

What is Labopharm's competitive edge?



Shorter development timelines

Faster market penetration

Lower development costs

Labopharm

Corporate Profile

Labopharm is an international pharmaceutical company specializing in the development of drugs using advanced controlled-release technologies. Labopharm's proprietary technology, Contramid®, can be applied to a wide range of medications in solid dosage form to improve their oral administration and performance by providing the therapeutic benefit of controlled-release drug delivery.

The Company generates revenues from in-house development and late-stage licensing of oral controlled-release products using Contramid®, and from collaborations with large international pharmaceutical companies where its controlled-release technologies are used to enhance the therapeutic benefits of their branded products.

Labopharm has a number of products in its pipeline with high potential and has secured strategic alliances with leaders in the pharmaceutical industry, which demonstrates the strength of its platform technology, Contramid®.

Based in Laval, Quebec, Labopharm has been a publicly traded company since June 1996 with shares listed on the Toronto Stock Exchange under the ticker symbol DDS.

Highlights

Fiscal 2001

March 2000

Labopharm assumes full development of the former Bouchara Project and is committed to the continued development of Betahistine for the treatment of Ménière's disease.

Results of a second pharmacokinetic study with twice-a-day formulation of the analgesic, Tramadol, show bioequivalence with a currently marketed product.

April 2000

Results of a pharmacokinetic study demonstrate the possibility of single daily dosing with a 200-mg, once-a-day formulation of Tramadol.

July 2000

James R. Howard-Tripp is announced as new President and Chief Executive Officer of Labopharm Inc.

August 2000

A feasibility and formulation agreement is signed with the international giant Aventis for the development of two formulations of a top selling product in a billion dollar market.

September 2000

Another agreement with Aventis is signed for the development of new formulations of a second major product in a multi-billion dollar (US\$) global market.

Labopharm completes the first pre-pilot study on a controlled-release formulation of Oxybutynin, in co-development with an international pharmaceutical company.

Initiation of the feasibility and formulation phase for both Aventis products.

October 2000

Warren Whitehead is announced as Interim Chief Financial Officer.

Dr. Allan Mandelzys is announced as Vice-President, Business Development.

Dr. Vincent Lenaerts, currently Vice-President, Research and Development, is also named Chief Scientific Officer.

November 2000

Labopharm completes a private placement totalling \$12 million with Research Capital Corporation acting as the agent.

Dr. André Uddin, Biotechnology Analyst at Research Capital Corporation, initiates coverage of Labopharm with a BUY recommendation.

December 2000

A new study to evaluate improved formulations of the once-a-day formulation of the analgesic, Tramadol, is concluded. Also, in a head-to-head comparison, these formulations show the potential for superior efficacy compared to a currently marketed product. The study demonstrates a pharmacokinetic profile consistent with once-a-day dosing while the competitor's does not.

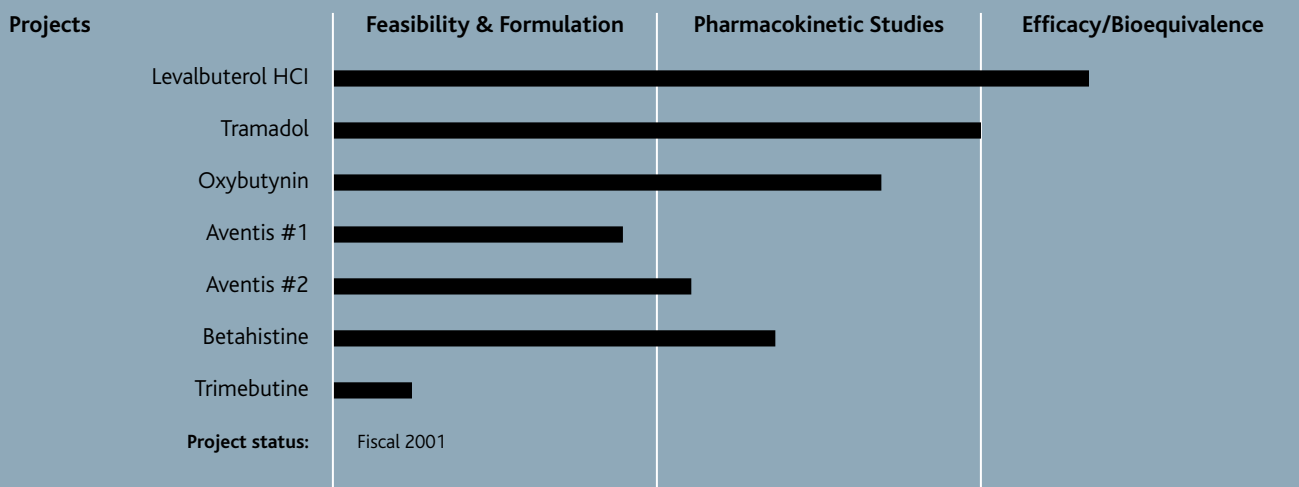
January 2001

Positive results are announced following completion of a Phase II clinical trial for a solid, oral dosage, once-a-day formulation of Levalbuterol for the treatment of asthma.

February 2001

Dr. Sylvie Bouchard is appointed to the position of Vice-President, Clinical Development.

Pipeline



President's Message to Shareholders

Fiscal 2001 has been an exciting year of renewal and promise for Labopharm. The Company has undergone significant changes which set it on a fast-track development path with renewed energy and vigour.

With a new management team, new strategic alliances, new financing and a new focus on developing in-house products, the Company is poised for aggressive growth as we move towards the achievement of our milestones.

Building a Solid Team

Gearing up its management team for an accelerated period of development has been a priority at Labopharm over the past year. In July 2000, I replaced Mr. Donald Buxton as President and Chief Executive Officer of the Company. Mr. Buxton took on the position of Chairman of the Board of Directors. Since that time, we have restructured the senior management group and have made a number of significant changes in the organization.

We brought in Warren Whitehead as Interim Chief Financial Officer, Dr. Allan Mandelzys as Vice-President, Business Development and named Dr. Vincent Lenaerts, our Vice-President, Research and Development as Chief Scientific Officer. More recently, we appointed Dr. Sylvie Bouchard as Vice-President, Clinical Development to oversee our in-house drug development program. This strong new team has the scientific, financial and business experience required to move the Company forward aggressively in this encouraging next phase of our development.

Securing Financing for Progress

Our first priority during the year was to ensure adequate financing to allow us to follow through with the aggressive development timelines we had set out and to attract the type of talent required to push our products through to commercialization. In fiscal 2001, Labopharm achieved a solid financial base with a private placement of special warrants accessing a broad base of Canadian investors. With Research Capital Corporation acting as the agent, we raised \$12 million in August 2000 and at the end of February 2001 the Company had sufficient cash on hand to assure continued operations for the next 2–3 years.

New Agreements — Aventis Becomes an Important Partner

The year was marked by a series of important successes on the business front. In August 2000, we signed the first of two partnership agreements with Aventis for the development

of new formulations of a top-selling Aventis product in a billion dollar market. In September 2000, we followed up with a second agreement with Aventis for the development of new formulations of a second top-selling product. These two agreements, with one of the world's leading pharmaceutical companies, validate our controlled-release technology and place us within the ranks of a select group of specialty pharmaceutical companies with world-ranked partners.

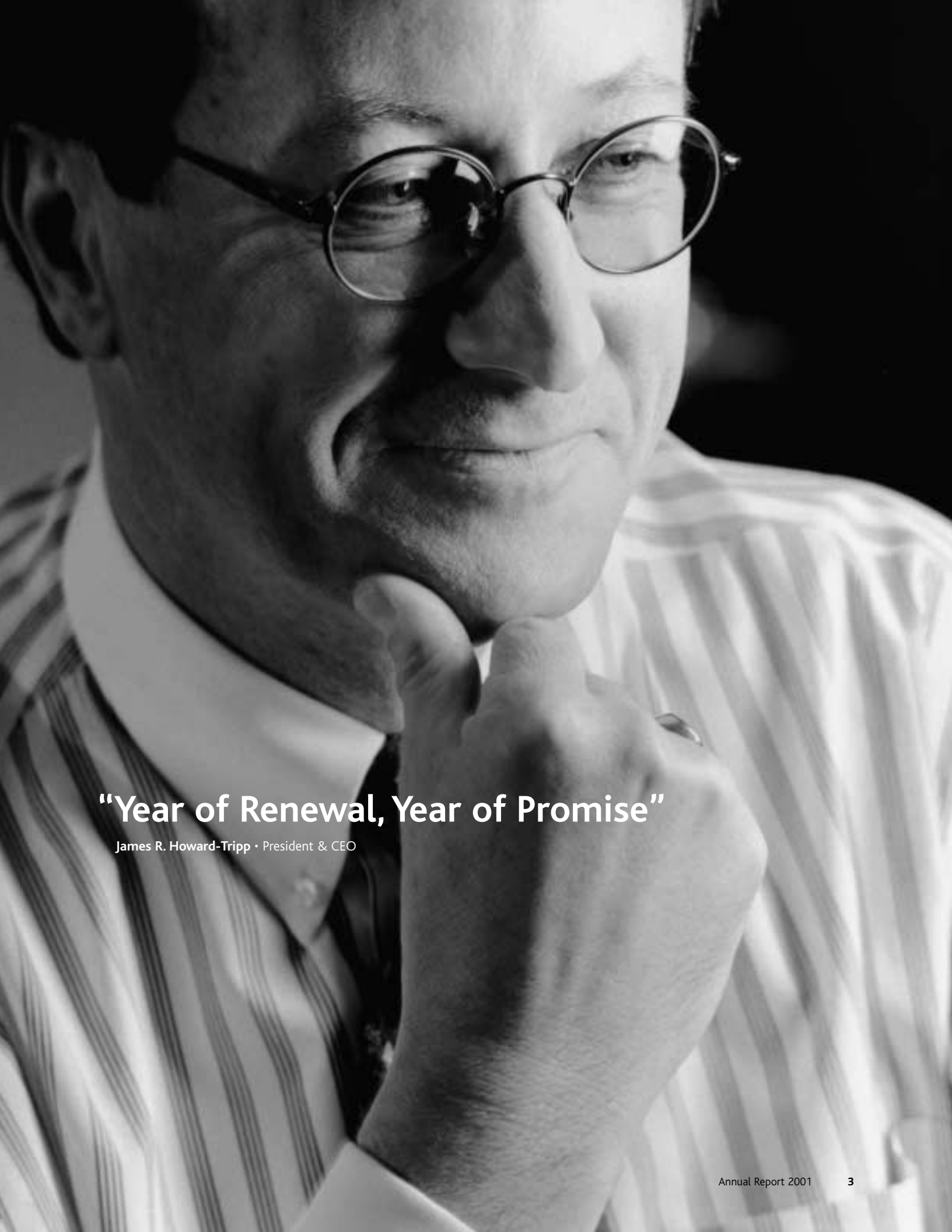
By the end of fiscal 2001 Labopharm successfully completed the feasibility and formulation phase for the Aventis #2 product, and is nearing completion of the formulation phase for the Aventis #1 product. We anticipate initiating pharmacokinetic studies for both products before year-end. Discussions with Aventis regarding full licensing agreements for both products have progressed well, which may lead to the signature of the first agreement as this report goes to press.

Research & Development Progressing on Schedule

In-house Progress Considerable

During this fiscal year, we put considerable emphasis on the in-house development of Tramadol. The Company has established a complete development plan for the product with aggressive timelines leading to an expected filing for product registration in 2002. We have engaged a highly qualified team to assume responsibility for its clinical development and have scheduled the first efficacy study on the drug to start in the third quarter of 2001.

Results have been very promising so far on our formulation of Tramadol. In a comparative study with a currently marketed drug, Labopharm's product demonstrated a pharmacokinetic profile consistent with once-a-day dosing, whereas the competitor's did not. These results suggest that our formulation may have the potential for superior efficacy.



“Year of Renewal, Year of Promise”

James R. Howard-Tripp • President & CEO

Partnered Projects on Track

We are very encouraged by the progress of our partnered projects. Not only have the two Aventis products successfully moved to the next stage of development, but our partnerships with Axcan Pharma, Sepracor and an international pharmaceutical company are yielding positive results.

In the co-development of solid, oral dosage forms of Levalbuterol with Sepracor, the Phase II clinical trial results were promising. Sepracor is in the process of carrying out a full analysis of the business opportunities for this product worldwide. Based on the results of this analysis, both Sepracor and Labopharm will decide on the best path forward.

A bioequivalent controlled-release formulation of Oxybutynin, a leading drug for the control of urinary incontinence, is in co-development with an international pharmaceutical company. Two pilot Phase I studies have been completed and a development plan is in the process of being agreed to with respect to further work. Labopharm is currently examining a non-generic approach to the development of Oxybutynin. This approach has yet to be fully delineated.

With Axcan Pharma, we are developing a new formulation for MODULON®. We expect to reduce the daily dosage requirements and to enhance patient compliance. We are currently in discussion with Axcan regarding a development plan and expect to initiate feasibility and formulation studies shortly.

Strategy and Vision

Labopharm's competitive edge lies in the sophistication and complexity of the release profiles of our proprietary technology, its cost-effectiveness and the ability to apply it to a wide range of products already on the market. As our potential products are primarily existing drugs on the market to which new drug delivery profiles are added to enhance the product's performance, our development timelines should be shorter, our costs lower and our market penetration, potentially faster.

Our corporate priorities have a singular focus – to bring our products to market in the shortest timeframe possible.

We have five products with the potential for market entry within the next 2-to-3 years; these are the two Aventis products, Tramadol, Levalbuterol and Oxybutynin. Three of these products are in billion dollar markets. It is also clear that with the risks inherent in drug development, not all of these products will get there.

Enhancing and adding to the product pipeline is therefore imperative. We intend to do this through a combination of new licensing deals (partnered programs), as well as by organic growth or acquisition in order to build our in-house portfolio.

Development of a strong, proprietary product portfolio is a critical component of careful strategic growth. Development of critical mass, both organizationally and in the financial markets, is necessary in order to maximize the commercial return from our portfolio. Our intent is to continue to build critical mass in the best way possible.

Before concluding, I wish to express my sincere thanks to Labopharm's Board of Directors, Management Team and Staff. Their encouragement, their enthusiasm and their commitment have facilitated the process of renewal initiated this year.

Last but not least, I would like to express my gratitude to all our shareholders for their support and continued confidence in Labopharm as we look forward to a year of important results.

(signed)

James R. Howard-Tripp

President and Chief Executive Officer

April 18, 2001

Fiscal 2002

A Year of Promise for Labopharm

Goals

Research & Development

Aventis #1	Complete the feasibility and formulation phase. Initiate pharmacokinetic studies.
Aventis #2	Complete initial pharmacokinetic studies. Initiate registration studies.
Tramadol	Initiate efficacy/bioequivalence studies. Complete pivotal trials.
Levalbuterol	Resolve path forward with Levalbuterol. Initiate Phase III studies.
Oxybutynin	Implement development plan for generic and/or non-generic formulation(s): <ul style="list-style-type: none">• Initiate efficacy/bioequivalence studies of generic formulation.• Initiate pharmacokinetic studies of non-generic formulation.
Trimebutine	Complete feasibility and formulation phase and initiate pilot pharmacokinetic studies.
Betahistine	Complete pharmacokinetic studies.
Implants/Ciprofloxacin	Complete <i>in vivo</i> proof-of-principle/osteomyelitis studies.
Micelles	Complete <i>in vivo</i> proof-of-principle studies.

Corporate Development

	Sign full licensing agreement for Aventis Product #1.
	Sign full licensing agreement for Aventis Product #2.
	Establish single-country partnership for Tramadol in Europe.
	Strengthen portfolio with addition of licensed product(s).
	Secure additional financial analyst coverage of Labopharm.

Labopharm's Management Team

The Management Team **ANSWERS** some often asked **QUESTIONS** on Labopharm's technology, product portfolio and business strategy.

Q: What makes Labopharm different from the typical "biotech" company?

A: We are different from the regular "biotech" model of business because we focus on drug delivery. As an international specialty pharmaceutical company, our potential products are often drugs that are already on the market, to which we add new drug delivery profiles, which may enhance the therapeutic benefits of the drug and improve patient compliance.

Focusing on drug delivery should allow us to have shorter development timelines, lower development costs and, through the marketing resources of our partners, also achieve faster market penetration. Our timelines are typically between two-to-three years compared to the 10–14 years for a regular biotech company. As a result, our costs are usually a fraction of what it costs to develop New Chemical Entities (NCEs). We therefore should provide a faster return on investment.

Q: What is distinctive about Labopharm's core technology, Contramid®?

A: Our core platform technology, Contramid®, works on extending the "therapeutic window" of effectiveness of drug products. As such, it can be applied to a wide range of already marketed medications in solid dosage form to improve their oral administration and performance. In addressing the needs of big pharma, we provide a way to add value by enhancing the therapeutic benefits of existing products and providing the means to extend patent protection. Contramid® provides the effectiveness of the gold standard in drug delivery technologies at a price which is comparable to the most economical.

Q: The products in your portfolio are at what stage of development?

A: We have a number of important products in our pipeline with high potential. Our portfolio mix includes seven products currently in development. Five of these products are being developed in partnership with international pharmaceutical companies. Three are in billion dollar markets and according to our product development timeline, we expect that at least one product should be on the market by 2003.



James R. Howard-Tripp • President and Chief Executive Officer

Q: What is the research and development timeline for the in-house development of Tramadol?

A: Tramadol, an analgesic for the treatment of moderate to severe pain, is Labopharm's highest priority in-house project and we are very enthusiastic about its market potential. With an aggressive development plan in place, we are moving towards a registration dossier in fiscal 2002.

We are working with a contract research organization to conduct an efficacy study in osteoarthritis patients with moderate to severe pain, which is scheduled to start in the third quarter of 2001.

We are exploring a single country partnership in Europe to facilitate European regulatory approval and commercialization. This will allow Tramadol to be developed primarily with the Company's resources and allow us to retain control of the pace of development and to maximize the commercial return for the Company. The current sales of marketed formulations of Tramadol are close to US\$1 billion.

In a head-to-head comparative study with a currently marketed product, completed in December 2000, Labopharm's formulation demonstrated a pharmacokinetic profile consistent with once-a-day dosing, whereas the competitor's did not. These results support the potential of Labopharm's formulation for superior efficacy versus other products in the market.

to reduce the daily dosage requirements and to enhance patient compliance. We are presently meeting with Axcan to determine the development plan for MODULON®.

Q: At what stage of development are the two Aventis products?

A: Labopharm signed two agreements in the second and third quarters of fiscal 2001 with Aventis — one of the world's largest pharmaceutical companies — for new formulations of two major products in multi-billion dollar (US\$) markets.

Significant progress has been made on these projects to date. Under the agreement for Aventis #2, Labopharm has completed feasibility and formulation studies as well as the successful scale-up of the product. Technical transfer to Aventis facilities



Dr. Sylvie Bouchard • Vice-President, Clinical Development



Dr. Vincent Lenaerts • Chief Scientific Officer and Vice-President, Research and Development

Q: What other products are being developed in-house?

A: Currently, our in-house portfolio includes a once-a-day formulation of Betahistine, for Ménière's disease — a disorder which is characterized by recurrent dizziness. A pilot pharmacokinetic study was recently completed with positive results. The product has now been developed to the point where we believe we have attractive potential formulations. Discussions are in progress with potential partners and further development will be carried out with the cooperation of a pharmaceutical partner.

Q: Are there any developments in your partnership with Axcan Pharma for the development of MODULON®?

A: The development of a controlled-release formulation of MODULON® for the treatment of irritable bowel syndrome, with Axcan Pharma, is moving forward. The new formulation is expected

is currently in process for the manufacture of clinical supplies of the product. We expect to begin initial clinical studies shortly.

In the development of Aventis #1, feasibility studies have also been successful and formulation work is nearing completion. Arrangements are now underway to prepare for technical transfer to the Aventis facilities.

Within the framework of these agreements, the next milestones for Labopharm will be fees upon the successful completion of pilot pharmacokinetic studies.

Q: Following the positive results of the Phase II clinical trials for Levalbuterol announced in January, what is the next step for Labopharm in its partnership with Sepracor for the development of this product?

A: The results of the Phase II efficacy study on a once-a-day oral (tablet) formulation of Levalbuterol for the treatment of asthma, which Labopharm presented to Sepracor in January, were very well received. The study demonstrated a significant improvement in breathing compared to placebo in both moderate and severe asthmatic patients. The success of the trial demonstrated that the product is efficacious in the treatment of bronchospasm due to asthma when compared to placebo. For patients who have

Q: Is Labopharm considering expanding its product portfolio to acquire any new products?

A: The Company is developing and expanding its existing technologies and looking to acquire complementary technologies. We continue to conduct a number of research programs, either in-house or in cooperation with universities, which point towards new applications for Contramid® technology.

A research program we are conducting using mini-tablets of Contramid® containing the antibiotic Ciprofloxacin, could be a very useful application of our technology. In animal osteomyelitis studies, mini-tablets were implanted in surgical wounds alongside



Dr. Allan Mandelzys • Vice-President, Business Development



Dr. Sylvie Bouchard • Vice-President, Clinical Development

difficulty using inhalers, such as the young and the elderly, this drug shows potential.

Sepracor is now conducting a full analysis of the worldwide business opportunities for a once-a-day oral formulation of Levalbuterol. Based on the results of the analysis, Labopharm and Sepracor will jointly decide how to proceed.

Q: How is the development of Oxybutynin progressing?

A: The development of a bioequivalent controlled-release formulation of Oxybutynin, a leading drug for the control of urinary incontinence, is continuing. We are now in Phase I co-development of the product with an international pharmaceutical company. We are also currently exploring a non-generic approach to the development of Oxybutynin, which has yet to be fully delineated.

muscle and bone. We were able to obtain therapeutic levels of antibiotic for 28 days in bone and localized tissue, while there was virtually no drug detected in the systemic circulation. This may have important implications in the prevention and treatment of infection. Discussions are in progress regarding the potential commercialization of this technology.

Another recent university research program, sponsored by Labopharm, aims at developing a new polymeric micelles system to improve cancer chemotherapy. Results of *in vivo* experiments in mice using cancer therapy models appear to demonstrate superiority of this system to existing micelles with respect to toxicity. Research is continuing on these studies.

Q: How many years of operation will your current cash resources cover?

A: With the proceeds from our recent private placement of special warrants, in August 2000, Labopharm raised \$12 million. While this has been a year of increased activity and we have sped up our program development significantly, we have nonetheless managed to keep our expenses in line. At fiscal year end, our cash on hand was about \$13.1 million and based on our current "burn rate" the Company now has between two and three years of cash on hand.

Q: When do you foresee generating profits from product sales?

A: Our intention is to have our first products on the market by 2003.

proprietary patent position with 46 patents issued on four patent cases in various countries in North America, South America, Europe, Australia, East Asia and Africa. We also have nine patents filed on six patent cases, including a product-by-process application which was filed in co-ownership with Cerestar, Labopharm's partner in the industrial manufacture of Contramid®.

Our future is dependent upon the strength of our intellectual property and we continue to be diligent and aggressive in ensuring that all intellectual property that we develop is protected.

Q: How do you see Labopharm developing over the next couple of years?

A: Our corporate priorities have a singular focus – to bring our products to market in the shortest timeframe possible. While we



Warren Whitehead • Interim Chief Financial Officer



Dr. Vincent Lenaerts • Chief Scientific Officer and Vice-President, Research and Development

Q: Will you be considering another round of financing in the foreseeable future?

A: With a good mix of products in our pipeline and an aggressive development timeline for our in-house project, Tramadol, the Company's operations are focused on meeting the major milestones it has set for itself. There is no immediate need for funding. Should additional funds be required, we will take the necessary measures to assure commercialization of our products.

Q: What is your current intellectual property position? Will you be seeking any additional patents?

A: Since acquiring all the rights to Contramid® technology from a group of researchers at the Université de Montréal and the Université du Québec à Montréal, in 1994, we have continued to actively protect our intellectual property. We have a strong

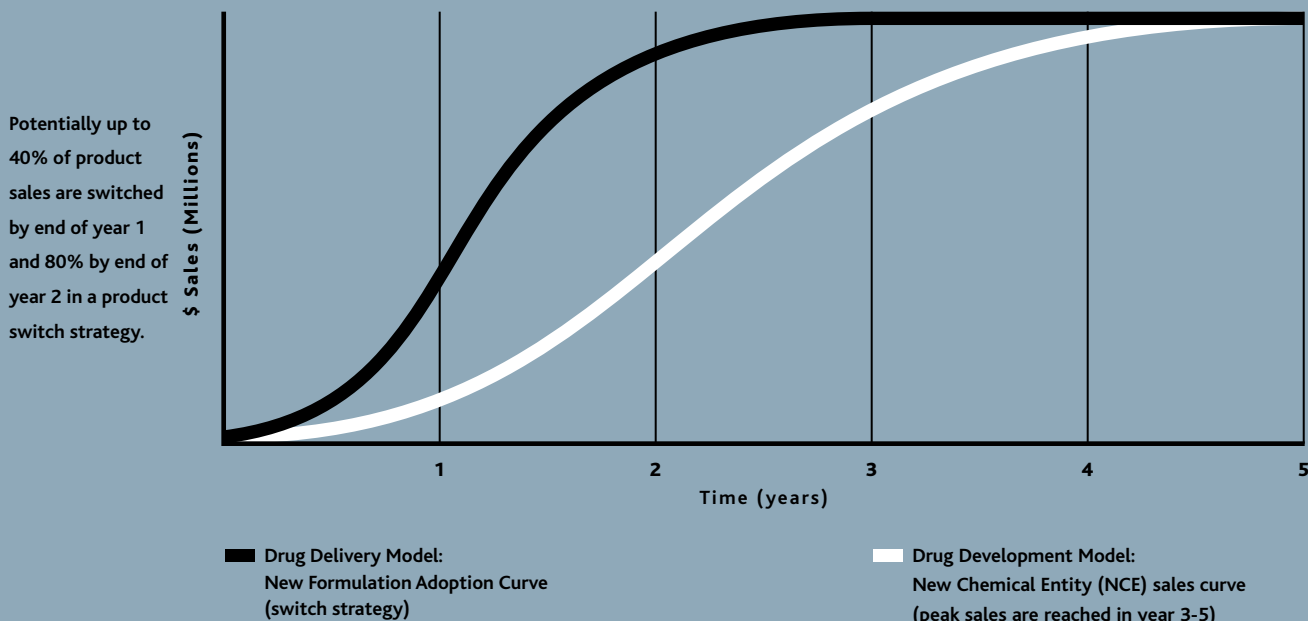
currently have five products with the potential for market entry within the next 2-to-3 years – three of which are in billion dollar markets – we will continue to enhance and add to our product pipeline. Through a combination of new licensing deals, acquisition or through organic growth we will continue to build our in-house portfolio in order to develop a strong, proprietary product portfolio.

Attaining critical mass, both organizationally and in the financial markets, is a critical component of our strategic growth, which is necessary in order to maximize the commercial return from our portfolio. Our intent is to continue to build critical mass in the best way possible ■

The Drug Delivery Model

As a specialty pharmaceutical company, Labopharm differs from the regular “biotech” model of business. Its potential products are primarily existing drugs on the market to which new drug delivery profiles are added to enhance the product’s performance. As a result, Labopharm’s products should have shorter development timelines, lower development costs and, through the marketing resources of the Company’s partners, should achieve faster market penetration. For Labopharm, the message is financial. The Company has a lower level of risk and a higher rate of return in a shorter length of time.

The Drug Delivery Model vs. The Drug Development Model



■ The Drug Delivery Model

Drug delivery reformulates products which already exist on the market. Where drug development takes between 10 and 14 years, drug delivery usually takes between 2-to-3 years. The average cost — between \$5 and \$10 million — is a fraction of the cost of developing an NCE. Also, the possibility of extending the patent to incorporate the new formulation of the drug is an important benefit. In the expected time-to-market, and rapid ramp-up of revenue if such a product uses a switch strategy, potentially up to 40% of product sales can be switched by the end of the first year on the market, and 80% can be switched by the end of year two. This means that an existing high revenue product, with the added drug-delivery value, can either maintain or increase its significant market share.

□ The Drug Development Model

The regular “biotech” model of business focuses on drug development. The average timeline in the development of NCEs (New Chemical Entities) is between 10–14 years and costs somewhere in the range of \$150–300 million. The risk of failure is high due to the inherent complexity of the drug discovery process ■

Shorter development timelines

“Our corporate priorities have a singular focus – to bring our products to market in the shortest timeframe possible.”

Labopharm's Technology

Labopharm has a number of important products in its pipeline which have high potential. The Company has seven products in development; five are in partnership; three are in billion dollar markets and we are targeting at least one product to be on the market by 2003.

Contramid® — Our Core Technology

The Company's platform technology, Contramid®, is a patented controlled-release drug delivery system, based on high amylose starch, for the oral administration of solid dosage forms. When used as an excipient and compressed with an active drug substance into a solid dosage form, Contramid® allows for the controlled-release of the active drug over an adjustable period of time. It is an advanced new class of drug delivery technology which is different from conventional hydrophilic matrix systems. It can be applied to a wide range of medications in solid dosage form to improve their oral administration and performance.

Once the Contramid® dosage form is in the stomach, gastric fluids turn its surface to gel and the resulting semi-permeable membrane stabilizes rapidly. This self-forming membrane ensures that a regular release of the active ingredients is contained in the dosage form. In traditional tablets without controlled-release, blood levels of the drug rise quickly after ingestion, reach a peak and then drop fairly rapidly, thus requiring frequent dosing.

A drug's effects may vary according to the concentration of the active ingredient in the bloodstream or other sites of action. Too low a concentration can often mean reduced efficacy, while too high a concentration increases the risk of side effects. For any drug, there is a range in which the desirable and undesirable effects are optimized — the "therapeutic window." By controlling the release of the active ingredients, we can maintain the concentration within this window and prolong the therapeutic effect over 12 or 24 hours. By definition, this means the drug is more effective, has a better safety profile, and for example, can be taken more conveniently such as once a day instead of three times a day, a fact that significantly increases patient compliance (see graph below).

Contramid® is cost-effective to manufacture. Also, it is generally possible to integrate a high proportion of active ingredient in the final dosage form. Tablets can therefore be manufactured in an acceptable size, which is not always the case with other technologies.

GMP production of Contramid® has been developed by Cerestar, a division of the multinational company Eridania Béghin-Say. Since January 2000, Labopharm's alliance with Cerestar has provided a completely new manufacturing process which is reliable, reproducible and economical.

In-house Products

Tramadol — Our Highest Priority In-house Project

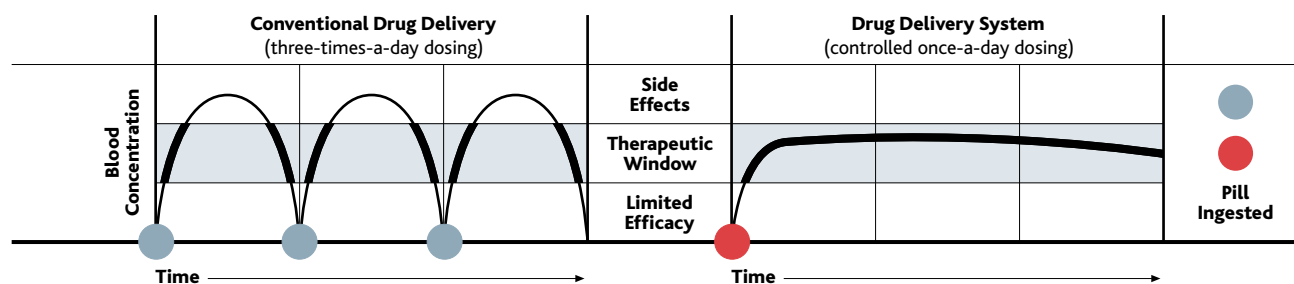
Indication: *Treatment of Moderate to Severe Pain*

Labopharm is currently developing a once-a-day, controlled-release formulation of Tramadol hydrochloride. It is a centrally acting analgesic that reduces pain by binding to μ -opioid receptors and inhibiting the re-uptake of the neurotransmitters norepinephrine and serotonin. Since chronic pain involves several biochemical pathways, Tramadol offers a unique advantage over many other analgesics.

Tramadol is prescribed in Europe and the US for the alleviation of acute and chronic pain and has sales of close to US\$1 billion. The difficulty in obtaining a once-a-day formulation lies in the narrow therapeutic index of this compound.

In a head-to-head comparative study with a currently marketed product, completed in December, Labopharm's formulation demonstrated a pharmacokinetic profile consistent with once-a-day dosing, whereas the competitor's did not. These results support the potential of Labopharm's formulation for superior efficacy versus other products in the market.

The Company has established a complete development plan leading to product registration, engaged a highly qualified team to assume responsibility for clinical development and has scheduled the first efficacy studies on the drug for early in the third quarter of 2001.



Labopharm is exploring a single country partnership in Europe to facilitate European regulatory approval and commercialization. This will allow Tramadol to be developed primarily with the Company's resources and allow Labopharm to retain control of the pace of development and to maximize the commercial return for the Company.

Betahistine

Indication: Ménière's Disease (Vertigo)

A once-a-day formulation of Betahistine, for Ménière's disease — a disorder characterized by recurrent dizziness, is currently being developed in-house. In March 2000, Labopharm took over full development of Betahistine which it had been developing jointly with Les Laboratoires Bouchara in France since the signing of an agreement in 1997. A pilot pharmacokinetic study was recently completed with positive results. The product has now been developed to the point where Labopharm believes it has attractive potential formulations. Discussions are currently in progress with potential partners and further development will be carried out with the cooperation of a pharmaceutical partner.

Partnered Products

Life-Cycle Management Projects

Aventis Product No. 1

In August 2000, Labopharm signed a feasibility and formulation agreement with Aventis for the development of two new formulations of a top selling product in a billion dollar market.

Labopharm has successfully completed the feasibility studies for this product and formulation work is nearing completion. Arrangements are underway to prepare for technical transfer to the Aventis facilities.

Aventis Product No. 2

A second Aventis agreement was signed in September 2000, for the development of new formulations of a second product. Under the agreement, Aventis transferred the active ingredient to Labopharm with the objective of developing new formulations with improved properties.

Significant progress has been made on this project to date. The feasibility and formulation phase for the drug as well as scale-up have been successfully completed. Technical transfer to Aventis facilities is currently in process for the manufacture of clinical supplies. It is anticipated that initial clinical studies will start shortly.

Trimebutine

Indication: Irritable Bowel Syndrome

In 1999, Labopharm signed an agreement with Axcan Pharma to develop a controlled-release formulation of the currently marketed product, MODULON®, which is indicated for the treatment of irritable bowel syndrome, a disease present in 15% of the population. The new formulation is expected to reduce the daily dosage requirements and to enhance patient compliance.

Labopharm and Axcan are discussing the timing for the beginning of Phase I clinical trials.

R-Albuterol (levalbuterol HCl)

Indication: Asthma

In 1997, Labopharm entered into a licensing and co-development agreement with Sepracor for the development of solid oral dosage forms of XOPENEX™ (levalbuterol HCl), for the treatment of asthma. XOPENEX™ is the therapeutically active isomer of racemic albuterol, which is one of the world's leading bronchodilators for asthma.

During the last quarter of the fiscal year, Labopharm announced positive results of a Phase II clinical trial on solid oral dosage (tablet) forms of XOPENEX™ (levalbuterol HCl). The trial's objective was to determine the efficacy of oral XOPENEX™ in dilating the bronchial passages of patients with moderate to moderately-severe asthma. The success of the trial demonstrated that the product candidate is efficacious in the treatment of bronchospasm due to asthma when compared to placebo. For patients who have difficulty using inhalers, such as the young and the elderly, this drug shows interesting potential.

Sepracor is now carrying out a full analysis of the business opportunities for this product worldwide, and based on the results of this analysis, both Sepracor and Labopharm will decide how best to proceed.

Generic

Oxybutynin

Indication: Urinary Incontinence

In January 2000, Labopharm signed an agreement with an international pharmaceutical company to develop one of its in-house projects, a controlled-release formulation of Oxybutynin, a leading drug for the control of urinary incontinence and a generic version of Ditropan XL. This product is now in Phase I co-development.

Labopharm is also exploring a non-generic approach to the development of Oxybutynin, which is currently being delineated ■

Faster market penetration

“We have five products with the potential for market entry within the next 2–3 years.”

Financial Report

Management's Discussion and Analysis

Overview

Established in 1990, and operational since 1995, Labopharm specializes in controlled-release drug delivery and the development of pharmaceutical products incorporating its proprietary technologies. As a specialty pharmaceutical company focused on drug delivery, it differs from the regular "biotech model" of business. Labopharm's potential products are very often existing drugs on the market to which it adds new drug delivery profiles. As a result, its products should have shorter development timelines, lower development costs and, through the marketing resources of the Company's partners, should achieve faster market penetration.

The Company generates revenues from in-house development and late-stage licensing of oral controlled-release products using Contramid®, and from collaborations with large international pharmaceutical companies where its controlled-release technologies are used to enhance the therapeutic benefits of their branded products. The Company is developing and expanding its existing technologies, including Contramid® and looking to acquire complementary technologies.

The controlled-release properties of cross-linked amylose were discovered in 1990 by a group of researchers at the Université de Montréal and the Université du Québec à Montréal, who also concluded that the addition of the alpha-amylase enzyme could act as an additional mechanism to control and adjust the rate of release. Patents have been issued on each of these discoveries. Labopharm acquired all rights to this technology in 1994. Since that time, on-going research efforts have led to the filing of two worldwide improvement patent applications in 1996 and in 1998, as well as the filing of a manufacturing process patent application in 1997. Additionally, Labopharm filed a continuation-in-part application in 1999 which covers some of its recent discoveries.

During fiscal 2001, Labopharm focused its attention on a pipeline of seven projects, five of which are being developed in partnership with international pharmaceutical companies, with two products, Tramadol and Betahistine, undergoing in-house development.

Partnership Projects

In 1997, Labopharm concluded a licensing and co-development agreement with Sepracor Inc., of Massachusetts, for the development of solid oral dosage forms of levalbuterol, trade-named Xopenex, as a treatment for asthma and chronic obstructive pulmonary disease. During the fiscal year under review, a Phase II clinical trial was successfully completed.

In February 1999, Labopharm announced the signing of a letter of intent to work with Axcan Pharma to develop a controlled-release formulation of the currently marketed product, MODULON®, which is indicated for the treatment of irritable bowel syndrome, a disease present in 15% of the population. The new formulation is expected to reduce the daily dosage requirements and to enhance patient compliance. Labopharm and Axcan are presently meeting to determine the development plan for MODULON®.

In January 2000, Labopharm signed an agreement with an international pharmaceutical company to develop one of its in-house projects, Oxybutynin, a bioequivalent controlled-release formulation of Ditropan XL. The drug is now in Phase I co-development with its partner. Under the agreement, Labopharm will receive development funding, milestone payments and royalties on sales to certain markets including the United States. In other markets, notably Europe, a profit sharing formula has been determined and marketing partners will be identified.

In the second and third quarters of fiscal 2001, the Company also signed two agreements with Aventis, one of the world's largest pharmaceutical companies. The agreements with the Aventis group provide for the development of new formulations of major products in multi-billion dollar (US\$) markets.

In-house Projects

In the third quarter of fiscal 2001, Labopharm intensified its commitment to the in-house development of Tramadol, an analgesic for the treatment of moderate to severe pain, with worldwide sales for existing formulations approaching US\$1 billion. The Company is enthusiastic about Tramadol's market potential and is aggressively moving towards filing a registration dossier in 2002. Labopharm has decided to develop this product with its own resources in order to maximize the commercial return for the Company by licensing it out only at a late stage of development.

Labopharm has also assumed full ownership of existing clinical data and full control of the development of Betahistine, a product for the treatment of Menière's disease (a form of vertigo). The product was initially being developed jointly with Les Laboratoires Bouchara in France. Labopharm believes it presently has an appropriate formulation and intends to continue the development of this product with an international company.

Manufacturing Agreement

Labopharm entered into an agreement with Cerestar in November 1998, to manufacture Contramid®. Cerestar is a major global operating company in the starch and starch derivatives industry and part of the worldwide agrifoods conglomerate, Eridania Béghin-Say. As the leader in the European market and one of the largest producers of starch in North America, Cerestar is regularly audited by pharmaceutical companies and has extensive experience in producing Drug Master Files. Cerestar has now scaled-up the production process for commercial use and has produced multiple GMP batches exceeding one ton each.

Additional Intellectual Property

In March 1999, the Company received a new patent from the U.S. Patent Office expanding and solidifying its position on the controlled-release platforms offered with Contramid®. It also filed worldwide applications related to this particular patent.

In 2000, a product-by-process patent was filed in co-ownership with Cerestar, Labopharm's partner in the industrial manufacture of Contramid®. Another patent, which covers the use of certain natural polymers as matrices for the controlled-release of highly soluble drugs, was also recently filed.

Potential New Applications for Contramid® Technology

Labopharm has conducted a number of new research programs, some in-house and some in cooperation with universities, that point towards new applications for Contramid® technology.

The use of Contramid® as an implant containing an antibiotic could be very valuable in the prevention of infection in post-surgical orthopedic care and in the treatment of post-traumatic infections. Animal osteomyelitis studies, which the Company sponsored, produced promising results. Mini-tablets of Contramid® which contained the antibiotic Ciprofloxacin were implanted in surgical wounds between bone and muscle. These studies demonstrated local concentrations of the drug in bone and tissue in excess of therapeutic levels for at least 28 days, while there was virtually no drug detected in the systemic circulation. This may have important implications in the prevention and treatment of infection.

Labopharm has also initiated a research program involving polymeric aggregates (micelles) for drug targeting and has filed two patent applications relating to this technology.

Operating Revenue

Operating revenue for the fiscal year ended February 28, 2001 amounted to \$2,616,062 compared to \$1,902,652 the preceding year, for an increase of 37.5%. Revenues from research and development contracts totaled \$2,106,307, an increase of \$586,117 compared to the previous year, primarily as a result of the two new contracts with Aventis and the continuation of clinical studies undertaken during the last fiscal year with our partners. Investment income was \$509,755 compared to \$382,462 during the previous year. This increase is the result of \$12,000,225 in financing received on August 31, 2000.

Research and Development Expenses

The Company incurred research and development expenses of \$4,306,372, before investment tax credits, during the last fiscal year compared to \$3,938,377 in the previous year, representing a 9.3% increase. Tax credits for research and development totaled \$693,611 or the equivalent of 16.1% of research and development expenses, compared to \$651,008 or 16.5% of such expenses for the previous year.

Research and development expenses, net of investment tax credits, therefore totaled \$3,612,761 for the year compared to \$3,287,369 in the previous period. This 10% increase is attributable to an increase in both partnered and in-house project development activity.

Selling and Administrative Expenses

Selling and administrative expenses amounted to \$2,617,669 in fiscal 2001, compared to \$2,312,778 for the year 2000, representing a 13.2% increase or \$304,891. The year 2001 has been dedicated to the strengthening of the Company's senior management team. During the year, Labopharm hired a new Vice-President, Business Development and a new Chief Financial Officer, which accounts for 75% of the Company's increase in administrative costs. Administrative expenses were higher due to successful efforts by management to conclude additional financing.

Finance Charges

Finance charges were \$10,246 during fiscal 2001 compared to \$54,295 for fiscal 2000. The charges represent the payment of interest on a new capital lease equipment.

Net Loss

The net loss from operating activities amounted to \$3,624,614 compared to \$3,649,916 for the preceding fiscal year. The increase in revenue for the fiscal year ended February 28, 2001, offset the increase in research and administrative costs. As a result, losses remained stable in 2001 compared to the previous year.

Sources of Funding and Cash Position

Since its creation, Labopharm has financed its activities by issuing equity, by the use of term loans, as well as by funds derived from operations. On December 21, 1994, the Company completed a private placement and realized net proceeds of \$5,136,141. In October 1995, the Company received \$660,000 from the government of Quebec as a tax credit to increase capitalization of small and medium-sized businesses. On June 25, 1996, the Company completed an initial public offering that resulted in net proceeds of \$20,989,257. On August 31, 2000, the Company completed a private placement that resulted in net proceeds of \$11,220,210.

Funds applied to operations amounted to \$2,889,978 in fiscal 2001 compared to \$6,371,776 in fiscal 2000.

Capital expenditures were \$597,265 for fiscal 2001 compared to \$484,965 for fiscal 2000. Capital expenditures for fiscal 2001 were principally related to the acquisition of laboratory equipment, computer equipment and to patent expenses.

Cash and Investments totalled \$13,096,257 at the end of fiscal 2001, compared to \$5,476,012 at the end of the previous fiscal year.

Risks and Uncertainties

The field of drug delivery systems is still a relatively new and rapidly expanding market that brings therapeutic benefits to patients and offers great commercial potential for pharmaceutical companies.

Labopharm's success in this market will depend, in the short- and medium-term, on the applicability of its Contramid® technology and its competitiveness with other available technologies. The Company is of the opinion that Contramid® can be applied successfully to a wide variety of active ingredients. Even though no product incorporating Contramid® has yet been fully developed and marketed, Labopharm's results to date with different active ingredients have been promising. Contramid®'s performance in the studies done to date has been shown to be equivalent to the most advanced competing technologies, while remaining among the most economical. Nevertheless, there has been rapid and considerable evolution of technology within the drug delivery system industry and the competitive advantages of new systems developed by competitors could challenge those of Contramid®.

Labopharm places great importance on the protection of its intellectual property and has a portfolio of patents and patent applications that it intends to enforce. However, nothing guarantees that these patents are valid, even if they are reputed to be, or that its patent applications will be approved, or that the Company will be successful in defending them.

Labopharm's success also depends, in large measure, on its ability to conclude licensing, development, manufacturing and marketing agreements for products using its drug delivery systems with other pharmaceutical companies. This type of agreement or alliance is common in the pharmaceutical industry, and we are pleased with the way in which Labopharm's technology has been received in the industry. To date, the Company has 5 agreements with pharmaceutical companies. There is no assurance that partners will not withdraw from agreements at a later date or that projects will successfully reach the market.

The development of pharmaceutical products is a process that requires large investments and can take years to complete. Projects can be abandoned along the way or regulatory authorities can refuse to approve new products. With respect to projects it has itself initiated, the Company attempts to minimize risk through the judicious selection of product candidates and by focusing on improving products that have already been approved.

With respect to manufacturing Contramid®, the Company has an exclusive manufacturing agreement with Cerestar, a well-known European manufacturer of starch and starch derivatives. Cerestar is qualified to provide the scaled-up quantities required to satisfy Phase III and commercial needs.

Labopharm expects to generate significant revenues from the licensing agreements and alliances it has concluded and will continue to conclude with pharmaceutical companies. Conditions of these agreements could vary greatly depending on a number of factors. The principal forms of revenue will be milestone payments, which are lump-sum payments made at key stages of product development, as well as royalties on product sales.

Until it begins to receive royalties and milestone payments according to the terms of its strategic alliances, the Company foresees continued losses, primarily as a result of its research and development activities. Over the last three fiscal years, Labopharm's drug delivery systems' activities have accumulated net losses of approximately \$13.7 million.

Labopharm's management believes that current liquidity, funds from operations and funds available through its line of credit are sufficient to allow it to respond to the Company's liquidity needs for 2–3 years. During the next fiscal year, liquidity is expected to diminish by approximately \$5 million.

The Company will also need supplementary, medium-term capital. The amount and the time needed will depend on a number of factors, notably the costs associated with research and development activities and the activities necessary to obtain regulatory approvals. The Company will maintain its efforts to raise capital under reasonable terms and conditions. However, it is uncertain that the Company will be able to raise all the funds it needs at the necessary time.

The price of Labopharm's common shares is subject to fluctuation. Factors such as the conclusion of strategic alliances, research results and clinical studies, questions regarding patents and any number of other factors could considerably influence the price of Labopharm's common shares ■

Lower development costs

“Our potential products are often drugs that are already on the market, to which we add new drug delivery profiles.”

Management's Report

The accompanying financial statements of Labopharm Inc. are the responsibility of the management and have been approved by Labopharm's Board of Directors.

These financial statements were prepared by management in accordance with generally accepted Canadian accounting principles. They include some amounts that are based on estimates and judgments. The financial information contained elsewhere in the annual report is consistent with that in the financial statements.

To ensure the accuracy and objectivity of the information contained in the financial statements, Labopharm's management maintains a system of internal accounting controls. Management believes this system gives a reasonable degree of assurance that the financial documents are reliable and provide an adequate basis for the financial statements, and that the Company's assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this annual report primarily through its audit committee. The audit committee is formed of outside directors who review the Company's annual financial statements as well as the management's analysis and the operating results and recommend their approval by the Board. Arthur Andersen & cie, General Partnership, the external auditors designated by the shareholders, periodically meet with the audit committee to discuss auditing, the reporting of financial information and other related subjects.

(signed)

James R. Howard-Tripp

President and Chief Executive Officer

Laval, April 18, 2001

(signed)

Warren Whitehead

Interim Chief Financial Officer

Auditors' Report

To the Shareholders of Labopharm Inc.,

We have audited the balance sheets of LABOPHARM INC. as at February 28, 2001 and 2000 and the statements of income, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at February 28, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed)

Arthur Andersen & cie

General Partnership

Chartered Accountants

March 23, 2001

Montreal, Canada

Balance Sheets

February 28

	2001	2000
	\$	\$
Assets		
Current assets		
Cash	257,126	248,716
Temporary investments	4,981,029	4,220,929
Accounts receivable	864,611	1,071,429
Tax credits receivable on research and development (Note 5)	608,412	631,539
Prepaid expenses	16,649	17,188
	6,727,827	6,189,801
Capital assets (Note 6)	2,406,868	2,092,244
Investments	7,858,102	1,006,367
Future income taxes	176,154	176,154
	17,168,951	9,464,566
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	1,150,772	963,052
Current portion of obligations under capital leases (Note 8)	6,138	21,612
	1,156,910	984,664
Obligations under capital leases (Note 8)	27,114	—
	1,184,024	984,664
Commitments (Note 11)		
Shareholders' equity		
Capital stock (Note 9)	44,073,574	31,808,149
Deficit	(28,088,647)	(23,328,247)
	15,984,927	8,479,902
	17,168,951	9,464,566

Approved on behalf of the Board:

(signed)

James R. Howard-Tripp

Director

(signed)

Gordon J. Fehr

Director

The accompanying notes are an integral part of these financial statements.

Statements of Income

For the years ended February 28

	2001	2000
	\$	\$
Operating revenue		
Research and development contracts	2,106,307	1,520,190
Investment income	509,755	382,462
	2,616,062	1,902,652
Operating expenses (Note 4)		
Research and development expenses (Note 5)	3,612,761	3,287,369
Selling and administrative expenses	2,617,669	2,312,778
Finance charges	10,246	54,295
	6,240,676	5,654,442
Loss before other item and discontinued operations	(3,624,614)	(3,751,790)
Costs related to an agreement with a former supplier (Note 9)	—	42,499
Loss before discontinued operations	(3,624,614)	(3,709,291)
Discontinued operations (Note 15)		
Gain from discontinued operations	—	59,375
Net loss	(3,624,614)	(3,649,916)
Loss before discontinued operations per share	(0.1708)	(0.1860)
Net loss per share	(0.1708)	(0.1830)

Statements of Deficit

For the years ended February 28

	2001	2000
	\$	\$
Balance, beginning of year	(23,328,247)	(19,678,331)
Issuance costs of capital stock	(1,135,786)	—
Net loss	(3,624,614)	(3,649,916)
Balance, end of year	(28,088,647)	(23,328,247)

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

For the years ended February 28

	2001	2000
	\$	\$
Operating activities		
Loss before discontinued operations	(3,624,614)	(3,709,291)
Items not affecting cash		
Amortization	310,305	337,104
Loss on disposal and write-off of capital assets	6,127	6,303
	(3,308,182)	(3,365,884)
Net change in non-cash working capital items	418,204	(3,065,267)
	(2,889,978)	(6,431,151)
Gain from discontinued operations (Note 15)	—	59,375
	(2,889,978)	(6,371,776)
Investing activities		
Acquisition of temporary investments	(14,754,682)	(1,015,672)
Proceeds of temporary investments	7,142,847	7,781,682
Acquisition of capital assets	(597,265)	(484,965)
Proceeds from disposal of capital assets	3,534	12,000
	(8,205,566)	6,293,045
Financing activities		
Reimbursement of capital leases obligations	(25,685)	(190,056)
Issuance costs of capital stock	(1,135,786)	—
Proceeds from issuance of capital stock	12,265,425	—
	11,103,954	(190,056)
Increase (decrease) in cash and cash equivalents	8,410	(268,787)
CASH, beginning of year	248,716	517,503
CASH, end of year	257,126	248,716
Cash flows include the following item:		
Interest paid	10,246	54,295

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

February 28, 2001 and 2000

1. Statutes of incorporation and nature of activities

The Company, incorporated under the Companies Act (Québec), is specialized in the development of drugs using advanced central release technologies and the development of pharmaceutical products incorporating its proprietary technologies.

The Company's strategy is to form strategic alliances or licensing agreements with national or international pharmaceutical companies that have the necessary resources and distribution networks to market and sell the pharmaceutical products incorporating the Company's proprietary technologies. The future profitability of the Company is dependent upon such factors as the success of the clinical trials, the approval by regulatory authorities of products developed by the Company and the ability of Labopharm to obtain the necessary financing to complete its projects through licensing and research agreements.

2. Significant accounting policies

Revenue recognition

Research and development contracts are accounted for using the percentage-of-completion method.

Temporary investments

Bonds are accounted for at amortized cost including accrued interests.

Property, plant and equipment

Property, plant and equipment are carried at cost less any tax credit on research and development.

Assets acquired under capital leases are carried at cost, being the present value of the minimum lease payments after deduction of executory costs.

Amortization of property, plant and equipment and assets acquired under capital leases is calculated over their useful life using the following methods and rates:

	Methods	Rates
Laboratory equipment	Diminishing balance	20%
Computer hardware	Diminishing balance	30%
Software	Diminishing balance	30%
Furniture	Diminishing balance	20%
Leasehold improvements	Straight-line	3 to 5 years

Intangible assets

Intangible assets are valued at cost.

Intellectual property rights are amortized using the straight-line method at the rate of 5% which approximates the service lives of the related assets.

Patents will be amortized over periods of 17 to 20 years beginning on the date they are used in commercial activities.

Research and development expenses

Research expenses are charged to operations less related tax credits. Development costs net of related tax credits are charged to operations as incurred unless a development project meets generally accepted accounting criteria for deferral and amortization. As at February 28, 2001 and 2000, no development costs have been deferred.

2. Significant accounting policies (continued)

Use of estimates

The presentation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Stock-based compensation plans

The Company has a stock-based compensation plan, which is described in Note 10. No compensation expense is recognized for this plan when stock or stock options are issued to employees.

Income taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

3. Change in accounting policy

The Company retroactively adopted in 2000 the recommendations of the Canadian Institute of Chartered Accountants concerning the cash flow statement. The prior year figures have been restated. The changes relate primarily to the components of cash and cash equivalents and to the presentation of non-cash transactions.

4. Information relating to the statement of income

	2001	2000
	\$	\$
The following items are included in the operating expenses:		
Amortization – capital assets	310,305	337,104
Interest on capital leases	2,824	8,495
Other interest	7,422	45,800

Research and development expenses are presented net of tax credits of \$693,611 and \$651,008 for the years ended February 28, 2001 and 2000 respectively.

5. Research and development tax credits

Certain research and development tax credits accounted for are related to tax returns not yet assessed by the taxation authorities.

6. Capital assets

	2001		
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
Property, plant and equipment:			
Laboratory equipment	1,310,734	633,956	676,778
Computer hardware and software	357,706	224,994	132,712
Furniture	278,309	150,103	128,206
Leasehold improvements	285,229	211,774	73,455
	2,231,978	1,220,827	1,011,151
Assets under capital leases			
Laboratory equipment	37,325	5,310	32,015
	2,269,303	1,226,137	1,043,166
Intangible assets:			
Intellectual property rights	500,000	150,000	350,000
Patents	1,013,702	—	1,013,702
	1,513,702	150,000	1,363,702
	3,783,005	1,376,137	2,406,868
			2000
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
Property, plant and equipment:			
Laboratory equipment	853,055	299,446	553,609
Computer hardware and software	262,698	148,519	114,179
Furniture	220,547	96,216	124,331
Leasehold improvements	234,035	173,113	60,922
	1,570,335	717,294	853,041
Assets under capital leases			
Laboratory equipment	367,382	175,757	191,625
Computer hardware and software	67,201	46,056	21,145
Furniture	43,645	21,858	21,787
	478,228	243,671	234,557
	2,048,563	960,965	1,087,598
Intangible assets:			
Intellectual property rights	500,000	125,000	375,000
Patents	629,646	—	629,646
	1,129,646	125,000	1,004,646
	3,178,209	1,085,965	2,092,244

Capital assets of \$37,325 were acquired during the year ended February 28, 2001 through capital leases.

7. Bank indebtedness

The Company has a credit line of \$500,000 available which is secured by a movable hypothec on the universality of claims bearing interest at prime rate and is renewable annually. As at February 28, 2001 and 2000, the credit line is unused.

8. Capital leases obligations

	2001	2000
	\$	\$
Laboratory equipment, computer hardware and other capital assets lease contract, repayable in monthly instalments of \$10,912 including interest calculated at 7.82% with transfer of ownership at maturity on April 30, 2000	—	21,824
Laboratory equipment, repayable in monthly instalments of \$836 including interest calculated at 11.89% with transfer of ownership at maturity on June 7, 2005	43,472	—
	43,472	21,824
Interest included in instalments	10,220	212
	33,252	21,612
Current portion	6,138	21,612
	27,114	—

Minimum lease payments under capital leases for the next five years are as follows:

	2001
	\$
2002	10,032
2003	10,032
2004	10,032
2005	10,032
2006	3,344

9. Capital stock

Authorized

Unlimited number of preferred shares, non-participating, non-voting, without par value

Unlimited number of common shares, without par value

	2001	2000
	\$	\$
Issued		
24,207,481 common shares (2000 – 20,016,681)	44,073,574	31,808,149

Issuance

During the year ended February 28, 2001, the Company issued 3,934,500 special warrants for a total of 3,934,500 shares for a cash consideration of \$12,000,225. These warrants were converted into common shares on November 28, 2000. Moreover, 256,300 options were exercised (2000 – Nil) for a total of 256,300 shares for a cash consideration of \$265,200.

9. Capital stock (continued)

A prospectus was filed on November 27, 2000, whereby the Company proposes to issue 3,934,500 common shares, which are issuable upon the exercise of these 3,934,500 Special Warrants. The Company has granted a special broker's warrant entitling the Agent to acquire at no additional consideration that number of compensation options equal to 5.0% of the aggregate number of Special Warrants sold under this prospectus. These compensation options may be exercised for a period of twenty-four months from August 31, 2000 and will entitle the holder to purchase one common share at a price of \$3.40 per share. If the Agent exercises the compensation options in full, the total offering of common shares and the net proceeds to the Company will be \$12,669,090 and \$11,889,075, respectively, assuming the maximum offering.

During the year ended February 28, 1999, the Company accounted for a provision of \$1,700,000 for negotiating an agreement with the former manufacturing supplier of Contramid®. During the year ended February 28, 2000, an agreement was concluded, which involves consideration of the issuance of 300,000 common shares at a price of \$2.10 per share and an amount of \$1,000,000 in cash.

Furthermore, the Company has issued 200,000 warrants to the supplier which can be exercised at the average market price of the last five days, expiring on May 2004.

10. Stock-based compensation plans

Stock option plan

In May 1995, Labopharm Inc. established a stock option plan for directors, executive officers, employees and consultants of the Company, which was modified in March and June of 1996 as well as in July 2000. The maximum number of common shares that are issuable under the plan will not exceed 3,000,000 (2000 – 1,965,578) common shares, excluding the 891,000 options granted prior to the public offering of 1996, and the maximum number of common shares that may be optioned in favour of any individual will not exceed 5% of the number of outstanding common shares.

The price at which the common shares may be purchased will not be lower than the average of the closing price of the common shares on the Toronto Stock Exchange for the five preceding days. Any options issued will be non-transferable.

All of the options that may be granted under the Plan are exercisable according to a schedule up to a maximum period of ten years following the grant date thereof. The outstanding options, as at February 28, 2001, may be exercised no later than February 2006.

The changes in the number of stock options granted are as follows:

	2001	2000
Balance, beginning of year	2,235,550	1,904,300
Granted	1,025,800	348,000
Exercised	(256,300)	—
Cancelled	(522,800)	(16,750)
Balance, end of year	2,482,250	2,235,550
Options eligible to be exercised	1,604,500	1,304,300

During the year ended February 28, 2001, 256,300 options were exercised (2000 – Nil) for a total of 256,300 shares for a cash consideration of \$265,200.

The following table summarizes information about fixed stock options outstanding at February 28, 2001:

Range of exercise price	Number of options outstanding at February 28, 2001	Weighted-average remaining contractual life	Weighted-average exercise price	Options eligible to be exercised at February 28, 2001	Weighted-average exercise price
\$			\$		\$
1 to 3	1,199,250	3.69 years	2.20	691,500	2.20
3 to 6	1,133,000	2.48 years	4.03	763,000	4.03
6 to 9	150,000	0.96 years	7.47	150,000	7.47
1 to 9	2,482,250	2.97 years	3.36	1,604,500	3.36

10. Stock-based compensation plans (continued)

In addition, in 1996, the Université de Montréal and Université du Québec à Montréal were granted an option to purchase 160,000 common shares at a price of \$6.25. Such option will expire on June 25, 2001.

11. Commitments

The Company rents premises under operating leases. The aggregate minimum rental commitment amounts to \$300,806, excluding a property tax escalator clause. The aggregate minimum rental commitments for the next five years are as follows:

	2001
	\$
2002	140,399
2003	80,174
2004	26,883
2005	26,800
2006	26,550

Furthermore, a first rank chattel mortgage without delivery has been granted for an amount of \$100,000 to the lessor on all present and future movable assets located in the rented space.

12. Related party transactions

The principal transactions undertaken with a shareholder company during the year were as follows:

	2001	2000
	\$	\$
Fees	—	50,000

These transactions are carried out in the normal course of operations and are measured at the exchange amount.

As at June 2000, the Company loaned an amount of \$50,000 without interest or repayment terms to an executive officer.

13. Tax benefits available

The fiscal losses available to reduce future income taxes payable, amount to \$15,272,692 and \$13,276,834 at the federal and provincial levels, respectively. The expiration dates of the loss carried forwards are as follows:

	2001	
	Federal	Provincial
	\$	\$
2002	1,319,002	1,129,077
2003	535,363	494,240
2004	1,838,927	1,607,644
2005	3,633,666	3,701,394
2006	3,900,953	3,480,160
2007	2,339,183	1,891,884
2008	1,705,598	972,435

The balance of scientific research expenses that could possibly reduce future income taxes amounts to \$8,212,427 and \$13,834,536 at the federal and provincial levels respectively. The Company can take advantage of tax benefits resulting from carrying forward these expenses over an undetermined period.

13. Tax benefits available (continued)

The balance of the income tax credits related to scientific research applicable against future federal income taxes amounts to \$1,957,084. The Company can take advantage of tax benefits resulting from the carrying forward of these credits until the following years:

	2001
	\$
2005	38,527
2007	217,818
2008	345,129
2009	368,893
2010	497,233
2011	489,484

The capital losses that could possibly reduce future income taxes are \$2,532,529. The Company can take advantage of these losses resulting from carrying forward over an undetermined period.

Other timing differences which can be carried forward to offset net future income for tax purposes amount to \$908,628.

No future income tax asset relating to these above items has been accounted for, except on losses of \$381,650 and \$612,245 at the federal and provincial levels, respectively.

14. Fair value of financial instruments

Given their short-term maturity, the fair value of cash, accounts receivable and accounts payable approximate the carrying value.

Temporary investments include bonds issued by governments and public companies. These bonds will mature in the following year with an average weighted yield of 5.58% (2000 – 5.56%). The market value of temporary investments held as at February 28, 2001 is \$4,843,082 (2000 – \$4,585,362).

Long-term investments include bonds issued by governments and public companies. These bonds will primarily mature over the next two years with an average weighted yield of 5.64% (2000 – 5.71%). The market value of the long-term investments held as at February 28, 2001 is \$8,110,099 (2000 – \$987,474).

The fair value of the obligations under capital leases approximates the carrying value given the short-term maturity or the interest rates.

Concentration of credit risk

The Company provides credit to its clients in the normal course of its operations. It carries out, on a continuing basis, credit evaluations of its clients. As at February 28, 2001, approximately 80% (2000 – 78%) of accounts receivable are due from two customers.

15. Discontinued operations

On January 31, 1998, the Company announced its intention to dispose of its subsidiary Analex Inc. which operated an analytical test laboratory in the pharmaceutical and food industries. On April 16, 1998, the subsidiary was disposed. A gain of \$59,375 occurred in 2000 (1999 – \$194,646, 1998 – \$(1,918,308)) due to the disposition of this subsidiary.

16. Comparative figures

Certain comparative figures have been reclassified to conform with the presentation used in the current year.

Shareholders Information

Board of Directors

Donald Buxton (1)

Chairman of the Board, Labopharm Inc.

James R. Howard-Tripp (1)

President and Chief Executive Officer, Labopharm Inc.

Normand Balthazard (1)*

President, BioCapital Inc.

Luc Cournoyer (3)

Senior Investment Advisor, Health and Biotechnology,
Fonds de Solidarité FTQ

James S. Scibetta**

Director, Shattuck Hammond Partners, N.Y.
A Division of Pricewaterhouse Coopers Securities LLC

Gordon J. Fehr (2) (3)

Corporate Director, Former Chairman and President,
Pfizer Canada Inc.

Richard J. MacKay (1) (2)

President and Chief Executive Officer, Stiefel Canada Inc.

Jim McDonald (3)

Executive Vice-President, Corporate Development,
Nexia Biotechnologies Inc.

Frédéric Porte (1)

President, Mediprass Management Inc.

Percy Skuy (2)

Corporate Director, Former President,
Johnson & Johnson Corporation Affiliate

Claude Vezeau

Vice-President, Investments, BioCapital Inc.

* Mr. Balthazard resigned in December 2000.

** Mr. Scibetta was appointed in April 2001.

1. Member of the Executive Committee
2. Member of the Human Resources Committee
3. Member of the Audit Committee

Scientific Advisory Board

Dr. Vincent Lenaerts, PhD

Chairman, Labopharm's Scientific Advisory Board,
Chief Scientific Officer,
Vice-President, Research and Development, Labopharm Inc.

Dr. Robert Gurny, PhD

Professor and Head of the Department of Biopharmaceutics and
Pharmaceutical Technology, University of Geneva, Switzerland

Dr. Jorge Heller, PhD

Executive Director, Advanced Polymer Systems Research Institute
California

Dr. Jindrich Kopecek, PhD

Professor of Bioengineering, Pharmaceuticals and Pharmaceutical
Chemistry, Adjunct Professor of Materials Science and
Engineering and Co-Director, Center for Controlled Chemical
Delivery, University of Utah

Dr. Joseph R. Robinson, PhD

Professor of Pharmacy, School of Pharmacy,
University of Wisconsin-Madison

Dr. Vladimir Torchilin, PhD

Professor and Chairman, Department of Pharmaceutical Sciences
Northeastern University, Associate Professor of Radiology,
Harvard Medical School, Boston, Massachusetts

Officers

Donald Buxton

President and Chief Executive Officer (Until July 5, 2000)

James R. Howard-Tripp

President and Chief Executive Officer (Since July 5, 2000)

Sylvie Bouchard, MD, PhD

Vice-President, Clinical Development

Vincent Lenaerts, PhD

Chief Scientific Officer, Vice-President, Research and Development

Allan Mandelzys, PhD, MBA

Vice-President, Business Development

Warren Whitehead, CMA

Interim Chief Financial Officer

Me Lisane Dostie, LLB

Director, Corporate Affairs and Secretary

General Information

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Laval, Québec H7V 3Z3
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E-mail: info@labopharm.com

Annual Meeting

July 5, 2001, 10 a.m.
Omni Hotel, Montreal

Investor Relations

James R. Howard-Tripp
President and Chief Executive Officer

Warren Whitehead, CMA
Interim Chief Financial Officer

Stock Exchange Listing

Toronto Stock Exchange
Trading Symbol: DDS

Transfer Agent

General Trust of Canada

Auditors

Arthur Andersen

Corporate Governance

Labopharm believes that sound management is important for all of its shareholders. In accordance with the requirements of the Toronto Stock Exchange, the Board of Directors adopted internal corporate governance guidelines in January 1997. These guidelines were modified in July 1997. A policy on the use of insider information was also adopted by the Board in October of the same year. The overall structure and operating methods of the Board of Directors and its committees are discussed in the management proxy circular.

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