OFFICE DEPOT INC
Form 10-K
February 24, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

(Mark One)

x **Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 27, 2008

or

o **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 1-10948
Office Depot, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**59-2663954**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6600 North Military Trail, Boca Raton, Florida	**33496**
(Address of principal executive offices)	(Zip Code)

(561) 438-4800
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 28, 2008 (based on the closing market price on the Composite Tape on June 27, 2008) was approximately $3,010,635,490 (determined by subtracting from the number of shares outstanding on that date the number of shares held by affiliates of Office Depot, Inc.).

The number of shares outstanding of the registrant s common stock, as of the latest practicable date: At January 24, 2009, there were 274,832,415 outstanding shares of Office Depot, Inc. Common Stock, $0.01 par value.

Documents Incorporated by Reference:

Certain information required for Part III of this Annual Report on Form 10-K is incorporated by reference to the Office Depot, Inc. definitive Proxy Statement for its 2009 Annual Meeting of Shareholders, which shall be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Act of 1934, as amended, within 120 days of Office Depot, Inc. s fiscal year end.

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PART I

Item 1. Business.

Office Depot, Inc. is a global supplier of office products and services. The company was incorporated in 1986 with the opening of our first retail store in Fort Lauderdale, Florida. In fiscal year 2008, we sold $14.5 billion of products and services to consumers and businesses of all sizes through our three business segments: North American Retail Division, North American Business Solutions Division and International Division. Sales are processed through multiple channels, consisting of office supply stores, a contract sales force, an outbound telephone account management sales force, internet sites, direct marketing catalogs and call centers, all supported by our network of crossdock facilities, warehouses and delivery operations.

Additional information regarding our business segments is presented below and in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Note L Segment Information of Notes to Consolidated Financial Statements located elsewhere in this Annual Report on Form 10-K.

North American Retail Division

Our North American Retail Division sells a broad assortment of merchandise through our chain of office supply stores in the U.S. and Canada. We currently offer general office supplies, computer supplies, business machines and related supplies, and office furniture from national brands as well as our own private brands, which include Office Depot®, Foray®, Ativa®, Break Escapes , Worklife and Christopher Lowell . Most stores also contain a design, print and ship center offering graphic design, printing, reproduction, mailing, shipping, and other services. Also, during 2008, we announced the nationwide availability of a PC support and network installation service that provides our customers with in-home, in-office and in-store support for their technology needs.

Our retail stores are designed to provide a positive shopping experience for the customer. We strive to optimize visual presentation, product placement, shelf capacity, in-stock positions, and inventory turnover. Our goal is to maintain sufficient inventory in the stores to satisfy current and near-term customer needs, while controlling the overall working capital invested in inventory. Currently, most store replenishment is handled through our crossdock flow-through distribution system. Bulk merchandise is sorted for distribution and generally shipped the same day to stores needing to replenish their inventory. We operated 12 crossdock facilities at the end of 2008, one of which will be closed during 2009. As we work to optimize our supply chain, we may operate combination facilities to satisfy both the needs of retail stores and delivery customers.

In recent years, we have developed a new store format that we call M2. This design is intended to provide improved lines of sight, effective product adjacencies and updated signage and lighting, while lowering overall operating costs. This format is being used for all new store openings and remodels. While we believe the current M2 format is a desirable design and an improvement over prior designs, we may continue to modify it in the future.

At the end of 2008, our North American Retail Division operated 1,267 office supply stores throughout the U.S. and Canada. The largest concentration of our retail stores is in California, Texas and Florida, but we have broad representation across North America. The count of open stores may include locations temporarily closed for remodels or other factors. Store opening and closing activity for the last three years has been as follows:

	Open at Beginning of Period	Opened	Closed	Open at End of Period	Relocated
2006	1,047	115	4	1,158	7
2007	1,158	71	7	1,222	3
2008	**1,222**	**59**	**14**	**1,267**	**7**

Due to changes in the economic climate, we have reduced our store opening and remodel plans. We currently plan to add approximately 15 new retail stores in North America in 2009. Also, we will be closing 108 additional retail stores in North America in the first quarter of 2009 and another 10 stores throughout the year as their leases expire or other lease arrangements are finalized. See Charges discussed in MD&A for additional information.

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North American Business Solutions Division

Our North American Business Solutions Division sells nationally branded and private brand office supplies, technology products, furniture and services by means of a dedicated sales force, through catalogs and electronically through our internet sites. We strive to ensure that our customers needs are satisfied through various channel offerings, and we continue to develop the people, systems and processes to enable us to meet those needs. Our direct business is tailored to serve small- to medium-sized customers. Our direct customers can order products from our catalogs, by phone or through our public web sites (www.officedepot.com), including our public web site devoted to technology products (www.techdepot.com).

Our contract business employs a dedicated sales force that services the office supply needs of predominantly medium-sized to Fortune 100 customers. We believe sales representatives impact revenues by building relationships with customers and providing information, business tools and problem-solving services to them. We offer contract customers the convenience of shopping on dedicated web sites and in our retail locations, while charging their contract pricing in lieu of retail pricing. During 2008, we implemented a contact strategy that allows us to continue to aggressively pursue customers using the tools and processes of this initiative. We also use telephone account management for outbound sales contacts with our customers. Sales made at retail locations to our contract customers are included in the results of our North American Retail Division.

We also entered into government contracts through a multi-state contract available to local and state government agencies, school districts (K-12), higher education and non-profits nationwide. We were awarded this contract on January 2, 2006, and the contract expires on January 1, 2010. Multi-state contracts enable individual states or municipalities to utilize the buying power of multiple states, which results in lower costs based on volume purchasing. These contracts include an administrative fee payable to a third party administrator. As part of a normal process of doing business with local and state governmental agencies, we are subject to audits and reviews of these government contracts. See Part I Item 3 Legal Proceedings for additional discussion.

Contract and direct customers orders are filled primarily through deliveries from our distribution centers (DCs) located across the United States and Canada. Some DCs and some retail locations also house sales offices and administrative offices. We have outsourced our inbound call center activities; however, in-house staff manages what we consider to be the most critical points of customer interaction.

Inventory is held in our DCs at levels we believe sufficient to meet current and anticipated customer needs. We utilize processes to evaluate the appropriate timing and quantity of reordering with the objective of controlling our investment in inventory, while at the same time ensuring customer satisfaction. Certain purchases may be sent directly from the manufacturer to our customers.

Over the past several years, we have implemented technologies to assist with reordering, stocking, the pick-and-pack process and delivery operations. We have also increased our use of third party delivery services and reduced our own fleet of vehicles where cost reductions could be achieved without compromising customer service levels. We operated 20 DCs at the end of 2008. During 2009, we will consolidate certain of our supply chain facilities, which will result in the closure of four of these distribution centers as well as one distribution center that had ceased operations as of the end of 2008. Additionally, we are likely to modify our supply chain operations to include combination facilities that will service both our North American Retail and North American Business Solutions Divisions.

Because sales and marketing efforts and catalog production have similarities between the North American Business Solutions Division and the International Division, those topics are addressed separately after the three segment discussions, though they are integral to understanding the processes and management of these Divisions.

International Division

As of December 27, 2008, we sold to customers in 48 countries throughout North America, Europe, Asia and Central America either through wholly-owned entities, majority-owned entities or other ventures covering 38 countries, and through alliances in an additional ten countries. Our International Division sells office products and services through direct mail catalogs, contract sales forces, internet sites and retail stores, using a mix of company-owned operations, joint ventures, licensing and franchise agreements, alliances and other arrangements. International operations are managed on a geographic basis through three regional offices rather than by sales channel; however, for consistency of discussion, sales channels will be used to describe the activities of the International Division.

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The international direct channel was launched in 1990 with the start-up of operations in the United Kingdom (UK). We offer products under the Viking name that is co-branded with Office Depot, and we may migrate to the Office Depot brand in Europe over a multi-year period. We now have catalog offerings in 14 countries outside of North America, and we operate approximately 35 separate web sites in the International Division.

In 2000, we launched the Office Depot contract channel in the UK and subsequently expanded the channel to four additional countries. We further expanded our contract start-up business in 2003 with the acquisition of Guilbert, S.A. Guilbert operations and customers have been fully integrated into the Office Depot operations since the end of 2006.

In an effort to expand our geographic footprint around the globe, we have made certain acquisitions over the past few years. During 2006, we completed acquisitions in South Korea (majority ownership interest in Best Office), China (majority ownership interest in AsiaEC) and Eastern Europe (100% ownership interest in Papirius s.r.o.). Also in 2006, we increased our ownership interest to a majority stake in Office Depot Israel. During 2008, we became a 51% owner of a joint venture, which acquired eOfficePlanet India pvt. Also in 2008, we completed an acquisition in Sweden (majority ownership interest in AGE Kontor & Data AB) and purchased the remaining shares of Asia EC and Office Depot Israel.

To appropriately support our geographic expansion, our International Division operates separate regional headquarters for Europe/Middle East (The Netherlands), Asia (Hong Kong) and Latin America (South Florida). During 2007, we began to transition our back-office accounting functions in Europe to a shared-services facility in Eastern Europe and at the end of 2008, that transition was essentially complete.

At the end of 2008, the International Division operated, through wholly-owned or majority-owned entities, 162 retail stores in France, Hungary, Israel, Japan, South Korea and Sweden. In addition, we participate under licensing and merchandise arrangements in 98 stores in South Korea and Thailand. Following a strategic review of the business in late 2008, we have decided to close our retail store operations in Japan during 2009.

Since 1994, we have participated in a joint venture in Mexico. In recent years, this venture, Office Depot de Mexico, has grown in size and scope and now includes 186 retail locations in Mexico, Costa Rica, El Salvador, Guatemala, Honduras, and Panama, as well as call centers and distribution centers to support the delivery business in certain areas. We provide services to the venture through management consultation, product selection, product sourcing and information technology services. Because we participate equally in this business with a partner, we account for the activity under the equity method and venture sales of approximately $953 million in 2008 are not directly reflected in our revenues nor in our consolidated retail comparable store statistics.

Including company-owned operations, joint ventures, licensing and franchise agreements we sell office products through 446 retail stores outside North America.

International Division store and distribution center operations are summarized below (includes only wholly-owned and majority-owned entities):

	Office Supply Stores			
	Open at Beginning of Period	Opened/ Acquired	Closed	Open at End of Period
2006	70	55(1)		125
2007	125	26	3	148
2008	**148**	**15(2)**	**1**	**162**

	Distribution Centers			
	Open at Beginning	Opened/		Open at End

	of Period	Acquired	Closed	of Period
2006	25	10(3)	3	32
2007	32	2	1	33
2008	**33**	**19(4)**	**9**	**43**

(1) Includes 33 retail stores obtained in the acquisition of the business in Israel and nine retail stores obtained in the acquisition of the business in South Korea.

(2) Includes 13 retail stores obtained in the acquisition of the business in Sweden.

(3) Includes one DC obtained in the acquisition of the business in Israel, five DCs obtained in the acquisition of the business in China, one DC obtained in the acquisition of the business in South Korea and two DCs obtained in the acquisition of Papirius that are located in the Czech Republic and Lithuania (Lithuania was disposed during 2008).

(4)

Includes 12 DCs obtained in the acquisition of the business in India and four DCs obtained in the acquisition of the business in Sweden.

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Merchandising

Our merchandising strategy is to meet our customers needs by offering a broad selection of nationally branded office products, as well as an increasing array of private brand products and services. Our selection of private brand products has increased in breadth and level of sophistication over time. We currently offer general office supplies, computer supplies, business machines and related supplies, and office furniture under various labels, including Office Depot®, Viking Office Products®, Foray®, Ativa®, Break Escapes , Niceday , Worklife and Christopher Lowell .

Total sales by product group were as follows:

	2008	2007*	2006*
Supplies	61.5%	59.3%	60.1%
Technology	24.7%	26.7%	26.7%
Furniture and other	13.8%	14.0%	13.2%
	100.0%	100.0%	100.0%

* Conformed to current year product classification.

We buy substantially all of our merchandise directly from manufacturers and other primary suppliers, including direct sourcing of products from domestic and offshore sources. We also enter into arrangements with vendors that can lower our unit product costs if certain volume thresholds or other criteria are met. For additional discussion regarding these arrangements, see the Critical Accounting Policies section of MD&A. In most cases, our suppliers deliver merchandise directly to our DCs or crossdock facilities. The latter are flow-through facilities that re-supply our retail stores in North America.

We operate separate merchandising functions in North America, Europe and Asia as well as in our joint ventures. Each group is responsible for selecting, purchasing and pricing merchandise as well as managing the product life cycle of our inventory. In recent years, we have increasingly used global tenders across all regions to further reduce our product cost while maintaining product quality.

We operate a global sourcing office in Shenzhen, China, which allows us to take more direct control of our product sourcing, logistics and quality assurance. This office consolidates our purchasing power with Asian factories and, in turn, helps us to increase the scope of our private brand offerings.

Sales and Marketing

Our marketing programs are designed to attract new customers and to drive frequency of customer visits to our stores and web sites and increase the share of wallet of our existing customers by capturing more of what they spend in total on the products we sell. We regularly advertise in major newspapers in most of our North American markets. These advertisements are combined with local and national radio, network and cable television advertising campaigns, and direct marketing efforts.

We offer customer loyalty programs that provide customers with rewards that can be applied against future Office Depot purchases or other incentives. These programs have provided us with valuable information enabling us to market more effectively to our customers and drive incremental sales. These programs may change in popularity in the future, and we may make alterations to them from time to time.

We perform periodic competitive pricing analyses to monitor each market, and prices are adjusted as necessary to adhere to our pricing philosophy and further our competitive positioning. We generally expect our everyday prices to be highly competitive with other resellers of office products.

We acquire new customers by selectively mailing specially designed catalogs and by making on-premises sales calls to prospective customers. We also make outbound sales calls using dedicated agents through our telephone account management program. We obtain the names of prospective customers in new and existing markets through the purchase of selected lists from outside marketing information services and other sources as well as through the use of a proprietary mailing list system. We also acquire customers through e-mail marketing campaigns and online affiliates. We are a primary sponsor of NASCAR® and are currently designated NASCAR® s official office products partner. No single customer in any of our segments accounts for more than 5% of our total sales.

We consider our business to be only somewhat seasonal, with sales generally trending lower in the second quarter, following the back-to-business sales cycle in the first quarter and preceding the back-to-school sales cycle in the third quarter and the holiday sales cycle in the fourth quarter. Certain working capital components may build and recede during the year reflecting established selling cycles. Business cycles can and have impacted our operations and financial position when compared to other periods. See Item 1A Risk Factors for additional discussion.

Catalogs

We use catalogs to market directly to both existing and prospective customers throughout our operations globally. We have developed a distinctive style for our catalogs, most of which are produced in-house by our designers, writers and production artists. We also produce a Green Book® catalog, which features products that are recyclable, energy efficient, or otherwise have a reduced impact on the environment. We continually evaluate our catalog offerings for efficiency and effectiveness at generating incremental revenues.

Our catalog offerings typically include a complete buyers guide containing all of our products at their regular discount prices. This buyers guide, which is distributed to our active customers, varies in size among countries. Prospecting catalogs with special offers designed to attract new customers are mailed at certain intervals. In addition, specialty and promotional catalogs may be delivered more frequently to selected customers.

Design, Print and Ship

Most of our North American retail stores contain a Design, Print & Ship Depot™ offering graphic design, printing, reproduction, mailing, shipping, and other services. We have launched the exclusive Xerox Certified Print Specialist program, which certifies associates as experts in the area of digital imaging and printing. In addition to the in-store locations, we operate ten regional print facilities, which support copy and print orders taken in our North American Retail and North American Business Solutions Divisions.

Industry and Competition

We operate in a highly competitive environment in all three of our segments. We believe that we compete favorably on the basis of price, service, relationships and selection. We compete with office supply stores, wholesale clubs, discount stores, mass merchandisers, food and drug stores, computer and electronics superstores, internet-based companies and direct marketing companies. These companies, in varying degrees, compete with us in substantially all of our current markets.

Other office supply retail companies market similarly to us in terms of store format, pricing strategy and product selection and availability in the markets where we operate, primarily those in the United States and Canada. We anticipate that in the future we will face increased competition from these chains as each of us expands our operations locally and globally.

Internationally, we compete on a similar basis to how we compete in North America. Outside of the U.S. and Canada, we sell through contract and catalog channels in 20 countries and operate retail stores in six countries through wholly-owned or majority-owned entities, though we have recently announced our intent to close our retail operations in Japan. Additionally, our International Division provides office products and services in 26 countries through joint ventures, licensing and franchise agreements, cross-border transactions, alliances and other arrangements.

Employees

As of January 24, 2009, we had approximately 43,000 employees worldwide. Our workforce is largely non-union and our labor relations are generally good. In certain international locations, changes in staffing or work arrangements may need approval of local works councils or other bodies.

Environmental Activities

As both a significant user and seller of paper products, we have developed environmental practices that are values-based and market-driven. Our environmental initiatives center on three guiding principles: (1) recycling and pollution reduction; (2) sustainable forest management; and (3) issue awareness and market development for environmentally preferable products. We offer thousands of different products containing recycled content, including from 35% to 100% post-consumer waste content paper and technology recycling services in our retail stores.

In 2008, Office Depot continued to implement environmental programs in line with our stated environmental vision to increasingly buy green, be green and sell green including environmental sensitivity in our packaging, operations and sales offerings. Also, in January 2009, our Green retail store prototype received a Leadership in Energy and Environmental Design (LEED) Gold Certification from the U.S. Green Building Council. Additional information on our green product offerings can be found at www.officedepot.com/buygreen.

Available Information

We maintain a web site at www.officedepot.com. We make available, free of charge, on the Investor Relations section of our web site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file or furnish such materials to the U.S. Securities and Exchange Commission (SEC).

Additionally, our corporate governance materials, including governance guidelines; the charters of the Audit, Compensation, Finance, and Governance and Nominating Committees; and the code of ethical behavior may also be found under the Investor Relations section of our web site at www.offficedepot.com. Office Depot makes no provisions for waivers of the code of ethical behavior. A copy of the foregoing corporate governance materials is available upon written request to the company.

We submitted our 2008 annual Section 12(a) CEO certification with the New York Stock Exchange (NYSE). The certification was not qualified in any respect. Additionally, we filed with this Form 10-K, the CEO and CFO certifications required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

Executive Officers of the Registrant

Steve Odland Age: 50

Mr. Odland has been Chairman, Chief Executive Officer and a Director since early 2005. Prior to joining Office Depot, Inc., he was Chairman, Chief Executive Officer and President of AutoZone, Inc., from 2001 until 2005. Previously he was an executive with Ahold USA from 1998 to 2000, President of the Foodservice Division of Sara Lee Bakery from 1997 to 1998 and was employed by The Quaker Oats Company from 1981 to 1996 in various executive positions. Mr. Odland is also a director of General Mills, Inc.

Charles Brown Age: 55

Mr. Brown has been President, International since 2005. In 2007, oversight of business development was added to his role. He was the company s Executive Vice President and Chief Financial Officer from 2001 to 2005. Prior to that, Mr. Brown was Senior Vice President, Finance and Controller since he joined our company in 1998. Before joining Office Depot, he was Senior Vice President and Chief Financial Officer of Denny s, Inc. from 1996 until 1998; from 1994 until 1995, he was Vice President and Chief Financial Officer of ARAMARK International; and from 1989 until 1994, he was Vice President and Controller of Pizza Hut International, a Division of PepsiCo, Inc. Mr. Brown assumed the role of acting Chief Financial Officer of the Company effective March 1, 2008 and served in that role until August 2008, when Michael Newman began his role as the Company s permanent Chief Financial Officer.

Elisa Garcia Age: 51

Ms. Garcia was appointed Executive Vice President, General Counsel and Corporate Secretary in July 2007 with overall responsibility for global compliance matters and governmental relations. Prior to joining Office Depot, Ms. Garcia served as General Counsel and Corporate Secretary of Domino s Pizza, Inc. from April 2000. Prior to joining Domino s Pizza, Ms. Garcia served as Latin American Regional Counsel for Philip Morris International, and Corporate Counsel for GAF Corporation.

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Monica Luechtefeld Age: 60

Ms. Luechtefeld has been our Executive Vice President, Information Technology since early 2005. She was also responsible for business development from early 2005 to 2007. She assumed responsibility for supply chain from 2007 through 2008. Previously, she was Executive Vice President of E-Commerce from 2000. Prior to this role, she held several officer positions including Vice President, Marketing and Sales Administration and Vice President of Contract Marketing & Business Development. Ms. Luechtefeld joined Office Depot in 1993, serving as General Manager of the Southern California Region of Office Depot until 1996.

Michael Newman Age: 52

Mr. Newman was appointed Executive Vice President, Chief Financial Officer in August 2008. Prior to joining Office Depot, Mr. Newman served as Chief Financial Officer of Platinum Research Organization, Inc. from April 2007 through February 2008. Prior to joining Platinum Research Organization, Mr. Newman was employed as an independent consultant since 2005. Mr. Newman also served as Chief Financial Officer of Blackstone Crystal Holdings Capital Partners from 2004 to 2005 and Chief Financial Officer of Radio Shack Corp. from 2001 to 2004. Mr. Newman also held Chief Financial Officer roles at Intimate Brands and Hussmann International (which was acquired by Ingersoll-Rand in 2000). He also spent 17 years at General Electric in a variety of management roles both in the United States and Europe.

Kevin Peters Age: 51

Mr. Peters was appointed Executive Vice President, Supply Chain in October 2007. Prior to joining Office Depot, Mr. Peters spent five years in management roles at W. W. Grainger, Inc., most recently as Senior Vice President, Supply Chain. Prior to W. W. Grainger, Mr. Peters spent 11 years at The Home Depot, serving as the company s Vice President and General Manager, Strategic Initiatives, Toronto/San Diego. He also has held positions in physical distribution operations, purchasing and inventory management at McMaster-Carr Supply Company.

Carl (Chuck) Rubin Age: 49

Mr. Rubin was appointed President, North American Retail in early 2006. Prior to assuming that position, Mr. Rubin held the position of Executive Vice President, Chief Merchandising Officer and Chief Marketing Officer since 2004. Before joining the company, Mr. Rubin spent six years with Accenture Ltd., most recently as Partner, where he worked for clients, including Office Depot, across retail formats in the department, specialty and e-commerce channels, as well as new business startups. Prior to joining Accenture, Mr. Rubin spent six years in specialty retailing and 11 years in department store retailing, where he served as General Merchandise Manager and a member of the Executive Committees for two publicly-held companies.

Steven Schmidt Age: 54

Mr. Schmidt was appointed President, North American Business Solutions in July 2007. Prior to joining Office Depot, Mr. Schmidt spent 11 years with the ACNielsen Corporation, most recently serving as President and Chief Executive Officer. Prior to joining ACNielsen, Mr. Schmidt spent eight years at the Pillsbury Food Company, serving as President of its Canadian and Southeast Asian operations. He has also held management positions at PepsiCo and Procter & Gamble.

Daisy Vanderlinde Age: 57

Ms. Vanderlinde was appointed Executive Vice President, Human Resources in late 2005. Prior to joining Office Depot, Ms. Vanderlinde was Senior Vice President, Human Resources and Loss Prevention, for AutoZone Inc. from 2001 to 2005, and was a member of the Executive Committee. Ms. Vanderlinde has also served as a senior HR officer for other retailers, including Tractor Supply Company, Marshalls, Inc., and The Broadway Stores.

Mark Hutchens Age: 43

Mr. Hutchens was appointed Senior Vice President and Controller in September 2008. Prior to assuming that position, Mr. Hutchens held the position of Senior Vice President of Finance, International Division since late 2006. Prior to joining the company, Mr. Hutchens served as Assistant Treasurer at Yum! Brands, Inc., from February 2005 to November 2006 and as General Auditor from November 2003 to February 2005. In addition, Mr. Hutchens served in a variety of senior management positions at Yum! from May 1996 to November 2003. Prior to joining Yum! Mr. Hutchens served in various management positions at Ford Motor Company, where he was employed until May 1996.

Information with respect to our directors is incorporated herein by reference to information included in the Proxy Statement for our 2009 Annual Meeting of Shareholders.

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Item 1A. Risk Factors.

In addition to risks and uncertainties in the ordinary course of business that are common to all businesses, important factors that are specific to our industry and our company could materially impact our future performance and results. We have provided below a list of these risk factors that should be reviewed when considering our securities. These are not all the risks we face, and other factors currently considered immaterial or unknown to us may impact our future operations.

Economic Conditions May Cause a Decline in Business and Consumer Spending Which Could Adversely Affect Our Business and Financial Performance: Our operating results and performance depend significantly on worldwide economic conditions and their impact on business and consumer spending. The decline in business and consumer spending resulting from the global recession and the deterioration of global credit markets has caused our comparable store sales to decline from prior periods and we have experienced similar declines in our other domestic and international businesses. Our business and financial performance may continue to be adversely affected by current and future economic conditions and the level of consumer debt and interest rates, which may cause a continued or further decline in business and consumer spending.

Supplier Credit and Order Fulfillment Risk: We purchase products for resale under credit arrangements with our vendors. In recent years, we have worked to set payment terms to our vendors under these credit arrangements to occur at a time approximately equal to the anticipated time it takes to sell the vendor s products. In weak global markets, vendors may seek credit insurance to protect against non-payment of amounts due to them. If we continue to experience declining operating performance, and if we experience severe liquidity challenges, vendors may demand that we accelerate our payment for their products. Also, credit insurers may curtail or eliminate coverage to the vendors. If vendors begin to demand accelerated payment of amounts due to them or if they begin to require advance payments or letters of credit before goods are shipped to us, these demands could have a significant adverse impact on our operating cash flow and result in a severe drain on our liquidity. Borrowings under our existing credit facility could reach maximum levels under such circumstances and we would seek alternative liquidity measures but may not be able to meet our obligations as they become due. In addition if our suppliers are unable to access liquidity or become insolvent, they could be unable to supply us with product. Also, some of our suppliers may serve other industries. Any adverse impacts to those industries, as a result of the economic slowdown or credit crisis, could have a ripple effect on these suppliers which could adversely impact their ability to supply us as necessary. Any such disruptions could negatively impact our ability to deliver products and services to our customers, which in turn could have an adverse impact on our business, operating results, financial condition or cash flow.

Liquidity: Historically, we have generated positive cash flow from operating activities and have had access to broad financial markets that provide the liquidity we need to operate our business. Together, these sources have been used to fund operating and working capital needs, as well as invest in business expansion through new store openings, capital improvements and acquisitions. However, due to the downturn in the global economy our operating results and liquidity have diminished. In September 2008, we entered into a $1.25 billion asset based credit facility intended to provide liquidity. The recent distress in the financial markets has resulted in extreme volatility in the capital markets and diminished liquidity and credit availability. There can be no assurance that our liquidity will not be adversely affected by changes in the financial markets and the global economy. In addition, deterioration in our financial results could negatively impact our credit ratings. The tightening of the credit markets or a downgrade in our credit ratings could increase our borrowing costs and make it more difficult for us to access funds, to refinance our existing indebtedness, to enter into agreements for new indebtedness or to obtain funding through the issuance of securities. If such conditions were to persist, we would seek alternative sources of liquidity but may not be able to meet our obligations as they become due.

Financial Covenants in Existing Credit Facility: Our asset based credit facility contains a fixed charge coverage ratio covenant that is operative only when borrowing availability is below $187.5 million or prior to a restricted transaction, such as incurring additional indebtedness, acquisitions, dispositions, dividends, or share repurchases. The agreement also contains representations, warranties, fees, affirmative and negative covenants, and default provisions. A breach of any of these covenants could result in a default under our credit agreement. Upon the occurrence of an event of default under our credit agreement, the lenders could elect to declare all amounts outstanding to be immediately due and payable and terminate all commitments to extend further credit. If the lenders accelerate the repayment of borrowings, we may not have sufficient assets to repay our revolving credit agreement and our other indebtedness. Also, should there be an event of default, or need to obtain waivers following an event of default, we may be subject to higher borrowing costs and/or more restrictive covenants in future periods. Acceleration of any obligation under any of our material debt instruments will permit the holders of our other material debt to accelerate their obligations. See Liquidity and Capital Resources .

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New York Stock Exchange (NYSE) Compliance Risk: Our common stock is currently listed on the NYSE. Subject to NYSE rules, we are required to maintain compliance with the minimum share price rule which requires that the average closing price of our common stock be at least $1.00. If we were unable to maintain a minimum share price of at least $1.00 for a period of 30 consecutive trading days our common stock could be subject to delisting. A delisting of our common stock could negatively impact us by reducing the liquidity and market price of our common stock, reducing the number of investors willing to hold or acquire our common stock, which could negatively impact our ability to raise equity financing.

Litigation / Regulatory Risks: We are involved in various legal proceedings, which may involve class action lawsuits, state and federal governmental inquiries and investigations, employment, tort, consumer litigation and intellectual property litigation. Certain of these legal proceedings are described in detail in our Legal Proceedings Section. These legal proceedings could expose us to significant defense costs, fines, penalties, suspensions, debarments and liability to private parties for monetary recoveries and attorneys fees, any of which could have a material adverse effect on our business and results of operations.

Litigation and governmental investigations could result in substantial additional costs. The SEC is investigating our compliance with Federal securities laws and certain states and federal agencies are investigating our pricing under certain contracts. Although we are cooperating with the governmental agencies in these matters, they may determine that we have violated some laws or regulations. If these agencies determine that we have violated some laws or regulations, we may face sanctions, including, but not limited to, significant monetary penalties, injunctive relief and loss of business.

In addition, we have been named a defendant in a number of class-action and related lawsuits. The findings and outcome of the SEC investigation may affect the class-action and derivative lawsuits that are pending. We are generally obliged, to the extent permitted by law, to indemnify our directors and our former directors and officers who are named defendants in some of these lawsuits. We are unable to estimate what our liability in these matters may be, and we may be required to pay judgments or settlements and incur expenses in aggregate amounts that could have a material adverse effect on our financial condition or results of operations. See Part I Item 3 Legal Proceedings for a description of pending litigation and governmental proceedings and investigations.

Competition: We compete with a variety of retailers, dealers, distributors, contract stationers, direct marketers and internet operators throughout our worldwide operations. This is a highly competitive marketplace that includes such retail competitors as office supply stores, warehouse clubs, computer and electronics stores, mass merchant retailers, local merchants, grocery and drug-store chains as well as other competitors including direct mail and internet merchants, contract stationers, and direct manufacturers. Our competitors may be local, regional, national or international. Further, competition may come from highly-specialized low-cost merchants, including ink refill stores and kiosks, original equipment manufacturers, concentrated direct marketing channels including well-funded and broad-based enterprises. There is a possibility that any or all of these competitors could become more aggressive in the future, thereby increasing the number and breadth of our competitors. In recent years, new and well-funded competitors have begun competing in certain aspects of our business. For example, two major common carriers of goods have retail outlets that allow them to compete directly for copy, printing, packaging and shipping business, and offer products and services similar to those we offer. While they do not yet have the breadth of products that we offer, they are extremely competitive in the areas of package shipping and copy and print centers. Recently, the so-called warehouse clubs have expanded upon their in-store offerings by adding catalog and internet sales channels, offering a broad assortment of office products for sale on a direct delivery basis. In order to achieve and maintain expected profitability levels in our three operating divisions, we must continue to grow by adding new customers and taking market share from competitors and using pricing necessary to retain existing customers. If we fail to adequately address and respond to these pressures in both North America and internationally, it could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Government Contracts: One of our largest U.S. clients currently consists of various state and local governments, a relationship, which is subject to uncertain future funding levels and federal and state procurement laws and requires restrictive contract terms; any of these factors could curtail current or future business. Contracting with state and local governments is highly competitive and can be expensive and time-consuming, often requiring that we incur significant upfront time and expense without any assurance that we will win a contract. Our ability to compete successfully for and retain business with the federal and various state and local governments is highly dependent on cost-effective performance. Our government business is also sensitive to changes in national and international priorities and U.S., state and local government budgets.

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Execution of Expansion Plans: We plan to open approximately 15 stores in the North American Retail Division during 2009. Circumstances outside of our control could negatively impact these anticipated store openings. We cannot determine with certainty whether our new store openings, including some newly sized or formatted stores or retail concepts, will be successful. The failure to expand by successfully opening new stores as planned, or the failure of a significant number of these stores to perform as planned, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Costs of Remodeling and Re-merchandising Stores: Remodeling and re-merchandising our stores is a necessary aspect of maintaining a fresh and appealing image to our customers. The expenses associated with such activities could have a significant negative impact on our future earnings. Business lost during remodeling periods, because of customer inconvenience, may not be recovered or successfully redirected to other stores in the area. Our growth, through both store openings and possible acquisitions, may continue to require the expansion and upgrading of our information, operational and financial systems, as well as necessitate the hiring of new store associates at all levels. If we are unsuccessful in achieving an acceptable return on this design, unsuccessful at hiring the right associates, or unsuccessful at implementing appropriate systems, such failure could have a material adverse effect on our business, financial condition, results of operations and cash flows.

International Activity: We may enter additional international markets as attractive opportunities arise. Such entries could take the form of start-up ventures, acquisitions of stock or assets or joint ventures or licensing arrangements. Internationally, we face such risks as foreign currency fluctuations, unstable political and economic conditions, and, because some of our foreign operations are not wholly owned, the potential for compromised operating control in certain countries. In addition, the business cultures in certain areas of the world are different than those that prevail in the United States, and we may be at a competitive disadvantage against other companies that do not have to comply with standards of financial controls, Foreign Corrupt Practices Act requirements, or business integrity that we are committed to maintaining as a U.S. publicly traded company. Our results may continue to be affected by all of these factors. All of these risks could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Product Availability; Potential Cost Increases: In addition to selling our private brand merchandise, we are a reseller of other manufacturers branded items and are thereby dependent on the availability and pricing of key products, including ink, toner, paper and technology products, to name a few. As a reseller, we cannot control the supply, design, function or cost of many of the products we offer for sale. Disruptions in the availability of raw materials used in production of these products may adversely affect our sales and result in customer dissatisfaction. Further, we cannot control the cost of manufacturers products and cost increases must either be passed along to our customers or result in an erosion of our earnings. Failure to identify desirable products and make them available to our customers when desired and at attractive prices could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Global Sourcing of Products/Private Brand: In recent years, we have substantially increased the number and types of products that we sell under our private brands. We currently offer general office supplies, computer supplies, business machines and related supplies, and office furniture under various labels, including Office Depot®, Viking Office Products®, Niceday , Foray®, Ativa®, Break Escapes , Worklife and Christopher Lowell™. Sources of supply may prove to be unreliable, or the quality of the globally sourced products may vary from our expectations. We have recently opened our own product sourcing office in China and are reducing our reliance on the use of third-party trading companies. While this may improve our cost structure, it also makes our company more accountable for relationships with the Asian factories and other sources of private branded product and increases our risks associated with doing business in that region of the world. Economic and civil unrest in areas of the world where we source such products, as well as shipping and dockage issues could adversely impact the availability or cost of such products, or both. Moreover, as we seek indemnities from the manufacturers of these products, the uncertainty of realization of any such indemnity and the lack of understanding of U.S. product liability laws in certain parts of Asia make it more likely that we may have to respond to claims or complaints from our customers as if we were the manufacturer of the products. Most of our imported goods to the United States arrive from Asia, and the ports through which these goods are imported are located primarily on the West Coast. Therefore, we are subject to potential disruption of our supplies of goods for resale due to labor unrest, security issues or natural disasters affecting any or all of these ports. Finally, as a significant importer of manufactured goods from foreign countries, we are vulnerable to security concerns, labor unrest and other factors that may affect the availability and reliability of ports of entry for the products that we source. Any of these circumstances could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Possible Business Disruption Because of Weather: Weather conditions may affect any business, especially retail businesses, including snow storms, high winds and heavy rain. Because of our heavy concentration in the southern United States (including Florida and the Gulf Coast), our company may be more susceptible than some others to the effects of tropical weather disturbances. For example, during 2004 and 2005, we sustained disruption to our businesses in the United States due to the number and severity of weather events in the Southeastern United States, including record numbers of hurricanes. While we have been able to recover quickly from these events in the past, the long-range weather forecast calls for higher than normal tropical storm activity, especially in the Southeastern United States, for a number of years into the future. It is impossible to know whether these storms will occur as forecasted, or the location or severity of such storms. Winter storm conditions in the Midwest and Southwest, areas that also have a large concentration of our business activities, could result in supply chain constraints or other business disruptions. We believe that we have taken reasonable precautions to prepare for any such weather-related events, but our precautions may not be adequate to deal with such events in the future. If these events occur in the future (as they almost certainly will), and if they should impact areas in which we have concentrations of retail stores or distribution facilities, such events could have a material adverse effect on our business, financial condition, results of operations and cash flows.

New Systems and Technology: We frequently modify our information systems and technology to increase productivity and efficiency. We are undertaking certain system enhancements and conversions that, if not done properly, could divert the attention of our workforce during development and implementation and constrain for some time our ability to provide the level of service our customers demand as well as our ability to complete requisite filings with the SEC. Also, when implemented, the new systems and technology may not provide the benefits anticipated and could add costs and complications to our ongoing operations. A failure to effectively convert to these systems or to realize the intended efficiencies could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Labor: We are heavily dependent upon our labor force to identify new customers and provide desired products and services to existing customers. We attempt to attract and retain an appropriate level of personnel in both field operations and corporate functions. Our compensation packages are designed to provide benefits commensurate with our level of expected service. However, within our retail operations, we face the challenge of filling many positions at wage scales that are appropriate to the industry and competitive factors. We operate in a number of jurisdictions. It can be cumbersome to comply with labor laws and regulations, many of which vary from jurisdiction to jurisdiction. This has added to our labor costs in some locales as we have had to add personnel to monitor and track compliance with sometimes arcane rules and regulations that impact retailers in particular. As a result of these and other factors, we face many external risks and internal factors in meeting our labor needs, including competition for qualified personnel, overall unemployment levels, works councils (in our international locations), prevailing wage rates, as well as rising employee benefit costs, including insurance costs and compensation programs. We also engage third parties in some of our processes such as delivery and transaction processing and these providers may face similar issues. Changes in any of these factors, including especially a shortage of available workforce in the areas in which we operate, could interfere with our ability to adequately provide services to customers and result in increasing our labor costs. Any failure to meet increasing demands on securing our workforce could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, changes in the process for our employees to join a union could disrupt our business and add costs.

Unionization: While our management believes that our employee relations are good, we cannot be assured that we will not experience pressure from labor unions or become the target of campaigns similar to those faced by our competitors. The potential for unionization could increase if the United States Congress passes federal card check legislation. We have always respected our employees right to unionize or not to unionize. However, the unionization of a significant portion of our workforce could increase our overall costs at the affected locations and adversely affect our flexibility to run our business in the most efficient manner to remain competitive or acquire new business. In addition, significant union representation would require us to negotiate wages, salaries, benefits and other terms with many of our employees collectively and could adversely affect our results of operations by increasing our labor costs or otherwise restricting our ability to maximize the efficiency of our operations.

Operating Costs: We operate a large network of stores and delivery centers around the globe. As such, we purchase significant amounts of fuel needed to transport products to our stores and customers. We also incur significant shipping costs to bring products from overseas producers to our distribution systems. While we may hedge our anticipated fuel purchases, the underlying commodity costs associated with this transport activity have been volatile in recent periods and disruptions in availability of fuel could cause our operating costs to rise significantly to the extent not covered by our hedges. Additionally, we rely on predictable and available energy costs to light our stores and operate our equipment. Increases in any of the components of energy costs could have an adverse impact on our earnings, as well as our ability to satisfy our customers in a cost effective manner. Any of these factors that could impact the availability or cost of our energy resources could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Possible Changes to Our Global Tax Rate: As a result of our operations in many foreign countries, in addition to the United States, our global tax rate is derived from a combination of applicable tax rates in the various jurisdictions in which we operate. Depending upon the sources of our income, any agreements we may have with taxing authorities in various jurisdictions, and the tax filing positions we take in various jurisdictions, our overall tax rate may be lower or higher than that of other companies or higher or lower than our tax rates have been in the past. At any given point in time, we base our estimate of an annual effective tax rate upon a calculated mix of the tax rates applicable to our company and to estimates of the amount of income likely to be generated in any given geography. The loss of one or more agreements with taxing jurisdictions, a change in the mix of our business from year to year and from country to country, changes in rules related to accounting for income taxes, changes in tax laws in any of the multiple jurisdictions in which we operate or adverse outcomes from the tax audits that regularly are in process in any of the jurisdictions in which we operate could result in an unfavorable change in our overall tax rate, which change could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Regulatory Environment: While businesses are subject to regulatory matters relating to the conduct of their businesses, including consumer protection laws, advertising regulations, wage and hour regulations and the like, certain jurisdictions have taken a particularly aggressive stance with respect to such matters and have stepped up enforcement, including fines and other sanctions. We transact substantial amounts of business in certain such jurisdictions, and to the extent that our business locations are exposed to what might be termed an overly aggressive enforcement environment or legal or regulatory systems that authorize or encourage private parties to pursue relief under so-called private attorney general laws and similar authorizations for private parties to pursue enforcement of governmental laws and regulations, the resulting fines and exposure to third party liability (such as monetary recoveries and recoveries of attorneys fees) could have a material adverse effect on our business and results of operations, including the added cost of increased preventative measures that we may determine to be necessary to conduct business in such locales.

Compromises of our Information Security: Through our sales and marketing activities, we collect and store certain personal information that our customers provide to purchase products or services, enroll in promotional programs, register on our web site, or otherwise communicate and interact with us. We also gather and retain information about our associates in the normal course of business. We may share information about such persons with vendors that assist with certain aspects of our business. Despite instituted safeguards for the protection of such information, we cannot be certain that all of our systems are entirely free from vulnerability to attack. A breach of our security system resulting in customer or employee personal information being obtained by unauthorized persons could adversely affect our reputation, disrupt our operations and expose us to claims from customers, financial institutions, payment card associations and other persons, which could have a material adverse effect on our business, financial condition and results of operations. In addition, our online operations at www.officedepot.com depend upon the secure transmission of confidential information over public networks, including information permitting cashless payments.

Pursuit or Execution of New Business Ventures: Our growth strategy includes expansion via new business ventures, strategic alliances and acquisitions both in the U.S. and abroad. While we employ several different valuation methodologies to assess a potential opportunity, we can give no assurance that new business ventures and strategic alliances will positively affect our financial performance. Acquisitions may result in the diversion of our capital and our management s attention from other business issues and opportunities. We may not be able to assimilate or integrate successfully companies that we acquire, including their personnel, financial systems, distribution, operations and general operating procedures. If we fail to assimilate or integrate acquired companies successfully, our business could suffer materially. We may also encounter challenges in achieving appropriate internal control over financial reporting in connection with the integration of an acquired company. In addition, the integration of any acquired company, and its financial results, into ours may have a material adverse effect on our financial condition, results of operations and cash flows.

Disclaimer of Obligation to Update

We assume no obligation (and specifically disclaim any such obligation) to update these Risk Factors or any other forward-looking statements contained in this Annual Report to reflect actual results, changes in assumptions or other factors affecting such forward-looking statements.

Item 1B. Unresolved Staff Comments.

None.

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Item 2. Properties.

As of January 24, 2009, we operated 1,238 office supply stores in 49 U.S. states, the District of Columbia and Puerto Rico, 29 office supply stores in five Canadian provinces and 162 office supply stores (excluding our participation in arrangements through non-consolidated entities) in six countries outside of the United States and Canada. The following table sets forth the locations of these facilities. As of January 24, 2009, we also had 19 DCs in 15 U.S. states and one Canadian province and 43 DCs in 16 countries outside of the United States and Canada.

STORES

State/Country	#	State/Country	#
UNITED STATES:			
Alabama	21	North Dakota	2
Alaska	2	Ohio	17
Arizona	7	Oklahoma	17
Arkansas	12	Oregon	22
California	153	Pennsylvania	25
Colorado	41	Puerto Rico	5
Connecticut	6	Rhode Island	2
Delaware	4	South Carolina	21
District of Columbia	1	South Dakota	1
Florida	147	Tennessee	27
Georgia	50	Texas	148
Hawaii	4	Utah	11
Idaho	6	Virginia	27
Illinois	64	Washington	39
Indiana	24	West Virginia	3
Iowa	5	Wisconsin	14
Kansas	9	Wyoming	3
Kentucky	21	TOTAL UNITED STATES	1,238
Louisiana	36		
Maine	2	**CANADA:**	
Maryland	32	Alberta	7
Massachusetts	7	British Columbia	9
Michigan	27	Manitoba	2
Minnesota	12	Ontario	9
Mississippi	16	Saskatchewan	2
Missouri	29	TOTAL CANADA	29
Montana	4		
Nebraska	6	FRANCE	48
Nevada	21	HUNGARY	17
New Hampshire	1	ISRAEL	44
New Jersey	23	JAPAN	27
New Mexico	7	SOUTH KOREA	13
New York	16	SWEDEN	13
North Carolina	38	TOTAL OUTSIDE NORTH AMERICA	162

We did not open or close any retail stores during January 2009. We plan to close 118 stores in North America, of which 116 are part of the strategic review launched in the fourth quarter of 2008. We also plan to exit our retail operations in Japan during 2009. See Charges discussed in MD&A for additional information.

DCs

State/Country	#	State/Country	#
UNITED STATES:			
Arizona	1	BELGIUM	1
California	2	CHINA	

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Patheon Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(unaudited)

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
(in millions of U.S. dollars)	$	$	$	$
Net loss attributable to restricted voting shareholders	(0.7)	(3.0)	(11.4)	(3.2)
Other comprehensive (loss) income, net of income taxes				
Change in foreign currency gains on investments in subsidiaries, net of hedging activities[1]	(11.8)	(4.2)	24.7	(14.8)
Change in value of derivatives designated as foreign currency and interest rate cash flow hedges[2]	0.2	(0.7)	4.2	8.6
Losses on foreign currency and interest rate cash flow hedges reclassified to consolidated statement of loss[3]	(1.1)	(0.5)	(2.5)	(5.7)
Other comprehensive (loss) income for the period	(12.7)	(5.4)	26.4	(11.9)
Comprehensive (loss) income attributable to restricted voting shareholders	(13.4)	(8.4)	15.0	(15.1)

see accompanying notes

The amounts disclosed in other comprehensive income have been recorded net of income taxes as follows:

1 Net of an income tax benefit of $0.3 million and an expense of $1.4 million for the three and nine months ended July 31, 2011. (Net of an income tax expense of $1.8 million for the three and nine months ended July 31, 2010.)

2

Net of an income tax benefit of $0.1 million and an expense of $0.9 million for the three and nine months ended July 31, 2011. (Net of an income tax expense of $0.9 million and $2.4 million for the three and nine months ended July 31, 2010.)

[3] Net of an income tax benefit of $0.4 million and $0.9 million for the three and nine months ended July 31, 2011.

(Net of an income tax benefit of nil and $0.8 million for the three and nine months ended July 31, 2010.)

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Patheon Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
(in millions of U.S. dollars)	$	$	$	$
Operating activities				
Loss before discontinued operations	(0.5)	(3.0)	(10.9)	(2.4)
Add (deduct) charges to operations not requiring a current cash payment				
Depreciation and amortization	12.6	13.2	40.8	39.5
Impairment charge		2.1		3.4
Non-cash interest	0.4	0.2	0.8	2.3
Change in other long-term assets and liabilities	(7.6)	0.4	(9.7)	(8.9)
Future income taxes	(0.6)	1.4	10.3	(11.7)
Amortization of deferred revenues	(1.6)	(13.0)	(42.6)	(24.5)
(Gain) loss on sale of fixed assets	(0.1)		0.1	0.1
Stock-based compensation expense	1.3	0.8	2.6	1.4
Other	0.1	0.4	0.4	
	4.0	2.5	(8.2)	(0.8)
Net change in non-cash working capital balances related to continuing operations	(0.1)	(12.3)	(6.8)	(3.4)
Increase in deferred revenues	7.6	3.8	27.2	44.1
Cash provided by (used in) operating activities of continuing operations	11.5	(6.0)	12.2	39.9
Cash (used in) provided by operating activities of discontinued operations	(0.1)	0.3	(0.5)	(0.8)
Cash provided by (used in) operating activities	11.4	(5.7)	11.7	39.1
Investing activities				
Additions to capital assets	(10.2)	(13.5)	(31.2)	(32.9)
Proceeds on sale of capital assets	0.1		0.3	
Net increase in investments				(0.9)
Investment in intangibles				(0.2)
Cash used in investing activities of continuing operations	(10.1)	(13.5)	(30.9)	(34.0)
Cash used in investing activities	(10.1)	(13.5)	(30.9)	(34.0)
Financing activities				
Increase (decrease) in short-term borrowings	3.5	3.5	1.3	(9.1)
Increase in long-term debt	6.0	2.0	6.0	288.9
Repayment of long-term debt	(6.2)	(2.1)	(7.4)	(246.4)

Cash provided by (used in) financing activities of continuing operations	3.3	3.4	(0.1)	33.4
Cash provided by (used in) financing activities	3.3	3.4	(0.1)	33.4
Effect of exchange rate changes on cash and cash equivalents	(4.4)	(3.0)	5.3	(3.8)
Net increase (decrease) in cash and cash equivalents during the period	0.2	(18.8)	(14.0)	34.7
Cash and cash equivalents, beginning of period	39.3	75.8	53.5	22.3
Cash and cash equivalents, end of period	39.5	57.0	39.5	57.0
Supplemental cash flow information				
Interest paid	0.3	3.8	12.5	11.1
Income taxes (received) paid, net	(1.3)	5.7	(0.6)	4.8

see accompanying notes

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(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 Canadian generally accepted accounting principles (Canadian GAAP) on a basis consistent with those followed in the most recent audited consolidated financial statements except as noted below. Operating results for the three and nine months ended July 31, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending October 31, 2011 (fiscal 2011). These consolidated financial statements do not include all the information and footnotes required by Canadian 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, 2010 (fiscal 2010).

The preparation of the consolidated financial statements in conformity with Canadian 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 had no changes in accounting policy from the previously audited consolidated financial statements for fiscal 2010.

Recently issued accounting pronouncements

(a) Business combinations
Canadian Institute of Chartered Accountants (CICA) Section 1582, Business Combinations, replaces Section 1581, Business Combinations. Section 1582 was intended to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. This section outlines a variety of changes, including, but not limited to the following: an expanded definition of a business, a requirement to measure all business combinations and non-controlling interests at fair value, and a requirement to recognize future income tax assets and liabilities and acquisition and related costs as expenses of the period. The section applies to annual and interim financial statements for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Currently the Company does not believe these standards will have a material impact on the financial statements.

(b) Consolidations

In January 2009, the CICA issued Handbook Section 1601, Consolidations (CICA 1601), and Section 1602, Non-controlling Interests (CICA 1602). CICA 1601 establishes standards for the preparation of consolidated financial statements. CICA 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These sections apply to annual and interim financial statements for fiscal years beginning on or after January 1, 2011, with early adoption permitted. The Company does not believe these standards will have a material impact on the financial statements.

(c) Multiple deliverable revenue arrangements

In December 2009, the Emerging Issues Committee issued EIC-175, Multiple Deliverable Revenue Arrangements. This Abstract addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this Abstract addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This standard may be applied prospectively and should be applied to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. The Company does not believe this standard will have a material impact on the financial statements.

(d) Future accounting changes (U.S. GAAP and International Financial Reporting Standards)

In February 2008, the Canadian Accounting Standards Board confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRSs) in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011, unless, as permitted by Canadian securities regulations, registrants adopt U.S. generally accepted accounting principles (U.S. GAAP) on or before this date. The Company filed a registration statement with the United States Securities and Exchange Commission (the SEC) on February 25, 2011 that became effective on April 26, 2011. As a consequence, the Company will convert to and report under U.S. GAAP beginning with the fiscal year ending October 31, 2012. As a result, the Company will not adopt IFRSs on November 1, 2011.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

2. Discontinued operations and plant consolidations
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. During fiscal 2010, the Company received a letter of intent for the purchase of its Caguas facility for a purchase price of $7.0 million, which resulted in the Company increasing the impairment charge related to the value of the land to $3.6 million from the initial impairment amount of $1.3 million recorded earlier in fiscal 2010. 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, the Company now expects the transition to continue beyond the end of calendar year 2012. Therefore, the letter of intent was rescinded, and the extended time-frame will result in additional repositioning costs. The Company has increased its estimated total project repositioning expenses from $9.0 million to $11.5 million, of which an additional $0.9 million of severance costs was included in the repositioning expenses of $1.9 million booked in the three months ended July 31, 2011. 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 Company closed its Carolina facility in Puerto Rico effective January 31, 2009. In the second half of fiscal 2010, the Company performed an impairment analysis based on recent offers, which resulted in the complete write down as the fair value less the cost to sell was nil. The Company continues marketing this property. The results of the Carolina operations for the three and nine months ended July 31, 2011 and 2010 are reported in discontinued operations as follows:

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
	$	$	$	$
Revenues				
Cost of goods sold				
Gross loss				
Selling, general and administrative expenses	0.2		0.5	0.8
Operating loss	(0.2)		(0.5)	(0.8)
Loss before income taxes	(0.2)		(0.5)	(0.8)
Net loss for the period	(0.2)		(0.5)	(0.8)

3. 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, 2011:

	Outstanding	Exercisable
Class I preferred shares series D[1]	150,000	N/A
Restricted voting shares	129,167,926	N/A
Restricted voting share stock options	12,725,924	3,666,957

[1] Special voting preferred shares held by JLL Patheon Holdings, LLC (JLL) entitling it to elect up to three of our directors based on the number of restricted voting shares that it holds.

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4. Segmented information

The Company is organized and managed in two business segments: commercial manufacturing and pharmaceutical development services (PDS). These segments are organized around the service activities provided to the Company s customers.

	As of and for the three months ended July 31, 2011			
	Commercial $	PDS $	Corp. & Other $	Total $
Revenues	138.7	34.0		172.7
Adjusted EBITDA	11.5	9.3	(8.9)	11.9
Depreciation	10.9	1.4	0.3	12.6
Capital expenditures	8.3	1.7	0.2	10.2

	As of and for the three months ended July 31, 2010			
	Commercial $	PDS $	Corp. & Other $	Total $
Revenues	130.2	33.1		163.3
Adjusted EBITDA	17.9	11.3	(5.5)	23.7
Depreciation	11.6	1.4	0.2	13.2
Capital expenditures	11.3	2.1	0.1	13.5

	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	20.0	(28.3)	55.8
Total assets	682.2	77.8	79.1	839.1
Depreciation	35.8	4.2	0.8	40.8
Goodwill	3.6			3.6
Capital expenditures	25.4	5.3	0.5	31.2

	As of and for the nine months ended July 31, 2010			
	Commercial $	PDS $	Corp. & Other $	Total $
Revenues	400.5	93.0		493.5
Adjusted EBITDA	45.7	35.8	(18.4)	63.1
Total assets	626.3	66.8	94.7	787.8
Depreciation	34.7	4.4	0.4	39.5
Impairment	3.4			3.4
Goodwill	3.4			3.4
Capital expenditures	28.3	4.4	0.2	32.9

Cash and cash equivalents as well as future 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 fixed assets, gain on extinguishment of debt, income taxes, asset impairment charges, depreciation and amortization and other income and expenses. The Company s presentation of Adjusted EBITDA may not be comparable to similarly-titled measures used by other companies.

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

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
	$	$	$	$
Total Adjusted EBITDA	11.9	23.7	55.8	63.1
Depreciation and amortization	(12.6)	(13.2)	(40.8)	(39.5)
Repositioning expenses	(1.9)	(2.4)	(3.4)	(5.8)
Interest expense, net	(6.3)	(6.3)	(18.9)	(13.2)
Impairment charge		(2.1)		(3.4)
Gain (loss) on sale of fixed assets	0.1		(0.1)	(0.1)
Refinancing expenses		(0.3)		(12.0)
Benefit from (provision for) income taxes	2.7	(2.0)	(8.6)	8.4
Other income (expense), net	5.6	(0.4)	5.1	0.1
Loss before discontinued operations	(0.5)	(3.0)	(10.9)	(2.4)

As illustrated 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, 2011				
	Canada	US*	Europe	Other	Total
	$	$	$	$	$
Revenues	3.6	88.9	69.6	10.6	172.7

	Three months ended July 31, 2010				
	Canada	US*	Europe	Other	Total
	$	$	$	$	$
Revenues	4.1	80.1	62.0	17.1	163.3

* Includes Puerto Rico

	As of and for the nine months ended July 31, 2011				
	Canada	U.S.*	Europe	Other	Total
	$	$	$	$	$
Revenues	8.9	246.2	237.2	26.1	518.4
Capital assets	118.8	132.9	229.7	1.8	483.2
Goodwill	3.6				3.6

	As of and for the nine months ended July 31, 2010				
	Canada	U.S.*	Europe	Other	Total
	$	$	$	$	$
Revenues	12.3	239.3	215.7	26.2	493.5
Capital assets	116.7	130.2	215.9	1.0	463.8
Impairment		3.4			3.4
Goodwill	3.4				3.4

* Includes Puerto Rico

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5. 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. The plan previously provided that the maximum number of shares that may be issued under the plan was 7.5% of the sum, at any point in time, of the issued and outstanding restricted voting shares of the Company and the aggregate number of restricted voting shares issuable upon exercise of the conversion rights attached to the issued and outstanding Class I Preferred Shares, Series C of the Company. As of July 31, 2011 and 2010, the total number of restricted voting shares issuable under the plan was 15,500,151 shares and 9,687,594 shares, respectively, of which there were stock options outstanding to purchase 12,725,924 shares and 8,333,928 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 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.

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.

The fair value of stock options is estimated at the date of the grant. The weighted-average fair value of the 400,000 and 5,442,000 stock options granted for each of the three and nine months ended July 31, 2011 was CAD$1.09 and CAD$1.34. The fair value of stock options is estimated using the Black-Scholes option pricing model with the following assumptions:

	Three months ended July 31, 2011	Nine months ended July 31, 2011
Risk free interest rate	2.2%	2.5%
Expected volatility	59%	59%
Expected weighted-average life of options	5 years	5 years
Expected dividend yield	0%	0%

Stock-based compensation expense recorded in the three and nine months ended July 31, 2011 was $1.3 million and $2.6 million, respectively, impacted by new options granted including those to the Company s new Chief Executive Officer (CEO), partially offset by the forfeitures of stock options related to the departure of the Company s previous CEO. Stock-based compensation expense recorded in the three and nine months ended July 31, 2010 was $0.8 million and $1.4 million, respectively.

6. Repositioning expenses

During the three and nine months ended July 31, 2011, the Company incurred $1.9 million and $3.4 million, respectively, in expenses associated with the shutdown of its Caguas facility. As a result of additional time required to transition manufacturing operations from Caguas to Manati due to longer than expected customer regulatory time lines, increased product demand and fewer than expected employee transfers, the Company will incur additional repositioning costs. The Company has increased its estimated total project repositioning expenses from $9.0 million to $11.5 million, of which an additional $0.9 million of severance costs was included in the repositioning expenses in the three months ended July 31, 2011. During the three and nine months ended July 31, 2010, the Company incurred $2.4 million and $5.8 million, respectively, in expenses associated with the shutdown of its Caguas facility.

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The following is a summary of these expenses as of and for the three and nine months ended July 31, 2011 and 2010:

	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 three months ended July 31, 2010			
	Commercial $	PDS $	Corporate $	Total $
Total repositioning liabilities at April 30, 2010				2.6
Employee-related expenses	1.8			1.8
Consulting, professional and project management costs	0.6			0.6
Total expenses	2.4			2.4
Repositioning expenses paid				(1.4)
Foreign exchange				(0.1)
Total repositioning liabilities at July 31, 2010				3.5

	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 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

	As of and for the nine months ended July 31, 2010			
	Commercial $	PDS $	Corporate $	Total $
Total repositioning liabilities at October 31, 2009				2.9
Employee-related expenses	3.6			3.6
Consulting, professional and project costs	2.2			2.2
Total expenses	5.8			5.8
Repositioning expenses paid				(5.0)
Foreign exchange				(0.2)
Total repositioning liabilities at July 31, 2010				3.5

7. Other information

Foreign exchange

During the three months ended July 31, 2011, the Company recorded foreign exchange gains of $3.6 million. These gains were primarily due to gains on hedging and operating exposures. During the nine months ended July 31, 2011, the Company recorded foreign exchange losses of $3.2 million. These losses related to operating exposures, partially offset by hedging gains on forward contracts. During the three and nine months ended July 31, 2010, the Company recorded foreign exchange gains of $2.2 million and $3.5 million, respectively, primarily on hedging gains. These gains were partially offset by losses related to operating exposures.

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Employee future benefits

The employee future benefit expense in connection with defined benefit pension plans and other post retirement benefit plans for the three and nine months ended July 31, 2011 was $1.9 million and $5.8 million, respectively. The employee future benefit expense in connection with defined benefit pension plans and other post retirement benefit plans for the three and nine months ended July 31, 2010 was $1.6 million and $5.3 million, respectively.

Other (income) expense, net

In May 2011, the Company settled an on-going insurance claim covering all current and future costs associated with water damage at its Swindon, U.K. facility for approximately $16.0 million. The Company recorded a settlement receivable of approximately $2.4 million against cost of goods sold (costs primarily related to repairs and maintenance, cleaning, validation, inspection, and compliance) in the fourth quarter of fiscal 2010, which was subsequently received in the first quarter of fiscal 2011. In the second quarter of fiscal 2011, the Company recorded an additional $2.6 million as a settlement receivable against cost of goods sold. In the third quarter of fiscal 2011, the Company received the final payout from the settlement of approximately $13.6 million. A portion of the settlement was used to offset capital expenditures and accrue for future remediation liabilities, with the remaining $6.0 million booked as other income.

8. Financial instruments and risk management
Categories of financial assets and liabilities

Under Canadian GAAP, financial instruments are classified into one of the following five categories: held-for-trading, held to maturity investments, loans and receivables, available-for-sale financial assets and other financial liabilities. The Company has also designated certain of its derivatives as effective hedges. The carrying values of the Company s financial instruments, including those held for sale on the consolidated balance sheets, are classified into the following categories:

	As of July 31, 2011 $	As of October 31, 2010 $
Held-for-trading [1]	39.5	53.5
Loans and receivables [2]	148.1	139.9
Other financial liabilities [3]	450.2	437.0
Derivatives designated as effective hedges [4] - gain	3.0	1.3
Other derivatives [5]	0.2	0.7

[1] Includes cash and cash equivalents in bank accounts bearing interest rates up to 1%.
[2] Includes accounts receivable.
[3] Includes bank indebtedness, accounts payable, accrued liabilities and long-term debt.
[4] Includes the Company s forward contracts and collars in 2011 and forward contracts in 2010.
[5] Includes the embedded call option on the Company s senior secured notes due April 15, 2017.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; 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, 2011 and October 31, 2010, the carrying amount of the financial assets that the Company has pledged as collateral for its long-term debt facilities was $105.7 million and $101.5 million, respectively.

Fair value measurements

The fair value under CICA Section 3862, Financial Instruments Disclosure, 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, 2011 and October 31, 2010:

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Assets measured at fair value

	Fair value measurement at July 31, 2011 using:				Fair value measurement at October 31, 2010 using:			
	Level 1 $	Level 2 $	Level 3 $	Total $	Level 1 $	Level 2 $	Level 3 $	Total $
Derivatives designated as hedging instruments:								
Foreign exchange forward contracts		1.5		1.5		1.3		1.3
Foreign exchange collars		1.8		1.8				
Total assets		3.3		3.3		1.3		1.3
Derivatives not designated as hedging instruments:								
Embedded call option on Notes			0.2	0.2			0.7	0.7
Total assets			0.2	0.2			0.7	0.7

Liabilities measured at fair value

	Fair value measurement at July 31, 2011 using:				Fair value measurement at October 31, 2010 using:			
	Level 1 $	Level 2 $	Level 3 $	Total $	Level 1 $	Level 2 $	Level 3 $	Total $
Derivatives designated as hedging instruments:								
Foreign exchange forward contracts		0.1		0.1				
Foreign exchange collars		0.2		0.2				
Total liabilities		0.3		0.3				

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.

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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, 2011 and October 31, 2010:

Fair values of derivative instruments

	Asset derivatives as of July 31, 2011		Asset derivatives as of October 31, 2010	
	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	1.3
Foreign exchange collars	Prepaid expenses and other	1.8		
Total designated derivatives		3.3		1.3
Derivatives not designated as hedging instruments:				
Embedded call option on Notes	Other long-term assets	0.2	Other long-term assets	0.7
Total non-designated derivatives		0.2		0.7

	Liability derivatives as of July 31, 2011		Liability derivatives as of October 31, 2010	
	Balance sheet location	Fair Value $	Balance sheet location	Fair Value $
Derivatives designated as hedging instruments:				

Foreign exchange forward contracts	Accounts payable and accrued liabilities	0.1
Foreign exchange collars	Other long-term liabilities	0.2
Total designated derivatives		0.3

The Company has optional pre-payment clauses on its senior secured notes due April 15, 2017 (the Notes), and is therefore required to account for the value of these optional pre-payment clauses separately as an embedded derivative under Canadian GAAP. The embedded derivative has been bifurcated from the Notes and recorded separately at fair value. In each subsequent period any change in fair value will be recorded as income or expenses in the Company s consolidated statements of income (loss).

The Company uses valuations from a third party evaluator to assist in estimating the fair value of the embedded call option on the Notes. These third party valuations are completed on a quarterly basis, and take into consideration current market rates and trends. For the debt instruments with embedded options, evaluators determine the price both with and without the option; the price without the option is the base price. In the case of debt instruments with calls, the final evaluation is the lesser of base price and price with call. The evaluator uses models that use the income approach, which discounts future cash flows to the net present value of the security, as the valuation technique.

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The following table presents a reconciliation of the closing balance with respect to the Company s only Level 3 financial instrument as of July 31, 2011:

Assets measured at fair value based on Level 3

	Embedded call option on Notes $	Total $
Opening balance (October 31, 2010)	0.7	0.7
Purchases		
Issues		
Total (losses) gains		
In net loss	(0.5)	(0.5)
In other comprehensive (loss) income		
Settlements		
Transfers out of Level 3		
Closing balance (July 31, 2011)	0.2	0.2

Foreign exchange forward contracts and other hedging arrangements

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

As of July 31, 2011, the Company s Canadian operations had entered into foreign exchange forward contracts to sell an aggregate amount of US$14.2 million. These contracts hedge the Canadian operations expected exposure to U.S. dollar denominated cash flows and mature at the latest on January 10, 2012, at an average exchange rate of $1.0568 Canadian. The mark-to-market value of these financial instruments as of July 31, 2011 was an unrealized gain of $1.5 million, which has been recorded in accumulated other comprehensive income in shareholders equity, net of associated income tax.

As of July 31, 2011, the Company s Canadian operations had entered into foreign exchange collars to sell an aggregate amount of US$104.5 million. These contracts hedge the Canadian operations expected exposure to U.S. dollar denominated cash flows and mature at the latest on January 2, 2013, at an average exchange rate of $0.9855 Canadian. The mark-to-market value of these financial instruments as of July 31, 2011 was an unrealized gain of $1.6 million, which has been recorded in accumulated other comprehensive income in shareholders equity, net of associated income tax.

As of July 31, 2011, 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 cash flows and mature at the latest on October 7, 2011, at an average exchange rate of $1.3929 Canadian. The mark-to-market value of these financial instruments as of July 31, 2011 was an unrealized loss of approximately $0.1 million, with nominal income tax impact, which has been recorded in accumulated other comprehensive income in shareholders equity.

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 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.

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.

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Foreign exchange risk

The Company operates in Canada, the United States, Puerto Rico, Italy, France, Switzerland, 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. Prior to the refinancing in the second quarter of fiscal 2010, the balance sheet of the Company s Canadian division included U.S. dollar denominated debt, which was designated as a hedge against the Company s investments in subsidiaries in the United States and Puerto Rico. The foreign exchange gains and losses related to the effective portion of this hedge were recorded in other comprehensive income. In the third quarter of fiscal 2010, the Company changed the functional currency of its corporate division in Canada to U.S. dollars, thereby eliminating the need for the Company to designate this U.S. dollar denominated debt as a hedge. In addition, 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, 2011, fluctuations of +/-10% would, everything else being equal, have an annual effect on (loss) income from continuing operations before income taxes of approximately +/- $8.9 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, 2011, the Company has entered into foreign exchange contracts to cover approximately 80% of its Canadian-U.S. dollar cash flow exposures for fiscal 2011. 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 (loss) in shareholders equity.

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, 2011 and October 31, 2010, the Company held deposits of $16.6 million and $14.6 million, respectively.

The carrying amounts of accounts receivable are reduced through the use of an allowance account, and the amount of the loss is recognized in the consolidated statements of income (loss) within operating expenses. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts receivable. Subsequent recoveries of amounts previously written off are credited against operating expenses in the consolidated statements of income (loss).

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The following table sets forth details of the age of receivables that are not overdue, as well as an analysis of overdue amounts and the related allowance for doubtful accounts:

	As of July 31, 2011 $
Total accounts receivable	148.5
Less: Allowance for doubtful accounts	(0.4)
	148.1
Of which:	
Not overdue	120.5
Past due for more than one day but for not more than three months	22.4
Past due more for than three months but for not more than six months	1.8
Past due for more than six months but not for more than one year	1.5
Past due for more than one year	2.3
Less: Allowance for doubtful accounts	(0.4)
Total accounts receivable, net	148.1

Liquidity risk

Liquidity risk arises when financial obligations due 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, 2011, the Company was holding cash and cash equivalents of $39.5 million and had undrawn lines of credit available to it of $98.2 million.

9. Management of capital

The Company defines the capital that it manages as the aggregate of its shareholders equity and interest bearing debt. The Company s objectives when managing capital are to ensure that the Company has adequate capital to achieve its business plans, so that it can provide products and services to its customers and returns to its shareholders.

In order to maintain or adjust its capital structure, the Company may adjust the type of capital utilized, including purchase versus lease decisions and issuing debt or equity securities, all subject to market conditions and the terms of the underlying third-party agreements.

As of July 31, 2011 and October 31, 2010, total managed capital was $566.1 million and $551.3 million, respectively, comprised of shareholders equity of $290.6 million and $273.0 million, respectively, and cash interest-bearing debt of $275.5 million and $278.3 million, respectively.

10. Related party transactions

Joaquín B. Viso, a director and significant shareholder of the Company, is the controlling shareholder of a company (the Viso Affiliate) that has two contractual commercial relationships with the Company. Revenues from the Viso Affiliate related to these relationships were less than $0.1 million for each of the three and nine months ended July 31, 2011, and were approximately $0.0 million and $0.2 million for the three and nine months ended July 31, 2010, respectively. These transactions were conducted in the normal course of business and are recorded at the exchanged amounts. There were no accounts receivable at July 31, 2011 and a balance of $0.1 million at October 31, 2010, 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 entered into between Patheon and the Viso Affiliate, but has been administered directly between Patheon and the third party on normal commercial terms since 2003.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

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As of each of July 31, 2011 and October 31, 2010, the Company had an investment of $3.3 million, representing an 18% interest in two Italian companies (collectively referred to as BSP Pharmaceuticals) whose largest investor was previously an officer of the Company. 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, 2011 and 2010, the Company recorded investment losses of less than $0.1 million and income of $0.6 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. There were no management fees recorded under this agreement for the three and nine months ended July 31, 2011 and 2010, respectively. Accounts receivable at July 31, 2011 and October 31, 2010 include a balance of $1.7 million and $2.2 million, respectively, in connection with the management services agreement. 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 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.

The cost sharing arrangement between JLL Partners Inc. (JLL Partners) and Patheon was terminated during the first quarter of fiscal 2011, and there are no outstanding payables to JLL Partners related to this arrangement.

11. Income taxes

The following is a reconciliation of the expected income tax expense (recovery) obtained by applying a single statutory tax rate to the loss from continuing operations before income taxes:

	Nine months ended July 31,	
	2011	2010
	$	$
Expected income tax recovery using statutory tax rates	(1.0)	(3.6)
Change in valuation allowance	1.6	(12.9)
Permanent differences and other:		
Foreign	(0.6)	0.8
Domestic	(0.7)	(0.9)
Foreign rate differentials	3.7	7.8

Other	5.6	0.4
Provision for (benefit from) income taxes	8.6	(8.4)
Effective tax rate	(374.0)%	78.0%

The effective tax rate for the nine months ended July 31, 2011 of (374.0)% was primarily due to the book versus tax treatment of foreign exchange gains in Canada included in Other above (resulting from the change in functional currency of the Company s corporate division in Canada to U.S. dollars as disclosed in the third quarter of fiscal 2010), tax rate differentials in foreign jurisdictions, and expenses not deductible for tax purposes in foreign jurisdictions. The change in the effective tax rate to (374.0)% in fiscal 2011 from 78.0% in fiscal 2010 was primarily due to the book versus tax treatment of foreign exchange gains in Canada recorded in Other above, the mix of earnings in the Company s subsidiaries, increase to the valuation allowance related to the U.S. local net operating losses, and the release of the valuation reserve in Canada in fiscal 2010.

During the second quarter of fiscal 2010 the Company evaluated its valuation reserves. The Company determined that the valuation allowance on its net Canadian future tax assets was no longer required based on its assessment of the future prospects of its Canadian operations. As a result of this determination, the Company released $13.8 million of valuation allowance through income tax benefit in the income statement.

While evaluating the Company s future tax assets and liabilities during the first quarter of 2010, the Company concluded it would be able to utilize certain Investment Tax Credits (ITCs) relating to scientific research and development costs. Therefore, the Company recorded a decrease of $7.2 million in the cost of goods sold relating to the partial utilization of previous years ITCs in the nine months ended July 31, 2010.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

12. Additional disclosure required under U.S. Generally Accepted Accounting Principles (U.S. GAAP)

The Company s consolidated financial statements have been prepared in accordance with Canadian GAAP. In the case of the Company, Canadian GAAP conforms in all material respects with U.S. GAAP except for certain matters, the details of which are as follows:

Consolidated Balance Sheets

The application of U.S. GAAP has the following effects on consolidated balance sheet items as reported under Canadian GAAP:

	As of July 31, 2011				As of October 31, 2010			
	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $
Assets								
Current								
Cash and cash equivalents	39.5			39.5	53.5			53.5
Accounts receivable	148.1			148.1	139.9			139.9
Inventories	88.2			88.2	73.3			73.3
Income taxes receivable	7.5	3.2	*i*	10.7	5.7			5.7
Prepaid expenses and other	16.9			16.9	9.5			9.5
Future tax assets - short-term	10.8		*g*	10.8	9.0	(1.3)	*g*	7.7
Total current assets	311.0	3.2		314.2	290.9	(1.3)		289.6
Capital assets	483.2	(0.8)	*e*	482.4	478.3	(0.9)	*e*	477.4
Intangible assets	0.3			0.3	1.4			1.4
Deferred financing costs		6.4	*f*	6.4		7.2	*f*	7.2
Future tax assets	8.7	23.0	*c*	31.7	11.2	17.7	*c*	28.9
Goodwill	3.6			3.6	3.4			3.4
Investments	5.3			5.3	5.3			5.3
Other long-term assets	27.0	(23.0)	*c,d*	4.0	18.4	(18.4)	*c,d*	

Total assets	839.1	8.8		847.9	808.9	4.3		813.2
Liabilities and shareholders equity								
Current								
Short term borrowings	3.3			3.3	2.0			2.0
Accounts payable and accrued liabilities	171.4			171.4	156.7			156.7
Income taxes payable	0.2	(0.2)	*i*		0.4	1.0		1.4
Deferred revenues - short-term	9.8			9.8	26.7			26.7
Current portion of long-term debt	1.2			1.2	3.5			3.5
Total current liabilities	185.9	(0.2)		185.7	189.3	1.0		190.3
Long-term debt	274.3	5.5	*d,f*	279.8	274.8	6.3	*d,f*	281.1
Deferred revenues	28.1			28.1	19.2			19.2
Future tax liabilities	38.2	(0.2)	*e*	38.0	29.7	(0.3)	*e*	29.4
Other long-term liabilities	22.0	23.7	*b,g*	45.7	22.9	22.2	*b,g*	45.1
Total liabilities	548.5	28.8		577.3	535.9	29.2		565.1
Shareholders equity								
Restricted voting shares	553.8	18.1	*a*	571.9	553.8	18.1	*a*	571.9
Contributed surplus	12.6			12.6	10.0			10.0
Deficit	(342.1)	(21.0)	*a,d,e,g,i*	(363.1)	(330.7)	(25.8)	*a,d,e,g*	(356.5)
Accumulated other comprehensive income	66.3	(17.1)	*a,b,e*	49.2	39.9	(17.2)	*a,b,e*	22.7
Total shareholders equity	290.6	(20.0)		270.6	273.0	(24.9)		248.1
Total liabilities and shareholders equity	839.1	8.8		847.9	808.9	4.3		813.2

See accompanying notes.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

Consolidated Statements of Loss

The application of U.S. GAAP had the following effects on net (loss) income per share as reported under Canadian GAAP:

	Three months ended July 31, 2011			
	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $
Revenues	172.7			172.7
Cost of goods sold	145.3	1.6	*c*	146.9
Gross profit	27.4	(1.6)		25.8
Selling, general and administrative expenses	31.7			31.7
Repositioning expenses	1.9			1.9
Gain on sale of fixed assets		(0.1)	*h*	(0.1)
Operating income	(6.2)	(1.5)		(7.7)
Interest expense, net	6.3		*d*	6.3
Foreign exchange gain	(3.6)			(3.6)
Gain on sale of fixed assets	(0.1)	0.1	*h*	
Other (income) expense, net	(5.6)	(0.7)	*d*	(6.3)
Loss from continuing operations before income taxes	(3.2)	(0.9)		(4.1)
Benefit from income taxes	(2.7)	(2.0)	*c,i*	(4.7)
(Loss) income before discontinued operations	(0.5)	1.1		0.6
Loss from discontinued operations	(0.2)			(0.2)
Net (loss) income attributable to restricted voting shareholders	(0.7)	1.1		0.4
Basic and diluted (loss) income per share				
From continuing operations	(0.004)			0.005
From discontinued operations	(0.002)			(0.002)
	(0.006)			0.003
Weighted-average number of shares outstanding during period - basic and diluted (in thousands)	129,168			129,168

See accompanying notes.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	Nine months ended July 31, 2011			
	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $
Revenues	518.4			518.4
Cost of goods sold	416.1	4.0	*c*	420.1
Gross profit	102.3	(4.0)		98.3
Selling, general and administrative expenses	84.3			84.3
Repositioning expenses	3.4			3.4
Loss on sale of fixed assets		0.1	*h*	0.1
Operating income	14.6	(4.1)		10.5
Interest expense, net	18.9	0.1	*d*	19.0
Foreign exchange loss	3.2			3.2
Loss on sale of fixed assets	0.1	(0.1)	*h*	
Other (income) expense, net	(5.3)	(0.5)	*d*	(5.8)
Loss from continuing operations before income taxes	(2.3)	(3.6)		(5.9)
Provision for income taxes	8.6	(8.5)	*c,i*	0.1
Loss before discontinued operations	(10.9)	4.9		(6.0)
Loss from discontinued operations	(0.5)			(0.5)
Net loss attributable to restricted voting shareholders	(11.4)	4.9		(6.5)
Basic and diluted loss per share				
From continuing operations	(0.084)			(0.046)
From discontinued operations	(0.004)			(0.004)
	(0.088)			(0.050)
Weighted-average number of shares outstanding during period - basic and diluted (in thousands)	129,168			129,168

See accompanying notes.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	Three months ended July 31, 2010			
	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $
Revenues	163.3			163.3
Cost of goods sold	128.9	2.7	*c*	131.6
Gross profit	34.4	(2.7)		31.7
Selling, general and administrative expenses	26.1			26.1
Repositioning expenses	2.4			2.4
Impairment charge		2.1	*h*	2.1
Operating income	5.9	(4.8)		1.1
Interest expense, net	6.3			6.3
Impairment charge	2.1	(2.1)	*h*	
Foreign exchange gain	(2.2)			(2.2)
Refinancing expenses	0.3			0.3
Other (income) expense, net	0.4	(0.7)		(0.3)
Loss from continuing operations before income taxes	(1.0)	(2.0)		(3.0)
Provision for income taxes	2.0	0.5	*c,i*	2.5
Loss before discontinued operations	(3.0)	(2.5)		(5.5)
Loss from discontinued operations				
Net loss attributable to restricted voting shareholders	(3.0)	(2.5)		(5.5)
Basic and diluted loss per share				
From continuing operations	(0.023)			(0.043)
From discontinued operations				
	(0.023)			(0.043)
Weighted-average number of shares outstanding during period - basic and diluted (in thousands)	129,168			129,168

See accompanying notes.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

	Nine months ended July 31, 2010			
	Canadian GAAP $	Increase (Decrease)	Notes	U.S. GAAP $
Revenues	493.5			493.5
Cost of goods sold	391.3	9.8	*c*	401.1
Gross profit	102.2	(9.8)		92.4
Selling, general and administrative expenses	82.1			82.1
Repositioning expenses	5.8			5.8
Impairment charge		3.4	*h*	3.4
Loss on sale of fixed assets		0.1	*h*	0.1
Operating income	14.3	(13.3)		1.0
Interest expense, net	13.2			13.2
Impairment charge	3.4	(3.4)	*h*	
Foreign exchange gain	(3.5)			(3.5)
Refinancing expenses	12.0			12.0
Loss on sale of fixed assets	0.1	(0.1)	*h*	
Other (income) expense, net	(0.1)	(0.5)		(0.6)
Loss from continuing operations before income taxes	(10.8)	(9.3)		(20.1)
Benefit from income taxes	(8.4)	(8.9)	*c,i*	(17.3)
Loss before discontinued operations	(2.4)	(0.4)		(2.8)
Loss from discontinued operations	(0.8)			(0.8)
Net loss attributable to restricted voting shareholders	(3.2)	(0.4)		(3.6)
Basic and diluted loss per share				
From continuing operations	(0.019)			(0.022)
From discontinued operations	(0.006)			(0.006)
	(0.025)			(0.028)
Weighted-average number of shares outstanding during period - basic and diluted (in thousands)	129,168			129,168

See accompanying notes.

Consolidated Statements of Cash Flows

There was no material difference in cash flow presentation between Canadian GAAP and U.S. GAAP for the three and nine months ended July 31, 2011 and 2010.

Consolidated Statements of Changes in Shareholders Equity

There was no material difference in presentation of changes in shareholders equity between Canadian GAAP and U.S. GAAP for the three and nine months ended July 31, 2011 and 2010.

(a) Preferred shares

Under Canadian GAAP, the convertible preferred shares held by JLL were classified at inception as having both an equity component and a debt component. Under U.S. GAAP, however, the preferred shares would have been deemed to be mezzanine equity at inception.

As discussed above, under U.S. GAAP, the value of the preferred stock would be adjusted from its initial value on the April 27, 2007 issuance date to its redemption value over the period from issuance date to the redemption or conversion date using the method discussed in U.S. GAAP ASC 480, Distinguishing Liabilities from Equity.

In September 2008, the Company entered into an agreement (the JLL Agreement) with JLL whereby JLL agreed to waive the mandatory redemption requirement contained in the terms of its Class I, preferred shares, series C (the Series C Preferred Shares). The JLL Agreement resulted in a deemed repayment of the debt and equity components of the Series C Preferred Shares, as well as in a change in the accounting treatment for those shares. Completion of the JLL Agreement resulted in the full carrying value of the preferred shares being classified within shareholders equity on the Company s balance sheets, and no further accretive interest expense was recorded in the consolidated statements of loss. Paid-in-kind dividend equivalents on the Series C Preferred Shares were reported below net loss to arrive at a loss attributable to the restricted voting shareholders.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

(Dollar information in tabular form is expressed in millions of U.S. dollars, except per share information)

Upon settlement of the debt portion of JLL s Series C Preferred Shares, the Company recognized a gain on the extinguishment of this debt. The Company reported this gain on its consolidated statement of loss below operating income and before income from continuing operations before income taxes. Additionally, upon settlement of the equity portion of the Series C Preferred Shares, the Company recognized a loss on the deemed redemption, which increased accumulated deficit. Under U.S. GAAP, there would be no gain or loss recognized since the Series C Preferred Shares would have been recorded solely as equity from inception.

(b) Pensions and post retirement plans

Under U.S. GAAP ASC 715, Compensation Retirement Benefits, the Company is required to recognize the over or underfunded status of defined benefit pension and other post-retirement plans on its balance sheet. The over or under funded status is measured as the difference between the fair value of the plan assets and the benefit obligation, being the projected obligation for pension plans and the accumulated benefit obligation for other post-retirement plans. In addition, the Company is required to recognize any previously unrecognized actuarial gains and losses and prior service costs and credits that arise during the applicable period in other comprehensive income, net of tax. No similar requirement currently exists under Canadian GAAP. In addition, overfunded plans are reported as non-current assets and underfunded plans are reported as non-current liabilities, with expected benefit payments over the next 12 months reclassified as short-term liabilities from non-current liabilities.

(c) Investment Tax Credits

Under U.S. GAAP ASC 740, Income Taxes (ASC 740), the Company s ITCs are credited against income tax expense, whereas under Canadian GAAP CICA Section 3805, Investment Tax Credits, ITCs are offset against the related operating expense.

Because the Company s ITCs are related to research and development costs, primarily labor, assets are not typically created as a part of the operations subject to the ITC calculation pool. Therefore, the Company has determined that the flow-through method of accounting under U.S. GAAP is appropriate. Under the flow-through method, ITCs are recognized as a reduction of federal income taxes in the year in which they arise instead of being reflected in net income over the productive life of acquired property (the deferral method).

Under U.S. GAAP, the Company has reclassified the credit to cost of goods sold related to its ITCs to income tax expense and has reclassified the related ITC receivables to deferred tax assets, short-term or long-term, based upon when they are expected to be used. The ITCs will impact current tax expense when used and deferred tax expense when accumulated during the course of a fiscal year.

(d) Embedded derivative on call option premium

Under CICA Section 3855, Financial Instruments Recognition and Measurement, if the economic characteristics of an embedded derivative (in this case the call option on the Notes) are not closely related to the economic characteristics of the host contract (the Notes), then bifurcation of the embedded derivative is required. CICA Section 3855 provides that the economic characteristics of a call option are not closely related to the economic characteristics of the host contract if the call option s exercise price is not approximately equal, on each exercise date, to the amortized cost of the host contract. In determining whether the exercise price is approximately equal, the amortized cost of the host contract is assumed to be its par value at any given time. Under U.S. GAAP ASC 815, Derivatives and Hedging, the bond call provisions were considered clearly and closely related to the host instrument; as such, the embedded derivative is not valued separately from the debt. Therefore, the Canadian GAAP valuations for the call options are reversed for the U.S. GAAP presentation.

(e) Deferred transaction costs

Both U.S. GAAP ASC 805, Business Combinations, and its predecessor, Statement of Financial Accounting Standards No. 141, Business Combinations, require deferred transaction costs to be expensed as incurred. Under Canadian GAAP, such costs are capitalized and amortized over 15 years. As such, the effect of the deferred transaction costs has been reversed as of the first period presented and included in opening accumulated deficit. The impact of these costs to the consolidated statements of loss for the periods presented was not material.

(f) Deferred financing costs

In accordance with Canadian GAAP, the Company accounts for deferred financing costs, or transaction costs, as a reduction from the related liability and amortizes such costs using the effective interest method. However, for U.S. GAAP purposes, the Company accounts for these costs as an asset and amortizes them over the expected term of the financial liability using the effective interest method.

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Notes to Unaudited Consolidated Financial Statements for the Three and Nine Months Ended July 31, 2011

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(g) Reserves for uncertain tax positions

The Company adopted the uncertain tax positions standard of ASC 740 on November 1, 2007. As a result of the implementation of this standard, the Company recognized no material adjustment in the liability for unrecognized income tax benefits or effect on accumulated deficit. As of July 31, 2011 and October 31, 2010, unrecognized tax benefits were $0.8 million and $1.4 million, respectively.

(h) Long-lived assets classified as held and used

Under U.S. GAAP ASC 360, Long-Lived Assets Classified as Held and Used, impairments and gains/losses on sale of assets should be reported in operating income.

(i) Income taxes

Under U.S. GAAP ASC 740-270, Income Taxes Interim Reporting, on an interim reporting basis, an entity subject to tax in multiple jurisdictions is required to use one overall estimated annual effective tax rate to compute the income tax expense (benefit) applicable to the interim reporting period. At the end of each interim period, the entity estimates the effective tax rate expected to be applicable for the full fiscal year. This annual estimated rate is adjusted, if necessary, for any significant unusual, infrequently occurring or extraordinary items, which are separately reported as period expenses. At the end of each interim period, the entity applies the estimated annual effective tax rate to year-to-date ordinary income (loss) to compute the year-to-date income tax expense (benefit).

Under CICA Section 3465, Income Taxes, income taxes are accounted for using the asset and liability method. This method requires the entity to calculate future income taxes in each jurisdiction at the end of each interim reporting period using the current or substantively enacted tax rates that are expected to apply when temporary differences reverse. These rates are applied to year-to-date pre-tax income (loss), adjusted for known permanent or temporary differences.

Additional U.S. GAAP disclosures

Accounts payable and accrued liabilities:

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

	As of July 31, 2011	As of October 31, 2010
Trade payables	93.6	88.9
Interest payable	7.1	1.0
	42.1	44.7

Accrued salaries and related expenses		
Customer deposits	16.6	14.6
Other accruals	12.0	7.5
	171.4	156.7

Included in other accruals are severance accruals, repositioning accruals, and customer liabilities for active pharmaceutical ingredients (API).

Inventories:

	As of July 31, 2011 $	As of October 31, 2010 $
Raw materials, packaging components and spare parts	56.3	47.3
Work-in-process	31.9	26.0
	88.2	73.3

Net income per share:

The computation of diluted net income per share did not include 12,725,924 and 8,333,928 outstanding options in the nine months ended July 31, 2011 and 2010, respectively, because such options were anti-dilutive in nature.

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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, 2011 and 2010, respectively, were as follows:

	For the nine months ended July 31, 2011		2010	
	Defined Benefit Pension Plans	Other Benefit Plans	Defined Benefit Pension Plans	Other Benefit Plans
	$	$	$	$
Service cost	2.7		2.7	
Interest cost	3.9	0.3	3.6	0.3
Expected return on plan assets	(3.6)		(3.0)	
Amortization of actuarial loss	0.6		0.6	
Net periodic benefit costs	3.6	0.3	3.9	0.3

Based on current information available from actuarial estimates, the Company anticipates that contributions required under its defined benefit pension plans for fiscal 2011 will be approximately $10.1 million compared to contributions of $4.6 million that were made in fiscal 2010. 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 amount that the Company will be required to contribute to such plans in the future may vary.

Impact of new and pending U.S. GAAP accounting standards

In June 2011, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This standard eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Under this new ASU, an entity can elect to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. This guidance is effective for publicly traded companies as of the beginning of a fiscal year that begins after December 15, 2011 and interim and annual periods thereafter. Early adoption is permitted, but full retrospective application is required. As the Company reports net (loss) income and comprehensive (loss) income in two statements, the adoption of this ASU will not impact the presentation of the Company s consolidated financial statements beginning in the first quarter of 2012.

In May 2011, the FASB issued 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 standard 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. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011, with early adoption prohibited. The Company does not expect this ASU would have a material impact on its consolidated financial statements if prepared under U.S. GAAP.

In April 2010, the FASB issued ASU 2010-13, Compensation Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades. This ASU codifies the consensus reached in Emerging Issues Task Force Issue No. 09-J, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades. The amendments in this ASU clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity shares trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Early adoption is permitted. The amendments are to be applied by recording a cumulative-effect adjustment to beginning accumulated deficit. The Company does not expect this ASU would have a material impact on its consolidated financial statements if prepared under U.S. GAAP.

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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 consolidated financial statements and the related notes beginning on page 1 of this quarterly report on Form 10-Q and on page F-2 of our Registration Statement on Form 10, as amended, filed with the Securities and Exchange Commission (the SEC) on April 13, 2011 (our Form 10). Our consolidated financial statements and MD&A have been prepared in accordance with Canadian GAAP. The impact of significant differences between Canadian GAAP and U.S. GAAP on our financial statements is disclosed under Note 12 Additional disclosures required under U.S. Generally Accepted Accounting Principles to our consolidated financial statements beginning on page 1 of this quarterly report on Form 10-Q. 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 this Form 10-Q and our Form 10. See Forward Looking Statements.

Executive Overview

We are a leading provider of contract manufacturing and development services 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, commercial manufacturing (CMO) and pharmaceutical development services (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 finished dosage formulation across approximately 40 dosage forms, clinical trial packaging 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 during the three and nine months ended July 31, 2011:

Revenues for the three months ended July 31, 2011 increased $9.4 million, or 5.8%, to $172.7 million, from $163.3 million for the three months ended July 31, 2010. Excluding currency fluctuations, revenues for the three months ended July 31, 2011 would have been approximately 0.2% higher than the same period of prior year.

Loss before discontinued operations for the three months ended July 31, 2011 was $0.5 million, compared to a loss before discontinued operations of $3.0 million for the three months ended July 31, 2010.

Adjusted EBITDA for the three months ended July 31, 2011 decreased $11.8 million, or 49.8%, to $11.9 million, from $23.7 million for the three months ended July 31, 2010.

Revenues for the nine months ended July 31, 2011 increased $24.9 million, or 5.0%, to $518.4 million, from $493.5 million for the nine months ended July 31, 2010. Excluding currency fluctuations, revenues for the nine months ended July 31, 2011 would have been approximately 3.7% higher than the same period of prior year.

Loss before discontinued operations for the nine months ended July 31, 2011 was $10.9 million, compared to a loss before discontinued operations of $2.4 million for the nine months ended July 31, 2010.

Adjusted EBITDA for the nine months ended July 31, 2011 decreased $7.3 million, or 11.6%, to $55.8 million, from $63.1 million for the nine months ended July 31, 2010.

On September 8, 2011, our board of directors reviewed and approved our new corporate strategy which includes, among other things, assessing strategic options for the Swindon commercial operation and the Burlington, Ontario facility, accelerating our operational excellence programs for our CMO and PDS segments, and continuing the evolution of our existing commercial sites into centers of excellence focusing on specific technologies or production types. In addition, we are in the process of transferring our Zug, Switzerland European Headquarter operations to our U.K. operations. We expect these initiatives will reduce costs and make our company more efficient over the next several years.

On May 19, 2011, we settled an on-going insurance claim covering all current and future costs associated with water damage at our Swindon, U.K. facility for approximately $16.0 million. We recorded a settlement receivable of

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approximately $2.4 million against cost of goods sold in the fourth quarter of fiscal 2010, which was subsequently received in the first quarter of fiscal 2011. In the second quarter of fiscal 2011, we recorded an additional $2.6 million as a settlement receivable against cost of goods sold. In the third quarter of fiscal 2011, we received the final payout from the settlement of approximately $13.6 million. A portion of the settlement was used to offset capital expenditures and accrue for future remediation liabilities, with the remaining $6.0 million booked as other income.

On May 11, 2011, Michael E. Lytton joined our company as Executive Vice President, Corporate Development and Strategy, and General Counsel.

On February 7, 2011, James C. Mullen was appointed as our Chief Executive Officer (CEO), and a member of our Board.

In December 2010, we amended a manufacturing and supply agreement with a major customer, in which both parties agreed to a contract termination date in February 2011, approximately two and a half years earlier than was originally planned. The amendment reflected the customer s decision not to proceed with a product following receipt of a Complete Response letter from the FDA. As part of the amendment, the customer agreed to pay us a reservation fee of 21.6 million, and as a result of the shortened contract life, we accelerated the related deferred revenue recognition and were relieved of the obligation to repay certain customer-funded capital related to the original manufacturing and supply agreement.

On November 30, 2010, Wesley P. Wheeler, our then President and Chief Executive Officer, left our company. We accrued approximately $1.4 million in the first quarter of fiscal 2011 for severance payments due to Mr. Wheeler under his employment agreement.

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. In the second half of the fiscal year ended October 31, 2010 (fiscal 2010), we performed an impairment analysis based on recent offers, which resulted in the complete write down as the fair value less the cost to sell was nil. We continue marketing this property. The results of the Carolina operations have been reported in discontinued operations in fiscal 2010 and the 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. Our current expectations with respect to the Caguas facility assumes completion of a sale during fiscal 2012 for a purchase price of approximately $7.0 million. In conjunction with this estimate the company booked an impairment charge of $3.6 million in fiscal 2010. The consolidation results in additional accelerated depreciation of Caguas assets of approximately $12.0 million by the end of the project. Because the business in our Caguas facility is being transferred within the existing site network, its results of operations are included in continuing operations in our consolidated financial statements.

As a result of the additional time required to fully transition manufacturing operations from Caguas to Manati due to longer than expected customer regulatory timelines and higher product demand, we now expect the transition to continue beyond the end of calendar year 2012. As a result of the additional time required to complete the transition, we now estimate that the restructuring program will cost $11.5 million, of which $10.2 million has been booked as of July 31, 2011.

Results of Operations

The results of the Carolina operations have been segregated and reported as discontinued operations for the three and nine months ended July 31, 2011 and 2010.

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Three Months Ended July 31, 2011 Compared to Three Months Ended July 31, 2010

	Three months ended July 31,			
(in millions of U.S. dollars)	2011 $	2010 $	$ Change	% Change
Revenues	172.7	163.3	9.4	5.8
Cost of goods sold	145.3	128.9	16.4	12.7
Gross profit	27.4	34.4	(7.0)	20.3
Selling, general and administrative expenses	31.7	26.1	5.6	21.5
Repositioning expenses	1.9	2.4	(0.5)	20.8
Operating (loss) income	(6.2)	5.9	(12.1)	205.1
Interest expense, net	6.3	6.3		
Impairment charge		2.1	(2.1)	100.0
Foreign exchange gain	(3.6)	(2.2)	1.4	63.6
Gain on sale of fixed assets	(0.1)		(0.1)	
Refinancing Expenses		0.3	(0.3)	100.0
Other (income) expense, net	(5.6)	0.4	6.0	1,500.0
Loss from continuing operations before income taxes	(3.2)	(1.0)	(2.2)	220.0
(Benefit from) provision for income taxes	(2.7)	2.0	4.7	235.0
Loss before discontinued operations	(0.5)	(3.0)	2.5	83.3
Loss from discontinued operations	(0.2)		0.2	
Net loss attributable to restricted voting shareholders	(0.7)	(3.0)	2.3	76.7

Operating Income Summary

Revenues for the three months ended July 31, 2011 increased $9.4 million, or 5.8%, to $172.7 million, from $163.3 million for the three months ended July 31, 2010. Excluding currency fluctuations, revenues for the three months ended July 31, 2011 would have been approximately 0.2% higher than the same period of prior year. CMO revenues for the three months ended July 31, 2011 increased $8.5 million, or 6.5%, to $138.7 million, from $130.2 million for the three months ended July 31, 2010. PDS revenues for the three months ended July 31, 2011 also increased $0.9 million, or 2.7%, to $34.0 million, from $33.1 million for the three months ended July 31, 2010.

Gross profit for the three months ended July 31, 2011 decreased $7.0 million, or 20.3%, to $27.4 million, from $34.4 million for the three months ended July 31, 2010. The decrease in gross profit was primarily due to a decrease in gross profit margin to 15.9% for the three months ended July 31, 2011 from 21.1% for the three months ended July 31, 2010. The decrease in gross profit margin was primarily due to unfavorable foreign exchange related to the weakening of the U.S. dollar (-3.9%), higher supplies and maintenance (-1.7%) and a reduction of take or pay revenue in the United Kingdom (-1.7%), partially offset by prior years research and development investment tax credits in the quarter (0.8%), and the impact of higher volumes.

Selling, general and administrative expenses for the three months ended July 31, 2011 increased $5.6 million, or 21.5%, to $31.7 million, from $26.1 million for the three months ended July 31, 2010. The increase was primarily due to higher consulting fees related to our strategic and operational review and higher compensation expense. The unfavorable foreign exchange impact on selling, general and administrative expenses versus prior year is approximately $1.9 million.

Repositioning expenses for the three months ended July 31, 2011 decreased $0.5 million, or 20.8%, to $1.9 million, from $2.4 million for the three months ended July 31, 2010. The decrease was due to lower expenses in connection with the Caguas closure and consolidation in Puerto Rico.

Operating (loss) income for the three months ended July 31, 2011 decreased $12.1 million, or 205.1%, to a loss of $6.2 million (3.6% of revenues), from income of $5.9 million (3.6% of revenues) for the three months ended July 31, 2010 as a result of the factors discussed above.

Foreign Exchange Gains

Foreign exchange gain for the three months ended July 31, 2011 was $3.6 million, compared to $2.2 million for the three months ended July 31, 2010. The foreign exchange gain was primarily due to favorable hedging contracts in the Canadian operations and operating exposures. The favorable hedging contracts resulted in gains of $1.7 million for the three months ended July 31, 2011 compared to gains of $1.0 million for the three months ended July 31, 2010.

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Refinancing Expenses

During the three months ended July 31, 2010, we incurred $0.3 million in connection with our refinancing activities, which included fees paid to advisors and other related costs.

Other (Income) Expense, Net

Other income for the three months ended July 31, 2011 was $5.6 million, compared to expenses of $0.4 million for the three months ended July 31, 2010. The increase of other income was primarily due to the final payout from the settlement of the insurance claim associated with water damage at our Swindon, U.K. facility, of which $6.0 million was recorded in other income.

Loss from Continuing Operations Before Income Taxes

We reported a loss from continuing operations before income taxes of $3.2 million for the three months ended July 31, 2011, compared to $1.0 million for the three months ended July 31, 2010. The operating items discussed above were the primary drivers of the year over year variance.

Income Taxes

Income taxes were a benefit of $2.7 million for the three months ended July 31, 2011, compared to an expense of $2.0 million for the three months ended July 31, 2010. The decrease in tax expense was primarily due to the mix of income and loss from our operating units.

Loss before Discontinued Operations and Loss Per Share from Continuing Operations

We recorded a loss before discontinued operations for the three months ended July 31, 2011 of $0.5 million, compared to a loss before discontinued operations of $3.0 million for the three months ended July 31, 2010. The loss per share from continuing operations for the three months ended July 31, 2011 was 0.4¢ compared to a loss of 2.3¢ for the three months ended July 31, 2010.

Loss and Loss Per Share from Discontinued Operations

Discontinued operations for the three months ended July 31, 2011 and 2010 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 and plant consolidations. The loss from discontinued operations for the three months ended July 31, 2011 was $0.2 million, or 0.2¢ per share, compared to a loss of less than $0.1 million, or 0.0¢ per share, for the three months ended July 31, 2010. On-going costs of discontinued operations relate to maintaining the Carolina building for sale.

Net Loss Attributable to Restricted Voting Shareholders and Loss Per Share

Net loss attributable to restricted voting shares for the three months ended July 31, 2011 was $0.7 million, or 0.6¢ per share, compared to a net loss of $3.0 million, or 2.3¢ per share, for the three months ended July 31, 2010.

The computation of net loss per share did not include 12,725,924 and 8,333,928 outstanding options in the nine months ended July 31, 2011 and 2010, 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, refinancing expenses, gains and losses on sale of fixed 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 net income (loss) determined in accordance with Canadian GAAP 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.

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

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
	$	$	$	$
Adjusted EBITDA	11.9	23.7	55.8	63.1
Depreciation and amortization	(12.6)	(13.2)	(40.8)	(39.5)
Repositioning expenses	(1.9)	(2.4)	(3.4)	(5.8)
Interest expense, net	(6.3)	(6.3)	(18.9)	(13.2)
Impairment charge		(2.1)		(3.4)
Gain (loss) on sale of fixed assets	0.1		(0.1)	(0.1)
Refinancing expenses		(0.3)		(12.0)
Benefit from (provision for) income taxes	2.7	(2.0)	(8.6)	8.4
Other income (expense), net	5.6	(0.4)	5.1	0.1
Loss before discontinued operations	(0.5)	(3.0)	(10.9)	(2.4)

The following provides certain information regarding our business segments for the three months ended July 31, 2011 and 2010:

	Three months ended July 31,			
	2011	2010	$	%
(in millions of U.S. dollars)	$	$	Change	Change
Revenues				
Commercial Manufacturing				
North America	72.9	62.7	10.2	16.3
Europe	65.8	67.5	(1.7)	2.5
Total Commercial Manufacturing	138.7	130.2	8.5	6.5
Pharmaceutical Development Services	34.0	33.1	0.9	2.7
Total Revenues	172.7	163.3	9.4	5.8
Adjusted EBITDA				
Commercial Manufacturing				
North America	9.3	6.6	2.7	40.9
Europe	2.2	11.3	(9.1)	80.5
Total Commercial Manufacturing	11.5	17.9	(6.4)	35.8
Pharmaceutical Development Services	9.3	11.3	(2.0)	17.7
Corporate Costs	(8.9)	(5.5)	3.4	61.8
Total Adjusted EBITDA	11.9	23.7	(11.8)	49.8

Commercial Manufacturing

Total CMO revenues for the three months ended July 31, 2011 increased $8.5 million, or 6.5%, to $138.7 million, from $130.2 million for the three months ended July 31, 2010.

Had local currency exchange rates remained constant to the rates of the three months ended July 31, 2010, CMO revenues for the three months ended July 31, 2011 would have been approximately 0.2% higher than the same period of prior year.

North American CMO revenues for the three months ended July 31, 2011 increased $10.2 million, or 16.3%, to $72.9 million, from $62.7 million for the three months ended July 31, 2010. Had Canadian dollar exchange rates remained constant to the rates of the three months ended July 31, 2010, North American CMO revenues for the three months ended July 31, 2011 would have been approximately 15.6% higher than the same period of prior year. The increase was primarily due to new product launch volumes in Cincinnati, higher volumes in Toronto and increased worldwide demand for a customer s product manufactured in our Puerto Rico facility.

European CMO revenues for the three months ended July 31, 2011 decreased $1.7 million, or 2.5%, to $65.8 million, from $67.5 million for the three months ended July 31, 2010. Had European currency exchange rates remained constant to the rates of the three months ended July 31, 2010, European CMO revenues for the three months ended July 31, 2011 would have been approximately 14.1% lower than the same period of prior year. The decrease was primarily due to the non-recurrence of take or pay revenue from the United Kingdom and lower current quarter sales in France and Italy.

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Total CMO Adjusted EBITDA for the three months ended July 31, 2011 decreased $6.4 million, or 35.8%, to $11.5 million, from $17.9 million for the three months ended July 31, 2010. This represents an Adjusted EBITDA margin of 8.3% for the three months ended July 31, 2011 compared to 13.7% for the three months ended July 31, 2010. Had local currency exchange rates remained constant to the rates of the three months ended July 31, 2010 rates and after eliminating the impact of all foreign exchange gains and losses, CMO Adjusted EBITDA for the three months ended July 31, 2011 would have been approximately $0.5 million lower than reported.

North American Adjusted EBITDA for the three months ended July 31, 2011 increased $2.7 million, or 40.9%, to $9.3 million, from $6.6 million for the three months ended July 31, 2010. The increase was primarily driven by a $2.7 million Adjusted EBITDA improvement in Puerto Rico, improvements in Cincinnati of $0.8 million from a prior year R&D credit recorded in the third quarter of fiscal 2011 and foreign exchange gains of $0.5 million, partially offset by lower volumes in Whitby. North American CMO had $1.9 million in repositioning relating to the Puerto Rican operations in the three months ended July 31, 2011 that were not included in Adjusted EBITDA.

European Adjusted EBITDA for the three months ended July 31, 2011 decreased $9.1 million, or 80.5%, to $2.2 million, from $11.3 million for the three months ended July 31, 2010. This decrease was primarily due to top line weakness in the United Kingdom and France. European CMO has $6.0 million in insurance proceeds relating to U.K. operations that was recorded in other income and was not included in Adjusted EBITDA.

Pharmaceutical Development Services

Total PDS revenues for the three months ended July 31, 2011 increased by $0.9 million, or 2.7%, to $34.0 million, from $33.1 million for the three months ended July 31, 2010. Had the local currency rates remained constant to the three months ended July 31, 2010, PDS revenues for the three months ended July 31, 2011 would have been 0.3% lower than the same period of prior year.

Total PDS Adjusted EBITDA for the three months ended July 31, 2011 decreased by $2.0 million, or 17.7%, to $9.3 million, from $11.3 million for the three months ended July 31, 2010. Had local currencies remained constant to the rates of the three months ended July 31, 2010 and after eliminating the impact of all foreign exchange gains and losses, PDS Adjusted EBITDA for the three months ended July 31, 2011 would have been approximately $0.4 million higher than reported. PDS Adjusted EBITDA for the three months ended July 31, 2011 included $0.7 million of prior years research and development investment tax credits compared to $2.8 million in the same period of fiscal 2010. In addition, lower than expected sales at certain sites resulting from project cancellations during the second quarter of fiscal 2011 related to customer regulatory approvals, clinical trial outcome issues, and industry consolidation contributed to the reduction in Adjusted EBITDA.

Corporate Costs

Corporate costs for the three months ended July 31, 2011 increased $3.4 million, or 61.8%, to $8.9 million, from $5.5 million for the three months ended July 31, 2010 primarily due to higher consulting fees related to our strategic and operational review and higher compensation expense.

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Nine Months Ended July 31, 2011 Compared to Nine Months Ended July 31, 2010

	Nine months ended July 31,			
	2011	2010	$	%
(in millions of U.S. dollars)	$	$	Change	Change
Revenues	518.4	493.5	24.9	5.0
Cost of goods sold	416.1	391.3	24.8	6.3
Gross profit	102.3	102.2	0.1	0.1
Selling, general and administrative expenses	84.3	82.1	2.2	2.7
Repositioning expenses	3.4	5.8	(2.4)	41.4
Operating income	14.6	14.3	0.3	2.1
Interest expense, net	18.9	13.2	5.7	43.2
Impairment charge		3.4	(3.4)	100.0
Foreign exchange loss (gain)	3.2	(3.5)	(6.7)	191.4
Loss on sale of fixed assets	0.1	0.1		
Refinancing Expenses		12.0	(12.0)	100.0
Other (income) expense, net	(5.3)	(0.1)	5.2	5,200.0
Loss from continuing operations before income taxes	(2.3)	(10.8)	8.5	78.7
Provision for (benefit from) income taxes	8.6	(8.4)	(17.0)	202.4
Loss before discontinued operations	(10.9)	(2.4)	(8.5)	354.2
Loss from discontinued operations	(0.5)	(0.8)	(0.3)	37.5
Net loss attributable to restricted voting shareholders	(11.4)	(3.2)	(8.2)	256.3

Operating Income Summary

Revenues for the nine months ended July 31, 2011 increased $24.9 million, or 5.0%, to $518.4 million, from $493.5 million for the nine months ended July 31, 2010. Excluding currency fluctuations, revenues for the nine months ended July 31, 2011 would have been approximately 3.7% higher than the same period of prior year. CMO revenues for the nine months ended July 31, 2011 increased $25.3 million, or 6.3%, to $425.8 million, from $400.5 million for the nine months ended July 31, 2010. PDS revenues for the nine months ended July 31, 2011 decreased $0.4 million, or 0.4%, to $92.6 million, from $93.0 million for the nine months ended July 31, 2010.

Gross profit for the nine months ended July 31, 2011 increased $0.1 million, or 0.1%, to $102.3 million, from $102.2 million for the nine months ended July 31, 2010. The increase in gross profit was due to higher revenue partially offset by a decrease in gross profit margin to 19.7% for the nine months ended July 31, 2011 from 20.7% for the nine months ended July 31, 2010. The decrease in gross profit margin was due to unfavorable foreign exchange impact on cost of goods sold related to the weakening of the U.S. dollar (-1.8%), increase in supplies and maintenance (-1.2%), increase in inventory reserves (-0.5%), increased depreciation expenses from accelerated depreciation in Puerto Rico (-0.6%) and the impact of prior years research and development investment tax credits (-1.0%), partially offset by favorable mix resulting from the reservation fee related to the amended manufacturing and supply agreement in the United Kingdom and higher deferred revenue amortization at our Swindon facility.

Selling, general and administrative expenses for the nine months ended July 31, 2011 increased $2.2 million, or 2.7%, to $84.3 million, from $82.1 million for the nine months ended July 31, 2010. The increase was primarily due to higher legal and consulting fees of $2.4 million, higher costs related to the former CEO s severance of $1.1 million and higher stock based compensation of $1.1 million, partially offset by costs associated with the special committee of independent directors (the Special Committee) of $3.0 million for the nine months ended July 31, 2010. Included in the numbers above was an unfavorable foreign exchange impact versus prior year of approximately $2.6 million.

Repositioning expenses for the nine months ended July 31, 2011 decreased $2.4 million, or 41.4%, to $3.4 million, from $5.8 million for the nine months ended July 31, 2010. The decrease was due to lower expenses in connection with the Caguas closure and consolidation in Puerto Rico during the nine months ended July 31, 2011 compared to the nine months ended July 31, 2010, as the prior period included the initial project accruals.

Operating income for the nine months ended July 31, 2011 increased $0.3 million, or 2.1%, to $14.6 million (2.8% of revenues), from $14.3 million (2.9% of revenues) for the nine months ended July 31, 2010 as a result of the factors discussed above.

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Interest Expense

Interest expense for the nine months ended July 31, 2011 increased $5.7 million, or 43.2%, to $18.9 million, from $13.2 million for the nine months ended July 31, 2010. The increase in interest expense primarily reflects the higher interest rates on the Notes versus the rates of our previous debt, as well as overall higher debt levels.

Impairment Charge

During the nine months ended July 31, 2010, we recorded an impairment charge of $3.4 million in connection with the consolidation of our Puerto Rico operations into our manufacturing site located in Manati. This charge wrote down the carrying value of the Caguas facility s long-lived assets to their anticipated fair value upon closure of the facility.

Foreign Exchange Losses (Gains)

Foreign exchange loss for the nine months ended July 31, 2011 was $3.2 million, compared to a gain of $3.5 million for the nine months ended July 31, 2010. The foreign exchange loss was primarily due to the overall strengthening of the Canadian dollar against the U.S. dollar, partially offset by favorable hedging contracts in the Canadian operations during the nine months ended July 31, 2011. Prior year gains were primarily from hedging and operational exposure.

Refinancing Expenses

During the nine months ended July 31, 2010, we incurred expenses of $12.0 million in connection with our refinancing activities, which included fees paid to advisors and other related costs.

Other (Income) Expense, Net

Other income for the nine months ended July 31, 2011 was $5.3 million, compared to $0.1 million for the nine months ended July 31, 2010. The increase of other income was primarily due to the final payout from the settlement of the insurance claim associated with water damage at our Swindon, U.K. facility, of which $6.0 million was recorded in other income.

Loss from Continuing Operations Before Income Taxes

We reported a loss from continuing operations before income taxes of $2.3 million for the nine months ended July 31, 2011, compared to a loss of $10.8 million for the nine months ended July 31, 2010. The $12.0 million of refinancing expenses during the nine months ended July 31, 2010, along with the other operating items discussed above, were the primary drivers of the year over year variance.

Income Taxes

Income taxes were an expense of $8.6 million for the nine months ended July 31, 2011, compared to a benefit of $8.4 million for the nine months ended July 31, 2010. The increase in tax expense for the period was primarily due to the benefit in fiscal 2010 of releasing $13.8 million of the valuation allowance pertaining to future tax assets in our Canadian operations and additional tax expense in fiscal 2011 due to book versus tax treatment of foreign exchange gains in Canada (resulting from the change in functional currency of a division of the Canadian corporate entity to U.S. dollars as disclosed in the third quarter of fiscal 2010).

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, 2011 of $10.9 million, compared to a loss before discontinued operations of $2.4 million for the nine months ended July 31, 2010. The loss per share from continuing operations for the nine months ended July 31, 2011 was 8.4¢ compared to a loss per share of 1.9¢ for the nine months ended July 31, 2010.

Loss and Loss Per Share from Discontinued Operations

Discontinued operations for the nine months ended July 31, 2011 and 2010 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, assets held for sale, and plant consolidations. The loss from discontinued operations for the nine months ended July 31, 2011 was $0.5 million, or 0.4¢ per share, compared to a loss of $0.8 million, or 0.6¢ per share, for the nine months ended July 31, 2010. On-going costs of discontinued operations relate to maintaining the Carolina building for sale.

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, 2011 increased $8.2 million, to $11.4 million, or 8.8¢ per share, from $3.2 million, or 2.5¢ per share, for the nine months ended July 31, 2010. Because we reported a loss for the nine months ended July 31, 2011 and 2010, there is no impact of dilution.

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Revenues and Adjusted EBITDA by Business Segment

	Nine months ended July 31,			
(in millions of U.S. dollars)	2011 $	2010 $	$ Change	% Change
Revenues				
Commercial Manufacturing				
North America	197.8	187.4	10.4	5.5
Europe	228.0	213.1	14.9	7.0
Total Commercial Manufacturing	425.8	400.5	25.3	6.3
Pharmaceutical Development Services	92.6	93.0	(0.4)	0.4
Total Revenues	518.4	493.5	24.9	5.0
Adjusted EBITDA				
Commercial Manufacturing				
North America	11.0	13.6	(2.6)	19.1
Europe	53.1	32.1	21.0	65.4
Total Commercial Manufacturing	64.1	45.7	18.4	40.3
Pharmaceutical Development Services	20.0	35.8	(15.8)	44.1
Corporate Costs	(28.3)	(18.4)	9.9	53.8
Total Adjusted EBITDA	55.8	63.1	(7.3)	11.6

Commercial Manufacturing

Total CMO revenues for the nine months ended July 31, 2011 increased $25.3 million, or 6.3%, to $425.8 million, from $400.5 million for the nine months ended July 31, 2010. Had local currency exchange rates remained constant to the rates of the nine months ended July 31, 2010, CMO revenues for the nine months ended July 31, 2011 would have been approximately 4.9% higher than the same period of prior year.

North American CMO revenues for the nine months ended July 31, 2011 increased $10.4 million, or 5.5%, to $197.8 million, from $187.4 million for the nine months ended July 31, 2010. Had Canadian dollar exchange rates remained constant to the rates of the nine months ended July 31, 2010, North American CMO revenues for the nine months ended July 31, 2011 would have been approximately 5.1% higher than the same period of prior year. The increase was primarily due to new product launch volumes in Cincinnati, higher volumes in Toronto and increased worldwide demand for a customer s product manufactured in our Puerto Rico facility.

European CMO revenues for the nine months ended July 31, 2011 increased $14.9 million, or 7.0%, to $228.0 million, from $213.1 million for the nine months ended July 31, 2010. Had European currencies remained constant to the rates of the nine months ended July 31, 2010, European CMO revenues for the nine months ended July 31, 2011 would have been approximately 4.8% higher than the same period of prior year. The increase was primarily due to higher revenues in the United Kingdom from the reservation fee related to the amended manufacturing and supply agreement and accelerated deferred revenue versus take-or-pay revenue in the prior year, partially offset by lower revenues across other sites.

Total CMO Adjusted EBITDA for the nine months ended July 31, 2011 increased $18.4 million, or 40.3%, to $64.1 million, from $45.7 million for the nine months ended July 31, 2010. This represents an Adjusted EBITDA margin of 15.1% for the nine months ended July 31, 2011 compared to 11.4% for the nine months ended July 31, 2010. Had local currencies remained constant to prior year rates, and after eliminating the impact of all foreign exchange gains and losses, CMO Adjusted EBITDA for the nine months ended July 31, 2011 would have been approximately $6.1 million higher.

North American Adjusted EBITDA for the nine months ended July 31, 2011 decreased $2.6 million, or 19.1%, to $11.0 million, from $13.6 million for the nine months ended July 31, 2010. The decrease was primarily driven by Cincinnati due to prior year recognition of accelerated deferred revenue of $4.2 million, and foreign exchange losses of $4.1 million as a result of the weakening of the U.S. dollar against the Canadian dollar. These were partially offset by a $4.6 million Adjusted EBITDA improvement in Puerto Rico and higher volumes in Toronto. North American CMO had $3.4 million in repositioning relating to the Puerto Rican operations in the nine months ended July 31, 2011 that were not included in Adjusted EBITDA.

European Adjusted EBITDA for the nine months ended July 31, 2011 increased $21.0 million, or 65.4%, to $53.1 million, from $32.1 million for the nine months ended July 31, 2010. This increase was primarily due to the recognition of the reservation fee related to the amended manufacturing and supply agreement in the United Kingdom and associated deferred revenue amortization,

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partially offset by lower revenue across other European sites. European CMO has $6.0 million in insurance proceeds relating to the U.K. operations that was recorded in other income and was not included in Adjusted EBITDA.

Pharmaceutical Development Services

Total PDS revenues for the nine months ended July 31, 2011 decreased by $0.4 million, or 0.4%, to $92.6 million, from $93.0 million for the nine months ended July 31, 2010. Had the local currency rates remained constant to the nine months ended July 31, 2010, PDS revenues for the nine months ended July 31, 2011 would have decreased approximately 1.5% from the same period of fiscal 2010.

Total PDS Adjusted EBITDA for the nine months ended July 31, 2011 decreased by $15.8 million, or 44.1%, to $20.0 million, from $35.8 million for the nine months ended July 31, 2010. Had local currencies remained constant to the rates of the prior year and after eliminating the impact of all foreign exchange gains and losses, PDS Adjusted EBITDA for the nine months ended July 31, 2011 would have been approximately $1.7 million higher than reported. PDS Adjusted EBITDA for the nine months ended July 31, 2011 includes $1.4 million of research and development investment tax credits compared to $7.2 million in the same period of fiscal 2010. In addition, lower than expected sales at certain sites resulting from project cancellations related to customer regulatory approvals, clinical trial outcome issues, and industry consolidation contributed to the reduction in Adjusted EBITDA.

Corporate Costs

Corporate costs for the nine months ended July 31, 2011 increased $9.9 million, or 53.8%, to $28.3 million, from $18.4 million for the nine months ended July 31, 2010. The increase was primarily due to unfavorable foreign exchange of $5.2 million, $2.4 million of higher advisor fees due to registration with the SEC and corporate strategy initiatives, expenses related to the change in our CEO of $2.0 million and higher compensation expenses. These were partially offset by the non-recurrence of $3.0 million in Special Committee costs booked in fiscal 2010.

Liquidity and Capital Resources

Overview

Cash and cash equivalents totaled $39.5 million at July 31, 2011 and $53.5 million at October 31, 2010. Our total debt was $275.5 million at July 31, 2011 and $278.3 million at October 31, 2010.

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 the foreseeable future.

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:

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
(in millions of U.S. dollars)	$	$	$	$
Cash provided by (used in) operating activities of continuing operations	11.5	(6.0)	12.2	39.9
Cash (used in) provided by operating activities of discontinued operations	(0.1)	0.3	(0.5)	(0.8)
Cash provided by (used in) operating activities	11.4	(5.7)	11.7	39.1
Cash used in investing activities of continuing operations	(10.1)	(13.5)	(30.9)	(34.0)
Cash provided by (used in) financing activities	3.3	3.4	(0.1)	33.4
Other	(4.4)	(3.0)	5.3	(3.8)
Net increase (decrease) in cash and cash equivalents during the period	0.2	(18.8)	(14.0)	34.7

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Cash Provided by (Used in) Operating Activities

Cash provided by operating activities from continuing operations for the three months ended July 31, 2011 increased $17.5 million to cash provided of $11.5 million, from a cash usage of $6.0 million for the three months ended July 31, 2010. The increase includes $12.0 million from the insurance claim settlement received in the third quarter of fiscal 2011, an increase in deferred revenue (customer funding for capital) in Cincinnati of $3.8 million and better usage of working capital from higher payables partially offset by receivables. These were partially offset by a voluntary pension contribution in the United Kingdom of $4.9 million and lower cash generated from operations.

Cash provided by operating activities from continuing operations for the nine months ended July 31, 2011 decreased $27.7 million, or 69.4%, to $12.2 million, from $39.9 million for the nine months ended July 31, 2010. Prior year cash contributions included take or pay receipts in our Swindon operations of $53.1 million versus $29.3 million received from the reservation fee related to the amended manufacturing and supply agreement in the United Kingdom in fiscal 2011. The nine months ended July 31, 2011 also included $3.4 million of higher working capital expenditures, the previously disclosed voluntary pension contribution in the U.K., and lower cash from operations, partially offset by $14.0 million from the insurance claim settlement.

Cash (used in) provided by operating activities from discontinued operations for the three months ended July 31, 2011 decreased $0.4 million, or 133.3%, to a cash usage of $0.1 million, from a cash source of $0.3 million for the three months ended July 31, 2010. The increase in cash outflow for the three months ended July 31, 2011 was due to costs related to the utilities, insurance and maintenance of the Carolina facility while it is in the process of being sold and the cash proceeds from a license sale of intellectual property in Puerto Rico in the nine months ended July 31, 2010.

Cash used in operating activities from discontinued operations for the nine months ended July 31, 2011 decreased $0.3 million, or 37.5%, to $0.5 million, from $0.8 million for the nine months ended July 31, 2010. The decrease in cash outflow for the nine months ended July 31, 2011 was due to lower costs related to utilities, insurance and maintenance of the Carolina facility while it is in the process of being sold.

Cash Used in Investing Activities

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

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
(in millions of U.S. dollars)	$	$	$	$
Total additions to capital assets	(10.2)	(13.5)	(31.2)	(32.9)
Proceeds on sale of capital assets	0.1		0.3	
Net increase in investments				(0.9)
Investment in intangibles				(0.2)
Cash used in investing activities of continuing operations	(10.1)	(13.5)	(30.9)	(34.0)
Cash used in investing activities	(10.1)	(13.5)	(30.9)	(34.0)

Cash used in investing activities from continuing operations for the three months ended July 31, 2011 decreased $3.4 million, or 25.2%, to $10.1 million, from $13.5 million for the three months ended July 31, 2010. The decrease is primarily due to lower capital expenditures in Puerto Rico and recovery of capital expenditures from the insurance settlement in the United Kingdom, partially offset by client project related capital expenditures in Cincinnati.

Cash used in investing activities from continuing operations for the nine months ended July 31, 2011 decreased $3.1 million, or 9.1%, to $30.9 million, from $34.0 million for the nine months ended July 31, 2010. The decrease was primarily due to lower capital expenditures in Puerto Rico in fiscal 2011 and the non-recurrence of cash contributions in two Italian companies (BSP Pharmaceuticals) in fiscal 2010, partially offset by higher client project related capital expenditures in Cincinnati.

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.

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Cash Provided by (Used in) Financing Activities

The following table summarizes the cash provided by (used in) financing activities for the periods indicated:

	Three months ended July 31,		Nine months ended July 31,	
	2011	2010	2011	2010
(in millions of U.S. dollars)	$	$	$	$
Increase (decrease) in short-term borrowings	3.5	3.5	1.3	(9.1)
Increase in long-term debt	6.0	2.0	6.0	288.9
Repayment of long-term debt	(6.2)	(2.1)	(7.4)	(246.4)
Cash provided by (used in) financing activities of continuing operations	3.3	3.4	(0.1)	33.4
Cash provided by (used in) financing activities	3.3	3.4	(0.1)	33.4

Cash provided by financing activities for the three months ended July 31, 2011 was $3.3 million compared to cash provided of $3.4 million for the three months ended July 31, 2010.

Cash (used in) provided by financing activities for the nine months ended July 31, 2011 decreased $33.5 million, or 100.3%, to a cash usage of $0.1 million, from a source of cash of $33.4 million for the nine months ended July 31, 2010, primarily due to the refinancing in the second quarter of fiscal 2010.

Financing Arrangements

Historical Credit Arrangements

On April 27, 2007, we entered into credit facilities in the aggregate amount of $225.0 million, which were comprised of a seven year, $150.0 million senior secured term loan and the five-year, $75.0 million ABL. We were required to make quarterly installment payments of $0.4 million on the term loan, along with additional mandatory repayments based on certain excess cash flow measures. The interest rate applicable to each alternative base rate borrowing under the term loan was equal to 1.5% plus the greater of the prime rate and the federal funds effective rate plus 0.5%. The interest rate applicable to each Eurocurrency borrowing was equal to an adjusted LIBOR plus 2.5%. The interest rate applicable to the ABL was a floating rate determined by the currency of the loan, plus an applicable margin determined by the leverage ratio. The credit facilities were secured by substantially all of the assets of our operations in Canada, the United States, Puerto Rico and the United Kingdom and our investments in the shares of all other operating subsidiaries. The term loan and any borrowings under our then-existing ABL were paid off as part of the refinancing discussed below.

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$280 Million Senior Secured Notes and Amended ABL

In April 2010, we issued the Notes for an aggregate principal amount of $280 million. We used the net proceeds of the offering to repay all of the outstanding indebtedness under our then-existing senior secured term loan and the $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 offering to, among other things, extend the maturity date of this facility to 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 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 Notes indenture contains language consistent with the ABL, which contains 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;
- 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 restricted subsidiaries or restrict our ability to incur liens on certain of our assets;
- sell or otherwise dispose of assets, including capital stock of restricted subsidiaries;
- enter into transactions with affiliates;
- create or incur liens; and
- merge, consolidate or sell substantially all of our assets.

Provided that we are not in default under the ABL or the indenture governing the Notes and are able to satisfy certain tests related to our 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 certain 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 $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, or up to 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 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 a Liquidity Event), we will be required to satisfy and maintain a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00 until the first day thereafter on which our borrowing availability has been greater than the greater of $10.0 million or 13.3% of our total commitments for 30 consecutive days. We will also be required to satisfy the required Fixed Charge Coverage Ratio in order to borrow on any day when our borrowing availability is below that level but a Liquidity Event has not yet occurred. Our ability to meet the required Fixed Charge Coverage 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.

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Financing Ratios

Total interest-bearing debt at July 31, 2011 was $275.5 million, $2.8 million lower than at October 31, 2010. At July 31, 2011, our consolidated ratio of interest-bearing debt to shareholders equity was 94.8%, compared to 101.9% at October 31, 2010.

Off-Balance Sheet Arrangements

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 Liquidity and Capital Resources under Item 2 of our Form 10. There have been no material changes to our contractual obligations since our fiscal year ended October 31, 2010.

Recent Accounting Pronouncements

See Note 1 Accounting policies Recently issued accounting pronouncements and Note 12 Additional disclosure required under U.S. Generally Accepted Accounting Principles Impact of new and pending U.S. GAAP accounting standards to our consolidated financial statements beginning on page 1 of 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 Policies and Estimates

For information about our critical accounting estimates, see Item 2. Financial Information Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates beginning on page 53 of our Form 10.

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, 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 and foreign exchange rates. 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; 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; 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 Item 1A. Risk Factors of this Form 10-Q and our Form 10. 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 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.

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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, 2011, 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 impact on annual pre-tax income, excluding any hedging activities, would be approximately $8.9 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, 2011, we had entered into 126 foreign exchange forward contracts and collars covering approximately 80% of our Canadian-U.S. dollar cash flow exposures for fiscal 2011 and had one forward exchange forward contracts covering our Euro-U.S. dollar cash flow. See Note 8 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 January 2013 and have an aggregate fair value of $121.5 million. As of July 31, 2011, an adverse exchange rate movement of 10% against our foreign exchange forward contracts and collars would result in a pre-tax loss of approximately $12.2 million.

Interest Rate Risk

As of July 31, 2011, 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, 2011, we had not borrowed any amounts under the 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
Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has 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) as of the end of the period covered by this quarterly report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures are effective in that they provide reasonable

assurances that the information we are required to disclose in the reports we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods required by the U.S. Securities and Exchange Commission 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.

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 period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Impact of the March 2011 Disaster in Japan

We are currently assessing the potential impact of the March 2011 disaster in Japan and its aftermath on our supply chain and operations in Japan for the remainder of 2011. These events did not have a material impact on our net sales, operating profit and supply chain in the second or third quarters of fiscal 2011. However, any sustained supply chain disruption involving multiple customers or vendors resulting from the disaster in Japan could have material adverse effects on our result of operations.

Failure to successfully implement our new corporate strategy or realize the expected benefits from this strategy could adversely affect our business and results of operations.

Our Board of Directors recently reviewed and approved a new corporate strategy for our company that is focused on improving the performance of our core operations. This new corporate strategy includes, among other things, assessing our global footprint, accelerating our operational excellence programs for our CMO and PDS segments, and continuing the evolution of our existing commercial sites into centers of excellence that focus on specific technologies or production types.

We have incurred and will likely continue to incur expenses in connection with the design, review and implementation of our new corporate strategy, and these expenses may exceed our estimates, may be significant and could materially adversely impact our financial performance.

We have based the design of our new corporate strategy on certain assumptions regarding our business, markets, cost structures and customers. If our assumptions are incorrect, we may be unable to fully implement our new corporate strategy and, even if fully implemented, our new corporate strategy may not yield the benefits that we expect. For example, our new corporate strategy may involve the acquisition or disposition of assets, which we may not be able to consummate in a timely manner, on terms acceptable to us or at all, or which may not achieve the benefits or cost savings we anticipate. If we do not effectively manage our new corporate strategy, instead of resulting in growth for and enhanced value to our company, our new strategy may cause us to experience operational issues and expose us to operational and regulatory risk, each of which could have material adverse effects on our reputation, business, financial condition and results of operations.

In addition to the other information set forth in this report, when evaluating our business, investors should carefully consider the risk factors discussed in Item 1A. Risk Factors in our Form 10.

Item 5. Other Information

On June 9, 2011, the Compensation and Human Resources Committee of our Board of Directors (our CHR Committee) adopted the Patheon Group s Leadership Incentive Plan (the Leadership Incentive Plan) to provide cash incentives for executive officers and certain other members of management for their contributions to our success.

Under the Leadership Incentive Plan, participants become eligible for bonus payouts based on the achievement of corporate and individual performance objectives. The CHR Committee approved the corporate performance objectives for each executive officer, the corporate performance objectives for other plan participants by functional area, and the individual performance objectives for our CEO. Individual performance objectives for executive officers other than our CEO were approved by our CEO, while those of plan participants other than executive officers were approved by the individual participant s supervisor. Each particular performance objective has three possible levels of achievement (minimum, target and maximum) that correspond to three levels of payouts, ranging from 0% up to 175% (depending on the plan participant) of the target payout for that particular objective. Achievement between levels (e.g., between minimum and target) will be interpolated on a linear basis.

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Each participant s target award is equal to his or her earned base pay (less certain benefit amounts), multiplied by the incentive target level, which level is determined on an individual basis as a percentage of base pay. Provided that all necessary conditions for payout have been met, each participant s payout will equal the participant s target award multiplied by the total achievement of the participant s designated weighted objectives.

All payouts are contingent upon us achieving 90% of target Corporate 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 fixed assets, gain on extinguishment of debt, income taxes, asset impairment charges, depreciation and amortization and other income and expenses, with additional adjustments for foreign currency exchange differences versus budgeted exchange rates and other one-time non-operating gains or losses. In addition, each individual s payout is contingent upon such individual receiving threshold performance ratings.

The foregoing summary is qualified in its entirety by reference to the Leadership Incentive Plan, a copy of which is filed as Exhibit 10.1 to this quarterly report on Form 10-Q and is incorporated herein by reference.

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.

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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 9, 2011

PATHEON INC.

By:	/s/ JAMES C. MULLEN **James C. Mullen** **Chief Executive Officer**	By:	/s/ ERIC W. EVANS **Eric W. Evans** **Chief Financial Officer**

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EXHIBIT INDEX

Exhibit Number	Description of Document	Incorporated by Reference Form	Filing Date	Number	Filed Herewith
10.1	The Patheon Group s Leadership Incentive Plan.				X
10.2	2011 Amended and Restated Incentive Stock Option Plan.				X
10.3	Employment Agreement between Patheon Pharmaceuticals Services Inc. and Michael E. Lytton effective May 9, 2011.				X
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