati and ultimately close or sell our plant in Caguas. As a result of additional time required to transition manufacturing operations from Caguas to Manati due to longer than expected customer regulatory time lines and increased product demand, an offer received during fiscal 2010 to purchase the facility was rescinded. The transition will continue beyond the end of calendar year 2012, and we now estimate the total project repositioning expenses to be \$13.2 million, of which \$12.3 million has been incurred as of July 31, 2012. The consolidation also results in accelerated depreciation of Caguas assets of approximately \$12.0 million over the life of the project. Because the business in the Caguas facility is being transferred within the existing site network, its results of operations are included in continuing operations.

### Results of Operations

The results of the Carolina operations have been segregated and reported as discontinued operations for the three months ended July 31, 2011.

### Three Months Ended July 31, 2012 Compared to Three Months Ended July 31, 2011

(in millions of U.S. dollars)	Three months ended July 31,			
	2012	2011	\$	%
	\$	\$	Change	Change
Revenues	203.7	172.7	31.0	18.0
Cost of goods sold	148.2	146.9	1.3	0.9
Gross profit	55.5	25.8	29.7	115.1
Selling, general and administrative expenses	29.9	31.7	(1.8)	(5.7)
Repositioning expenses	0.1	1.9	(1.8)	(94.7)
Gain on sale of capital assets	—	(0.1)	(0.1)	(100.0)
Operating income (loss)	25.5	(7.7)	33.2	—
Interest expense, net	6.8	6.3	0.5	7.9
Foreign exchange loss (gain), net	0.4	(3.6)	(4.0)	(111.1)
Other income, net	(0.5)	(6.3)	(5.8)	(92.1)
Income (loss) from continuing operations before income taxes	18.8	(4.1)	22.9	558.5
Provision for (benefit from) income taxes	3.3	(4.7)	(8.0)	(170.2)
Income before discontinued operations	15.5	0.6	14.9	—
Loss from discontinued operations	—	(0.2)	0.2	—
Net income attributable to restricted voting shareholders	15.5	0.4	15.1	—
Basic and diluted income (loss) per share				
From continuing operations	\$0.120	\$0.005		
From discontinued operations	—	\$(0.002)		
	\$0.120	\$0.003		
Weighted-average number of shares outstanding during period—basic (in thousands)	129,168	129,168		
Weighted-average number of shares outstanding during period—diluted (in thousands)	129,200	129,168		

### Operating (Loss) Income Summary

Edgar Filing: PATHEON INC - Form 10-Q

Revenues for the three months ended July 31, 2012 increased \$31.0 million, or 18.0%, to \$203.7 million, from \$172.7 million for the three months ended July 31, 2011. Excluding currency fluctuations, revenues for the three months ended July 31, 2012 would have been approximately 24.1% higher than the same period of the prior year. CMO revenues for the three months ended July 31, 2012 increased \$29.6 million, or 21.3%, to \$168.3 million, from \$138.7 million for the three months

ended July 31, 2011. The increase was primarily due to stronger results from our North American and Italian operations. PDS revenues for the three months ended July 31, 2012 increased \$1.4 million, or 4.1%, to \$35.4 million, from \$34.0 million for the three months ended July 31, 2011 primarily due to stronger results in our Cincinnati and Toronto operations, partially offset by weakness across other sites.

Gross profit for the three months ended July 31, 2012 increased \$29.7 million, or 115.1%, to \$55.5 million, from \$25.8 million for the three months ended July 31, 2011. Increase in gross profit was primarily due to higher volume and an increase in gross profit margin to 27.2% for the three months ended July 31, 2012 from 15.8% for the three months ended July 31, 2011. The increase in gross profit margin was driven by savings from our operational excellence initiatives, favorable material mix and lower depreciation as a result of our asset impairments in Swindon and Caguas of \$2.8 million, partially offset by higher inventory write-off of \$2.0 million. Foreign exchange rates had a negative impact of \$1.6 million on gross profit in the three months ended July 31, 2012 versus the same period in the prior year.

Selling, general and administrative expenses for the three months ended July 31, 2012 decreased \$1.8 million, or 5.7%, to \$29.9 million, from \$31.7 million for the three months ended July 31, 2011. The decrease was primarily due to lower consulting fees related to our strategic and operational review and transformation of \$1.5 million, and lower compensation expense of \$0.5 million. Foreign exchange rates had a favorable impact of \$1.2 million on selling, general and administrative expenses in the three months ended July 31, 2012 versus the same period in the prior year. Repositioning expenses for the three months ended July 31, 2012 decreased \$1.8 million, or 94.7%, to \$0.1 million, from \$1.9 million for the same period of the prior year. The decrease was primarily due to lower expenses in connection with the Caguas closure and consolidation.

Operating income (loss) for the three months ended July 31, 2012 increased \$33.2 million to income of \$25.5 million (12.6% of revenues), from a loss of \$7.7 million (-4.5% of revenues) for the three months ended July 31, 2011 as a result of the factors discussed above.

#### Foreign Exchange Losses (Gains)

Foreign exchange loss for the three months ended July 31, 2012 was \$0.4 million, compared to a gain of \$3.6 million for the same period of the prior year. The foreign exchange loss for the three months ended July 31, 2012 was primarily due to hedge losses, partially offset by operating exposures. The foreign exchange gain for the three months ended July 31, 2011 was from operating and hedge gains. The hedging contracts resulted in losses of less than \$0.5 million for the three months ended July 31, 2012 compared to gains of \$1.7 million for the three months ended July 31, 2011.

#### Income (loss) from Continuing Operations Before Income Taxes

We reported income from continuing operations before income taxes of \$18.8 million for the three months ended July 31, 2012, compared to a loss of \$4.1 million for the three months ended July 31, 2011. The operating items discussed above were the primary drivers of the year over year variance.

#### Income Taxes

Income taxes were an expense of \$3.3 million for the three months ended July 31, 2012, compared to a benefit of \$4.7 million for the three months ended July 31, 2011. The increase in tax expense was primarily driven by the mix of income and loss from our operating units and pre-tax losses in some entities for which no tax benefits were recognized.

#### Income before Discontinued Operations and Income Per Share from Continuing Operations

We recorded income before discontinued operations for the three months ended July 31, 2012 of \$15.5 million, compared to \$0.6 million for the three months ended July 31, 2011. The basic and diluted income per share from continuing operations for the three months ended July 31, 2012 was 12.0¢ compared to 0.5¢ for the three months ended July 31, 2011.

#### Loss and Loss Per Share from Discontinued Operations

Discontinued operations for the three months ended July 31, 2012 and 2011 include the results of the Carolina, Puerto Rico operations. Financial details of the operating activities of the Carolina operations are disclosed in "Note 2—Discontinued operation, plant consolidations and asset impairments." There was no loss from discontinued operations for the three months ended July 31, 2012. The loss from discontinued operations for the three months ended July 31, 2011 was \$0.2 million, or 0.2¢ per share. These costs relate to the final wind down of the Carolina facility.



Net Income Attributable to Restricted Voting Shareholders and Income Per Share

21

---

Net income attributable to restricted voting shares for the three months ended July 31, 2012 was \$15.5 million, or 12.0¢ per share for both basic and diluted, compared to \$0.4 million, or 0.3¢ per share, for the three months ended July 31, 2011.

The computation of net income per share did not include 12,996,416 and 12,725,924 outstanding options in the three months ended July 31, 2012 and 2011, respectively, because such options were anti-dilutive in nature.

#### Revenues and Adjusted EBITDA by Business Segment

The following discussion provides information regarding our business segments. References in this MD&A to “Adjusted EBITDA” are to income (loss) before discontinued operations before repositioning expenses, interest expense, foreign exchange losses reclassified from other comprehensive (loss) income, refinancing expenses, gains and losses on sale of capital assets, gain on extinguishment of debt, income taxes, asset impairment charges, depreciation and amortization and other income and expenses. “Adjusted EBITDA margin” is Adjusted EBITDA as a percentage of revenues.

Since Adjusted EBITDA is a non-GAAP measure that does not have a standardized meaning, it may not be comparable to similar measures presented by other issuers. Readers are cautioned that Adjusted EBITDA should not be construed as an alternative to income (loss) before discontinued operations determined in accordance with accounting principles generally accepted in the United States as an indicator of performance. Adjusted EBITDA is used by management as an internal measure of profitability. We have included Adjusted EBITDA because we believe that this measure is used by certain investors to assess our financial performance before non-cash charges and certain costs that we do not believe are reflective of our underlying business.

A reconciliation of Adjusted EBITDA to income (loss) before discontinued operations is set forth below:

	Three months ended July 31,		Nine months ended July 31,	
	2012	2011	2012	2011
(in millions of U.S. dollars)	\$	\$	\$	\$
Adjusted EBITDA	34.6	10.3	35.2	51.9
Depreciation and amortization	(9.3	) (12.6	) (30.8	) (41.0
Repositioning expenses	(0.1	) (1.9	) (6.9	) (3.4
Interest expense, net	(6.8	) (6.3	) (19.8	) (19.0
Impairment charge	—	—	(57.9	) —
Gain (loss) on sale of capital assets	—	0.1	—	(0.1
(Provision for) benefit from income taxes	(3.3	) 4.7	(3.6	) (0.1
Other	0.4	6.3	0.5	5.7
Income (loss) before discontinued operations	15.5	0.6	(83.3	) (6.0

The following provides certain information regarding our business segments for the three months ended July 31, 2012 and 2011:

Edgar Filing: PATHEON INC - Form 10-Q

(in millions of U.S. dollars)	Three months ended July 31,		\$	%
	2012	2011		
	\$	\$	Change	Change
Revenues				
Commercial Manufacturing				
North America	94.4	72.9	21.5	29.5
Europe	73.9	65.8	8.1	12.3
Total Commercial Manufacturing	168.3	138.7	29.6	21.3
Pharmaceutical Development Services	35.4	34.0	1.4	4.1
Total Revenues	203.7	172.7	31.0	18.0
Adjusted EBITDA				
Commercial Manufacturing				
North America	19.3	9.3	10.0	107.5
Europe	16.9	2.2	14.7	668.2
Total Commercial Manufacturing	36.2	11.5	24.7	214.8
Pharmaceutical Development Services	7.9	7.7	0.2	2.6
Corporate Costs	(9.5)	(8.9)	0.6	6.7
Total Adjusted EBITDA	34.6	10.3	24.3	235.9

Commercial Manufacturing

Total CMO revenues for the three months ended July 31, 2012 increased \$29.6 million, or 21.3%, to \$168.3 million, from \$138.7 million for the three months ended July 31, 2011. Had local currency exchange rates remained constant to the rates of the three months ended July 31, 2011, CMO revenues for the three months ended July 31, 2012 would have been approximately 28.4% higher than the same period of the prior year.

North American CMO revenues for the three months ended July 31, 2012 increased \$21.5 million, or 29.5%, to \$94.4 million, from \$72.9 million for the three months ended July 31, 2011. The increase was due to an increase in customer demand across all North American sites.

European CMO revenues for the three months ended July 31, 2012 increased \$8.1 million, or 12.3%, to \$73.9 million, from \$65.8 million for the three months ended July 31, 2011. Had European currency exchange rates remained constant to the rates of the three months ended July 31, 2011, European CMO revenues for the three months ended July 31, 2012 would have been approximately 26.9% higher than the same period of the prior year. The increase was primarily due to increases in our Italian operations, partially offset by weakness in Bourgoin and Swindon.

Total CMO Adjusted EBITDA for the three months ended July 31, 2012 increased \$24.7 million, or 214.8%, to \$36.2 million, from \$11.5 million for the three months ended July 31, 2011. This represents an Adjusted EBITDA margin of 21.5% for the three months ended July 31, 2012 compared to 8.3% for the three months ended July 31, 2011. Had local currency exchange rates and foreign exchange gains and losses remained constant to those of the three months ended July 31, 2011, CMO Adjusted EBITDA for the three months ended July 31, 2012 would have been approximately \$4.3 million higher. The increase was driven by higher volumes, improved margins driven by our operational excellence initiatives and favorable material mix, and lower consulting and compensation costs of \$2.7 million, partially offset by higher foreign exchange losses of \$2.8 million, and an increase in inventory write-offs of \$1.8 million.

North American Adjusted EBITDA for the three months ended July 31, 2012 increased \$10.0 million, to \$19.3 million, from \$9.3 million for the three months ended July 31, 2011. The increase was primarily driven by higher volumes, favorable material mix and margins as a result of our operational excellence initiatives and lower consulting fees of \$1.8 million, partially offset by reduction of foreign exchange gains of \$2.9 million. North American CMO recorded \$0.1 million in estimated repositioning expenses relating to the Puerto Rican operations in the three months ended July 31, 2012 that were not included in Adjusted EBITDA.

European Adjusted EBITDA for the three months ended July 31, 2012 increased \$14.7 million, to \$16.9 million, from \$2.2 million for the three months ended July 31, 2011. The increase was primarily driven by higher volumes,

favorable material mix and margins as a result of our operational excellence initiatives and lower compensation, consulting and other administrative costs of \$2.3 million, partially offset by an increase in inventory write-offs of \$1.4 million.

Pharmaceutical Development Services

23

---

Total PDS revenues for the three months ended July 31, 2012 increased by \$1.4 million, or 4.1%, to \$35.4 million, from \$34.0 million for the three months ended January 31, 2011. Had the local currency rates remained constant to the three months ended July 31, 2011, PDS revenues for the three months ended July 31, 2012 would have been 6.5% higher than the same period of the prior year. Higher development activities from new contracts across most sites contributed to the improved performance.

Total PDS Adjusted EBITDA for the three months ended July 31, 2012 increased by \$0.2 million, or 2.6%, to \$7.9 million, from \$7.7 million for the three months ended July 31, 2011. Had local currency exchange rates and foreign exchange gains and losses remained constant to those of the three months ended July 31, 2011, PDS Adjusted EBITDA for the three months ended July 31, 2012 would have been approximately \$0.2 million higher than reported. Included in the current quarter was \$0.7 million in consulting costs relating to our strategic initiatives.

#### Corporate Costs

Corporate costs for the three months ended July 31, 2012 increased \$0.6 million, or 6.7%, to \$9.5 million, from \$8.9 million for the three months ended July 31, 2011, primarily due to \$0.7 million in reduced foreign exchange gains versus the prior year.

#### Nine Months Ended July 31, 2012 Compared to Nine Months Ended July 31, 2011

(in millions of U.S. dollars)	Nine months ended July 31,			
	2012	2011	\$	%
	\$	\$	Change	Change
Revenues	539.1	518.4	20.7	4.0
Cost of goods sold	435.2	420.1	15.1	3.6
Gross profit	103.9	98.3	5.6	5.7
Selling, general and administrative expenses	99.0	84.3	14.7	17.4
Repositioning expenses	6.9	3.4	3.5	102.9
Impairment charge	57.9	—	57.9	—
Loss on sale of capital assets	—	0.1	(0.1)	(100.0)
Operating (loss) income	(59.9)	) 10.5	(70.4)	(670.5)
Interest expense, net	19.8	19.0	0.8	4.2
Foreign exchange loss, net	0.6	3.2	(2.6)	(81.3)
Other income, net	(0.6)	) (5.8)	(5.2)	(89.7)
Loss from continuing operations before income taxes	(79.7)	) (5.9)	(73.8)	—
Provision for income taxes	3.6	0.1	3.5	—
Loss before discontinued operations	(83.3)	) (6.0)	(77.3)	—
Loss from discontinued operations	(0.2)	) (0.5)	(0.3)	(60.0)
Net loss attributable to restricted voting shareholders	(83.5)	) (6.5)	(77.0)	—
Basic and diluted loss per share				
From continuing operations	(0.645)	) (0.046)	)	
From discontinued operations	(0.002)	) (0.004)	)	
	(0.647)	) (0.050)	)	
Weighted-average number of shares outstanding during period—basic and diluted (in thousands)	129,168	129,168		

#### Operating Income Summary

Revenues for the nine months ended July 31, 2012 increased \$20.7 million, or 4.0%, to \$539.1 million, from \$518.4 million for the nine months ended July 31, 2011. Excluding currency fluctuations, revenues for the nine months ended July 31, 2012 would have been approximately 7.1% higher than the same period of the prior year. CMO revenues for the nine months ended July 31, 2012 increased \$12.3 million, or 2.9%, to \$438.1 million, from \$425.8 million for the nine months ended July 31, 2011. The increase was primarily due to stronger results from our North American and Italian operations, partially offset by the \$50.3 million impact from the reservation fee and accelerated deferred

revenue recorded in the first nine months of fiscal 2011. PDS revenues for the nine months ended July 31, 2012 increased \$8.4 million, or 9.1%, to \$101.0 million, from

\$92.6 million for the nine months ended July 31, 2011, primarily driven by stronger results in our Cincinnati, Toronto and Swindon operations.

Gross profit for the nine months ended July 31, 2012 increased \$5.6 million, or 5.7%, to \$103.9 million, from \$98.3 million for the nine months ended July 31, 2011. The increase in gross profit was primarily due to higher volumes and margin improvement from 18.9% in fiscal 2011 to 19.3% in fiscal 2012 resulting from our transformation initiatives and decrease in depreciation expenses of \$8.3 million, which more than offset the unfavorable mix associated with replacing the reservation fee and deferred revenues with ongoing production at lower margins. Gross profit in the nine month period would have increased by \$55.9 million, or 116.5%, excluding the benefit from the prior year reservation fee and accelerated deferred revenue.

Selling, general and administrative expenses for the nine months ended July 31, 2012 increased \$14.7 million, or 17.4%, to \$99.0 million, from \$84.3 million for the nine months ended July 31, 2011. The increase was primarily due to \$9.7 million of higher consulting fees related to our strategic and operational review and transformation, \$3.8 million of higher compensation expense and \$1.0 million of higher travel and entertainment expenses. Foreign exchange had a favorable impact of \$2.1 million on selling, general and administrative expenses versus the prior year. Repositioning expenses for the nine months ended July 31, 2012 increased \$3.5 million, or 102.9%, to \$6.9 million, from \$3.4 million for the same period of the prior year. The increase was primarily due to the Plan of Termination which required us to record approximately \$5.4 million of estimated expenses associated with employee termination benefits during the second quarter of fiscal 2012, partially offset by higher accruals in the nine months ended July 31, 2011 related to the Caguas transition.

Impairment charges for the nine months ended July 31, 2012 were \$57.9 million relating to the winding down or transferring PDS and non-cephalosporin commercial production from our Swindon, U.K. facility to other facilities. Operating (loss) income for the nine months ended July 31, 2012 decreased \$70.4 million, to a loss of \$59.9 million (-11.2% of revenues), from income of \$10.5 million (2.1% of revenues) for the nine months ended July 31, 2011 as a result of the factors discussed above.

#### Foreign Exchange Losses

Foreign exchange loss for the nine months ended July 31, 2012 was \$0.6 million, compared to \$3.2 million for the same period of the prior year. The foreign exchange loss for the nine months ended July 31, 2012 was primarily due to hedging losses, partially offset by operating exposures. The foreign exchange loss for the nine months ended July 31, 2011 was primarily due to operating exposures, partially offset by hedging gains. The hedging contracts resulted in losses of \$0.8 million for the nine months ended July 31, 2012 compared to gains of \$3.6 million for the nine months ended July 31, 2011.

#### Loss from Continuing Operations Before Income Taxes

We reported a loss from continuing operations before income taxes of \$79.7 million for the nine months ended July 31, 2012, compared to a loss of \$5.9 million for the nine months ended July 31, 2011. The operating items discussed above were the primary drivers of the year over year variance.

#### Income Taxes

Income taxes were an expense of \$3.6 million for the nine months ended July 31, 2012, compared to an expense of \$0.1 million for the nine months ended July 31, 2011. The increase in tax expense was primarily driven by lower income, the mix of income and loss from our operating units and pre-tax losses in some entities for which no tax benefits were recognized.

#### Loss before Discontinued Operations and Loss Per Share from Continuing Operations

We recorded a loss before discontinued operations for the nine months ended July 31, 2012 of \$83.3 million, compared to \$6.0 million for the nine months ended July 31, 2011. The loss per share from continuing operations for the nine months ended July 31, 2012 was 64.5¢ compared to 4.6¢ for the nine months ended July 31, 2011.

#### Loss and Loss Per Share from Discontinued Operations

Discontinued operations for the nine months ended July 31, 2012 and 2011 include the results of the Carolina, Puerto Rico operations. Financial details of the operating activities of the Carolina operations are disclosed in "Note 2—Discontinued operations, plant consolidations and asset impairments." The loss from discontinued operations for the nine months ended July 31, 2012 was \$0.2 million, or 0.2¢ per share, compared to a loss of \$0.5 million, or 0.4¢ per share, for the nine months ended July 31, 2011. These costs relate to the final wind down of the Carolina facility.





## Net Loss, Loss Attributable to Restricted Voting Shareholders and Loss Per Share

Net loss attributable to restricted voting shares for the nine months ended July 31, 2012 was \$83.5 million, or 64.7¢ per share, compared to \$6.5 million, or 5.0¢ per share, for the nine months ended July 31, 2011.

The computation of net loss per share did not include 13,028,718 and 12,725,924 outstanding options in the nine months ended July 31, 2012 and 2011, respectively, because such options were anti-dilutive in nature.

## Revenues and Adjusted EBITDA by Business Segment

The following provides certain information regarding our business segments for the nine months ended July 31, 2012 and 2011:

(in millions of U.S. dollars)	Nine months ended July 31,		\$ Change	% Change
	2012	2011		
Revenues				
Commercial Manufacturing				
North America	249.1	197.8	51.3	25.9
Europe	189.0	228.0	(39.0)	(17.1)
Total Commercial Manufacturing	438.1	425.8	12.3	2.9
Pharmaceutical Development Services	101.0	92.6	8.4	9.1
Total Revenues	539.1	518.4	20.7	4.0
Adjusted EBITDA				
Commercial Manufacturing				
North America	34.1	11.0	23.1	210.0
Europe	14.7	53.1	(38.4)	(72.3)
Total Commercial Manufacturing	48.8	64.1	(15.3)	(23.9)
Pharmaceutical Development Services	16.9	16.1	0.8	5.0
Corporate Costs	(30.5)	(28.3)	2.2	7.8
Total Adjusted EBITDA	35.2	51.9	(16.7)	(32.2)

Total CMO revenues for the nine months ended July 31, 2012 increased \$12.3 million, or 2.9%, to \$438.1 million, from \$425.8 million for the nine months ended July 31, 2011, primarily due to stronger results from our North American and Italian operations, offset by weakness in Swindon and Bourgoin. Had local currency exchange rates remained constant to the rates of the nine months ended July 31, 2011, CMO revenues for the nine months ended July 31, 2012 would have been approximately 6.4% higher than the same period of the prior year. Excluding the \$50.3 million impact from the reservation fee and accelerated deferred revenue recorded in the first half of fiscal 2011, total CMO revenues for the nine months ended July 31, 2012 would have increased \$62.6 million, or 16.7% from the same period of the prior year.

North American CMO revenues for the nine months ended July 31, 2012 increased \$51.3 million, or 25.9%, to \$249.1 million, from \$197.8 million for the nine months ended July 31, 2011. The increase was due to an increase in customer demand across most North American sites.

European CMO revenues for the nine months ended July 31, 2012 decreased \$39.0 million, or 17.1%, to \$189.0 million, from \$228.0 million for the nine months ended July 31, 2011. Had European currency exchange rates remained constant to the rates of the nine months ended July 31, 2011, European CMO revenues for the nine months ended July 31, 2012 would have been approximately 10.9% lower than the same period of the prior year. This reduction was primarily due to the non-recurrence of the \$50.3 million in reservation fee and accelerated deferred revenue recorded in the first half of fiscal 2011, and weakness in Bourgoin, partially offset by stronger results from our Italian operations.

Total CMO Adjusted EBITDA for the nine months ended July 31, 2012 decreased \$15.3 million, or 23.9%, to \$48.8 million, from \$64.1 million for the nine months ended July 31, 2011. This represents an Adjusted EBITDA margin of

11.2% for the nine months ended July 31, 2012 compared to 15.1% for the nine months ended July 31, 2011. Had local currency exchange rates and foreign exchange gains and losses remained constant to those of the nine months ended July 31, 2011, CMO Adjusted EBITDA for the nine months ended July 31, 2012 would have been approximately \$0.6 million higher than reported.

The decrease was driven by the unfavorable material mix primarily from replacing the reservation fee and accelerated deferred revenue with other production and \$7.9 million in consulting fees related to our strategic initiatives, partially offset by improving margins across our sites as a result of our transformation initiatives and higher volumes.

North American Adjusted EBITDA for the nine months ended July 31, 2012 increased \$23.1 million, to \$34.1 million, from \$11.0 million for the nine months ended July 31, 2011. The increase was primarily driven by higher volumes, margin improvements resulting from the transformation initiatives, partially offset by \$2.0 million in consulting fees related to our strategic initiatives. North American CMO recorded \$2.3 million in estimated repositioning expenses relating to the Plan of Termination and Puerto Rican operations in the nine months ended July 31, 2012 that were not included in Adjusted EBITDA.

European Adjusted EBITDA for the nine months ended July 31, 2012 decreased \$38.4 million, or 72.3%, to \$14.7 million, from \$53.1 million for the nine months ended July 31, 2011. The decrease was primarily driven by the lower revenue resulting from the non-recurrence of the \$50.3 million in reservation fee and accelerated deferred revenue recorded in the first half of fiscal 2011 and \$5.9 million in consulting fees related to our strategic initiatives, partially offset by improving margins in fiscal 2012 as a result of our strategic initiatives and a reduction of foreign exchange losses of \$1.0 million. European CMO recorded \$1.5 million in estimated repositioning expenses relating to the Plan of Termination, and \$55.1 million in an asset impairment charge in the nine months ended July 31, 2012 that were not included in Adjusted EBITDA.

#### Pharmaceutical Development Services

Total PDS revenues for the nine months ended July 31, 2012 increased by \$8.4 million, or 9.1%, to \$101.0 million, from \$92.6 million for the nine months ended July 31, 2011. Had the local currency rates remained constant to the nine months ended July 31, 2011, PDS revenues for the nine months ended July 31, 2012 would have been 10.6% higher than the same period of the prior year. Higher development activities from new contracts across most sites contributed to the improved performance.

Total PDS Adjusted EBITDA for the nine months ended July 31, 2012 increased by \$0.8 million, or 5.0%, to \$16.9 million, from \$16.1 million for the nine months ended July 31, 2011. Had local currency exchange rates and foreign exchange gains and losses remained constant to those of the nine months ended July 31, 2011, PDS Adjusted EBITDA for the nine months ended July 31, 2012 would have been approximately \$0.5 million higher than reported. Improved revenues contributed to the higher Adjusted EBITDA, partially offset by \$2.3 million in consulting fees related to our strategic initiatives. PDS recorded \$3.1 million in estimated repositioning expenses relating to the Plan of Termination and \$2.8 million in an asset impairment charge in the nine months ended July 31, 2012 that were not included in Adjusted EBITDA.

#### Corporate Costs

Corporate costs for the nine months ended July 31, 2012 increased \$2.2 million, or 7.8%, to \$30.5 million, from \$28.3 million for the nine months ended July 31, 2011 primarily due to higher incentive based compensation, consulting fees of \$0.9 million and marketing expenses of \$0.9 million, partially offset by \$3.3 million in reduced foreign exchange losses versus the prior year.

#### Liquidity and Capital Resources

##### Overview

Cash and cash equivalents totaled \$35.4 million at July 31, 2012 and \$33.4 million at October 31, 2011. Our total debt was \$310.4 million at July 31, 2012 and \$281.2 million at October 31, 2011.

Our primary source of liquidity is cash flow from operations. Historically, we have also used availability under our asset-based revolving credit facility (the "ABL") for any additional cash needs. Our principal uses of cash have been for operating expenditures, capital expenditures, repositioning expenditures, debt servicing requirements, and employee benefit obligations. We expect cash flow from operations, cash on hand and borrowing under our current ABL to be sufficient to fund our existing level of operating expenses, capital expenditures, and interest expense for at least the next 12 months.

From time to time, we evaluate strategic opportunities, including potential acquisitions, divestitures or investments in complementary businesses, and we anticipate continuing to make such evaluations. We may also access capital

markets through the issuance of debt or equity securities in connection with the acquisition of complementary businesses or other significant assets or for other strategic opportunities.

Summary of Cash Flows

The following table summarizes our cash flows for the periods indicated:

27

---

Table of Contents

	Nine months ended July 31,	
	2012	2011
(in millions of U.S. dollars)	\$	\$
Cash provided by operating activities of continuing operations	7.2	12.2
Cash used in operating activities of discontinued operations	(0.4	) (0.5
Cash provided by operating activities	6.8	11.7
Cash used in investing activities	(32.7	) (30.9
Cash provided by (used in) financing activities	30.3	(0.1
Other	(2.4	) 5.3
Net increase (decrease) in cash and cash equivalents during the period	2.0	(14.0

**Cash Provided by Operating Activities**

Cash provided by operating activities from continuing operations for the nine months ended July 31, 2012 decreased \$5.0 million, to \$7.2 million, from \$12.2 million for the nine months ended July 31, 2011. In the current year, improved operating performance was offset by consulting and repositioning expense payments. Prior year cash from operations was primarily driven by the receipt of \$29.3 million for the reservation fee and \$14.0 million from the insurance claim settlement in Swindon, partially offset by the voluntary pension contribution in the U.K. of \$4.9 million and cash used in operations.

Cash used in operating activities from discontinued operations for the nine months ended July 31, 2012 decreased \$0.1 million, to \$0.4 million, from \$0.5 million for the nine months ended July 31, 2011.

**Cash Used in Investing Activities**

The following table summarizes the cash used in investing activities for the periods indicated:

	Nine months ended July 31,	
	2012	2011
(in millions of U.S. dollars)	\$	\$
Cash used in investing activities of continuing operations	(32.8	) (30.9
Cash provided by investing activities of discontinued operations	0.1	—
Cash used in investing activities	(32.7	) (30.9

Cash used in investing activities from continuing operations for the nine months ended July 31, 2012 increased \$1.9 million, or 6.2%, to \$32.8 million, from \$30.9 million for the nine months ended July 31, 2011 due to increased capital spend.

Our principal ongoing investment activities are project-related and sustaining capital programs at our network of sites. The majority of our capital allocation is normally invested in project-related programs, which are defined as outlays that will generate growth in capacity and revenues, while sustaining expenditures related to the preservation of existing assets and capacity.

**Cash Provided by (Used in) Financing Activities**

The following table summarizes the cash used in financing activities for the periods indicated:

	Nine months ended July 31,	
	2012	2011
(in millions of U.S. dollars)	\$	\$
Increase in short-term borrowings	0.9	1.3
Increase in long-term debt	35.5	6.0
Repayment of long-term debt	(6.1	) (7.4

Cash provided by (used in) financing activities	30.3	(0.1	)
---	------	------	---

Cash provided by financing activities for the nine months ended July 31, 2012 was \$30.3 million compared to cash used of \$0.1 million for the nine months ended July 31, 2011, due to higher aggregate borrowings primarily from our ABL during the nine months ended July 31, 2012.

28

---

## Table of Contents

### Financing Arrangements

#### \$280.0 Million Senior Secured Notes and \$75.0 Million Amended ABL

In April 2010, we issued an aggregate principal amount of \$280.0 million, 8.625% senior secured notes, due April 15, 2017 (the "Notes"). We used the net proceeds of the offering to repay all of the outstanding indebtedness under our then-existing senior secured term loan and \$75.0 million ABL, to repay certain other indebtedness and to pay related fees and expenses. We used the remaining proceeds for general corporate purposes.

We also amended and restated our then-existing \$75.0 million ABL in connection with the Notes offering to, among other things, extend the maturity date of this facility to April 23, 2014.

The Notes and the ABL are secured by substantially all of our assets and are guaranteed by, and secured by substantially all of the assets of, our subsidiaries in the United States (including Puerto Rico), Canada, the United Kingdom (except Patheon UK Pension Trustees Limited) and the Netherlands. The Notes and the ABL are guaranteed on a limited basis by, and secured by certain assets of, our subsidiaries in France, Italy and Switzerland.

The agreements governing the Notes and ABL contain usual and customary covenants and events of default provisions.

The agreements that govern the terms of our debt, including the indenture that governs the Notes and the credit agreement that governs the ABL, contain covenants that restrict our ability and the ability of our subsidiaries to, among other things:

• incur additional indebtedness;

• issue additional equity;

• pay dividends on or make distributions in respect of capital stock or make certain other restricted payments or investments;

• enter into agreements that restrict distributions from subsidiaries or restrict our ability to incur liens on certain of our assets;

• make capital expenditures;

• sell or otherwise dispose of assets, including capital stock of subsidiaries;

• enter into transactions with affiliates;

• create or incur liens; and

• merge or consolidate.

Provided that we are not in default under the ABL or the indenture governing the Notes and are able to demonstrate a certain Fixed Charge Coverage Ratio (as defined in the indenture governing the Notes), and will have a required minimum amount of remaining borrowing availability under the ABL after giving effect thereto, we are permitted to pay limited amounts of dividends or other distributions with respect to our restricted voting shares (as more particularly described in the ABL and the indenture governing the Notes), up to the lesser of (i) \$15.0 million plus 50.0% of Excess Cash Flow (as defined in the ABL), plus net proceeds of additional permitted equity offerings under the ABL, and (ii) 50.0% of Consolidated Net Income (as defined in the indenture governing the Notes) plus net proceeds from additional permitted equity offerings or sales of restricted investments under the Notes.

In addition, under the ABL, if an event of default occurs or our borrowing availability falls below the greater of \$10.0 million or 13.3% of total commitments under the ABL for any two consecutive days (which is defined under the ABL as an "Availability Trigger Event"), we will be required to satisfy and maintain a ratio of Consolidated EBITDA to Consolidated Fixed Charges (each as defined in the ABL) of not less than 1.10 to 1.00 until the first day thereafter on which, as applicable, either the event of default has been cured or our borrowing availability has exceeded the greater of \$10.0 million or 13.3% of our total commitments for 30 consecutive days. Our ability to meet the required ratio can be affected by events beyond our control, and we may not be able to meet this ratio. A breach of any of these covenants could result in a default under the ABL.

### Financing Ratios

Total interest-bearing debt at July 31, 2012 was \$310.4 million, \$29.2 million higher than at October 31, 2011. At July 31, 2012, our consolidated ratio of interest-bearing debt to shareholders' equity was 215%, compared to 118% at October 31, 2011.





## Table of Contents

### Off-Balance Sheet Entities

We do not use off-balance sheet entities to structure any of our financial arrangements. We do not have any interests in unconsolidated special-purpose or structured finance entities.

### Tabular Disclosure of Contractual Obligations

The disclosure of payments we have committed to make under our contractual obligations is set forth under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Tabular Disclosure of Contractual Obligations” under Item 7 of our 2011 Form 10-K. There have been no material changes outside of our ordinary course of business to our contractual obligations since the end of fiscal 2011.

### Recent Accounting Pronouncements

See “Note 1—Accounting policies—Recently issued accounting pronouncements” to our unaudited consolidated financial statements contained in this quarterly report on Form 10-Q for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

### Critical Accounting Estimates

For information about our critical accounting estimates, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Estimates” of our 2011 Form 10-K.

### Seasonality

Seasonality influences our revenues as some of our CMO and PDS operations have traditionally been lower in our first fiscal quarter. We attribute this trend to several factors, including (i) the reassessment by many customers of their need for additional product in the last quarter of the calendar year in order to use existing inventories of products; (ii) the lower production of seasonal cough and cold remedies in the first fiscal quarter; (iii) limited project activity towards the end of the calendar year by many small pharmaceutical and biotechnology customers involved in PDS projects in order to reassess progress on their projects and manage cash resources; and (iv) the Patheon-wide facility shutdown during a portion of the traditional holiday period in December and January.

### Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which reflect our expectations regarding our future growth, results of operations, performance (both operational and financial) and business prospects and opportunities. All statements, other than statements of historical fact, are forward-looking statements. Wherever possible, words such as “plans,” “expects,” or “does not expect,” “forecasts,” “anticipates” or “does not anticipate,” “believes,” “intends” and similar expressions or statements that certain actions, events or results “may,” “could,” “should,” “would,” “might” or “will” be taken, occur or be achieved have been used to identify these forward-looking statements. Although the forward-looking statements contained in this quarterly report on Form 10-Q reflect our current assumptions based upon information currently available to us and based upon what we believe to be reasonable assumptions, we cannot be certain that actual results will be consistent with these forward-looking statements. Our current material assumptions include assumptions related to customer volumes, regulatory compliance, foreign exchange rates and employee severance costs associated with termination. Forward-looking statements necessarily involve significant known and unknown risks, assumptions and uncertainties that may cause our actual results, performance, prospects and opportunities in future periods to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things, risks related to international operations and foreign currency fluctuations; customer demand for our services; regulatory matters affecting manufacturing and pharmaceutical development services; impacts of acquisitions, divestitures and restructurings; implementation of our new corporate strategy; our ability to effectively transfer business between facilities; the global economic environment; our exposure to complex production issues; our substantial financial leverage; interest rate risks; potential environmental, health and safety liabilities; credit and customer concentration; competition; rapid technological change; product liability claims; intellectual property; the existence of a significant shareholder; supply arrangements; pension plans; derivative financial instruments; and our dependence upon key management, scientific and technical personnel. These and other risks are described in greater detail in “Part 1—Item 1A. Risk Factors” of our 2011 Form 10-K filed with the U.S. Securities and Exchange Commission and with the Canadian

Securities Administrators. Although we have attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove

Table of Contents

to be accurate, as actual results and future events could differ materially from those anticipated in such statements. These forward-looking statements are made as of the date of this quarterly report on Form 10-Q, and except as required by law, we assume no obligation to update or revise them to reflect new events or circumstances.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Risk

Our business is conducted in several currencies—Canadian dollars and U.S. dollars for our Canadian operations, U.S. dollars for our U.S. operations and Euros, U. S. dollars and British Sterling for our European operations. We are subject to foreign currency transaction risk because a significant portion of our revenues and operating expenses from our operations in certain countries are denominated in different currencies. Our material foreign currency transaction risk arises from our Canadian operations. Our Canadian operations negotiate sales contracts for payment in both U.S. and Canadian dollars, and materials and equipment are purchased in both U.S. and Canadian dollars. The majority of the non-material costs (including payroll, facilities' costs and costs of locally sourced supplies and inventory) of our Canadian operations are denominated in Canadian dollars. In the nine months ended July 31, 2012, approximately 90% of the revenues and 10% of the operating expenses of our Canadian operations were transacted in U.S. dollars. As a result, if we do not effectively hedge such foreign currency exposure, our results of operations will be adversely affected by an increase in the value of the Canadian dollar relative to such foreign currency. In addition, we may experience hedging and transactional gains or losses because of volatility in the exchange rate between the Canadian dollar and the U.S. dollar. Based on our current U.S. denominated net inflows, for each 10% change in the Canadian-U.S. dollar exchange rate, the annual impact on pre-tax income, excluding any hedging activities, would be approximately \$17.1 million.

To mitigate exchange-rate risk, we utilize foreign exchange forward contracts and collars in certain circumstances to lock in exchange rates with the objective that the gain or loss on the forward contracts and collars will approximately offset the loss or gain that results from the transaction or transactions being hedged. As of July 31, 2012, we had entered into 97 foreign exchange forward contracts and collars covering approximately 80% of our Canadian-U.S. dollar cash flow exposures for fiscal 2012 and had one forward exchange forward contract covering our Euro-U.S. dollar cash flow. See "Note 10—Financial instruments and risk management" to our unaudited consolidated financial statements. We do not hedge any of our other foreign exchange exposures. Our foreign exchange forward contracts and collars mature at various dates through April 2014 and have an aggregate fair value of \$131.5 million. As of July 31, 2012, an adverse exchange rate movement of 10% against our foreign exchange forward contracts and collars would result in a pre-tax loss of approximately \$13.2 million.

Interest Rate Risk

As of July 31, 2012, our long-term debt consisted of the Notes, which have an aggregate principal amount of \$280 million and bear interest at a fixed rate, and the \$75 million ABL, which bears interest at a variable rate. As of July 31, 2012, we had borrowed \$35.5 million under our ABL. Assuming a fully drawn ABL and a 100 basis point increase in applicable interest rates, our interest expense, net, would increase by \$0.75 million on an annual basis.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of July 31, 2012, our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of July 31, 2012, our disclosure controls and procedures were effective in that they provided reasonable assurances that the information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required by the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended July 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are not involved in any material pending legal proceedings. Additionally, no such proceedings are known to be contemplated by governmental authorities.

Item 1A. Risk Factors

There have been no material changes in the risk factors described in Item 1A of our 2011 Form 10-K.

Item 6. Exhibits

The exhibits listed in the accompanying exhibit index are filed as part of this quarterly report on Form 10-Q, and such exhibit index is incorporated by reference herein.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: September 13, 2012

PATHEON INC.

By: /s/ JAMES C. MULLEN  
James C. Mullen  
Chief Executive Officer

By: /s/ STUART GRANT  
Stuart Grant  
Executive Vice President, Chief Financial Officer

Table of Contents

## EXHIBIT INDEX

Exhibit Number	Description of Document	Incorporated by Reference			Filed Herewith
		Form	Filing Date	Number	
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
101*	The following materials from Patheon Inc.'s Quarterly Report on Form 10-Q for the quarter ended July 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Unaudited Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Operations, (iii) the Unaudited Consolidated Statements of Cash Flows, (iv) the Unaudited Consolidated Statement of Changes in Shareholders' Equity and (v) the Notes to Unaudited Consolidated Financial Statements.				X

\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.