

This woman's
life could
change. As early
as tomorrow.

Annual Report 2002



Labopharm

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Corporate Profile


Labopharm Inc. is an international pharmaceutical company specializing in the development of drugs using the Company's advanced controlled-release technology. Labopharm's core technology, Contramid®, can be applied to a wide variety of drugs in solid oral dosage form to improve their oral administration and performance. Labopharm's proprietary technology is used to develop products that are either bioequivalent to existing branded products or are new branded products that improve on existing products by providing the therapeutic benefits of controlled-release drug delivery.

Labopharm's business model differentiates it from traditional drug development companies. By reformulating existing drugs, Labopharm should experience shorter development timelines, lower development costs and faster market penetration. The Company currently has nine products in its pipeline with five being developed in-house and four in partnership with leading international pharmaceutical companies.

Labopharm is a publicly traded company whose common shares trade on the Toronto Stock Exchange (TSX) under the ticker symbol "DDS".

Important Notice

In 2002, the Company changed its financial year-end from February 28 to December 31. Consequently, all financial information presented in this Annual Report is for the ten-month period ended December 31, 2002.

A close-up photograph of a person's hand, with fingers slightly curled, hovering just above a horizontal line of six identical white, round pills. The pills are resting on a smooth, light blue surface. The background is a blurred white, suggesting a clinical or laboratory setting. The lighting is soft and even, highlighting the texture of the skin and the smooth surface of the pills.

For her, multiple
doses could soon
be a thing of the
past.

A tablet a day.
A promising
future.



Major Advances for Labopharm

Advanced Once-Daily Tramadol Program to Regulatory Filing in Europe

- Investigational New Drug (IND) application approved by U.S. FDA
- Secured marketing agreement for France with Aventis France
- Completed Phase III clinical trial in Europe
- Initiated Phase III clinical trials in U.S.
- Reported positive European Phase III trial results including achievement of primary and secondary endpoints
- Initiated Mutual Recognition Procedures (MRP) in Europe with Marketing Authorization Application (MAA) in France (subsequent to December 31, 2002)



- Initiated development of new in-house product - DDS-2003 - with a market opportunity in excess of US\$1 billion

Achieved Significant Milestones Across Pipeline

- Initiated pilot pharmacokinetic study for once-daily Allegra-D® program
- Initiated pilot pharmacokinetic study for controlled-release trimebutine maleate program
- Completed feasibility study and initiated formulation work for DDS-2001
- Initiated feasibility and formulation work for DDS-2003
- Initiated feasibility and formulation work for oxybutynin (in-house)



Established Partnership with MedPointe Inc.

- Signed Letter of Intent to execute licensing agreement to develop novel, sustained-release products



Strengthened Scientific Team

- Dr. Damon Smith appointed Vice-President, Research and Development
- Doubled size of R&D team

Expanded Existing Agreement with Axcan Pharma

- Signed Letter of Intent to execute a global licensing agreement for the development of a controlled-release version of trimebutine maleate for global commercialization

Integrated Operations at New Corporate Headquarters

- Leased facility will house corporate offices, state-of-the-art laboratories and GMP-grade pilot manufacturing plant, allowing more efficient and economical development of an expanded number of products

Expanded Product Portfolio to Nine Products

- Initiated development of first product under Letter of Intent with MedPointe Inc. – DDS-2001 – with a market opportunity in excess of US\$300 million



James R. Howard-Tripp
President and
Chief Executive Officer

“We are now taking the final steps toward commercializing our first product.”

Executing the Strategy Two years ago, we outlined a five-year strategy focused on realizing value in our robust product pipeline and building Labopharm into a fully integrated, international specialty pharmaceutical company. 2002 was a year of tremendous success on all fronts as we moved our key products closer to global commercialization and continued to develop our people, infrastructure, and pipeline. Core to our business model is the ability to develop products quickly and cost-effectively. Over the last three years, we rapidly moved our lead in-house product, once-daily tramadol, from initial research through to regulatory filing, a significant accomplishment by any standard. With additional product registration filings possible in 2003, we now stand on the verge of realizing the value in our Contramid® drug delivery technology and the pipeline we have built around it.

First Products Nearing Commercialization In 2002, we achieved several critical milestones toward the commercialization of our first product, once-daily tramadol. We secured our first marketing partner, Aventis France, and completed the clinical portion of our European Phase III trial. Subsequent to year-end Labopharm announced the positive results of the trial.

The European Phase III clinical trial, designed to compare the safety and efficacy of our once-daily tramadol with the extended release, twice-daily version currently marketed in Europe, showed four things very clearly. Our once-daily formulation of tramadol:

- Showed a statistically and clinically significant reduction in pain;
- Delivered a superior adverse events profile compared to that of the extended release, twice-daily formulation;
- Provided sustained pain relief for a full 24-hour period, matching the twice-daily formulation; and,
- Afforded two-thirds of patients effective pain relief with a dose of only 200 mg or less.

The positive nature of these results offered the most significant validation yet of our proprietary Contramid® technology.

Subsequent to year-end, we initiated the Mutual Recognition Procedure (MRP) process in Europe for once-daily tramadol with the submission of a Marketing Authorization Application (MAA) in France. Under the MRP process, approval in France (the Reference Member State) will facilitate rapid approval across the European Union (EU).

In addition to the agreement already concluded with Aventis France, Europe’s largest tramadol marketer, we are actively engaged in discussions with potential marketing partners for other jurisdictions in Europe, the United States, and globally. Leveraging marketing approval in France, expected before the end of 2003, we will use that country as a Reference Member State to facilitate rapid acceptance of once-daily tramadol across the European Union in 2004.

Following our strategy for global market commercialization, subsequent to year-end we initiated pivotal Phase III trials for once-daily tramadol in the United States. With the clinical portion of the trials on track and scheduled for completion in 2003, and using the data from the European and other trials, we expect to file a New Drug Application (NDA) with the U.S. Food and Drug Administration (FDA) by the end of the year. Tramadol has experienced rapid growth in recent years and generated worldwide sales of approximately US\$1.3 billion in 2002. Labopharm expects to capitalize on this strong growth with its first commercial sales.

In 2003, our top priorities are the approval of once-daily tramadol for sale in Europe and the submission of an NDA in the United States. In preparation for commercialization in both regions, we will focus on ensuring that each individual component required for the market launch is firmly in place, from strong marketing partners to manufacturing and supply of commercial product.

Labopharm is also rapidly advancing additional products with near-term commercialization potential and this year could see us make additional regulatory filings for Allegra-D® and oxybutynin. Our goal is to continue to move products rapidly through our pipeline, concentrating on delivering drugs with strong revenue generating potential.

Moving Toward Full Integration Within our strategic plan we outlined four pillars that would support our evolution into a fully integrated, international specialty pharmaceutical company: expanding our product pipeline, investing in human capital and building infrastructure, broadening our technology base and capitalizing on acquisition opportunities. Together these four pillars form the foundation on which we wish to construct a strong and diverse company over the long term. This year, we made great progress.

With our lead products advancing toward commercialization, moving ever-greater numbers of drugs with reformulation potential into our pipeline is critical to driving and sustaining growth. In 2002, we added two new products to our pipeline, for a total now of nine high-potential, in-house and partnered products. DDS-2003, currently in the feasibility phase, is being developed internally and represents a global market opportunity in excess of US\$1 billion. We also signed a Letter of Intent with New Jersey-based MedPointe Inc. covering the joint development of novel sustained-release products. The first product to emerge from this collaboration, DDS-2001, currently in the formulation stage, represents a US\$300 million market opportunity.

Supporting the long-term drive to full integration, Labopharm broke ground on its new headquarters designed to integrate scientific, pilot manufacturing and administrative functions under one roof. The move to the new leased facility will streamline operations, while the recent doubling of our laboratory staff will facilitate rapid development across our ever-expanding pipeline.

While our focus has shifted toward adding skills and building rapidly toward commercialization, technology remains central to our long-term growth strategy. The Contramid® oral technology underpins Labopharm's first products. However, the Company is expanding its technology base to include implantable, controlled-release forms using Contramid® as well as micelle-based delivery systems. The development of these three complementary platforms should allow Labopharm to offer a broad range of drug delivery solutions to the problem of optimal drug delivery in the pharmaceutical industry.

The fourth pillar of our foundation, executing our acquisition strategy, will play an important role in our future growth as we build on the successes of 2002. Looking ahead, our business model remains focused on building both critical mass and the scale of our operations so that we are well positioned to rapidly commercialize our products. Supplementing organic growth and collaboration with leading pharmaceutical companies, we would expect to acquire new and complementary products, infrastructure, skills and technologies. Acquiring select pieces will allow us to progress swiftly toward becoming a fully integrated, international specialty pharmaceutical company offering a broad range of products and solutions.

In closing, I would like to recognize and thank our employees and the Board of Directors for their dedication and hard work. It is their efforts that have permitted us to progress so far this year. I would also like to thank our shareholders for their continuing confidence and support. 2003 promises to be a busy and exciting year for Labopharm as we strive to meet and surpass important value-driving milestones. I look forward to keeping you updated on our progress.

(signed)

James R. Howard-Tripp
President and Chief Executive Officer
March 19, 2003

“Labopharm is well positioned to generate significant revenue and enhance shareholder value as our lead products receive regulatory approval and are commercialized.”



Warren Whitehead
Chief Financial Officer

Dr. Sylvie Bouchard
Vice-President,
Clinical Development



“Labopharm’s ability to move products rapidly through the clinic to commercialization is key to maximizing the value in our pipeline.”

“Our evolving partnering focus reflects the need to conclude broader relationships that increase Labopharm’s participation at each stage along the product development path, which ultimately translates into greater returns for the Company and its shareholders.”



Dr. Allan Mandelzys
Vice-President,
Business Development

Dr. Damon Smith
Vice-President,
Research and Development



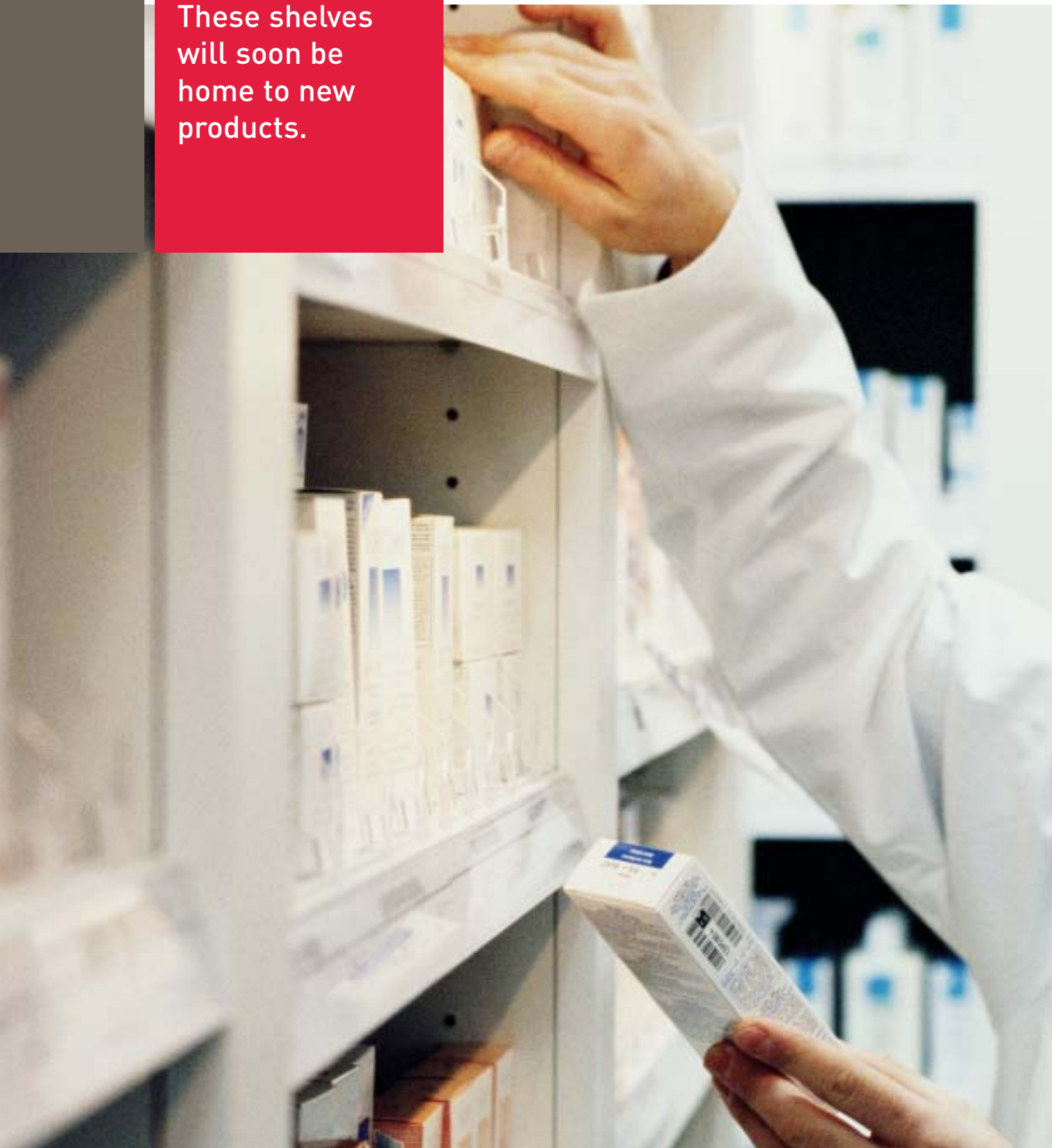
“Building for the future, Labopharm has made significant investments in highly skilled people and improved infrastructure to facilitate the efficient development of products and sustain long-term growth.”

“We believe that sound corporate governance is essential to building and maintaining shareholder value. In 2002, we undertook a complete review of our corporate governance guidelines and practices to ensure that they meet with elevated market and investor expectations.”



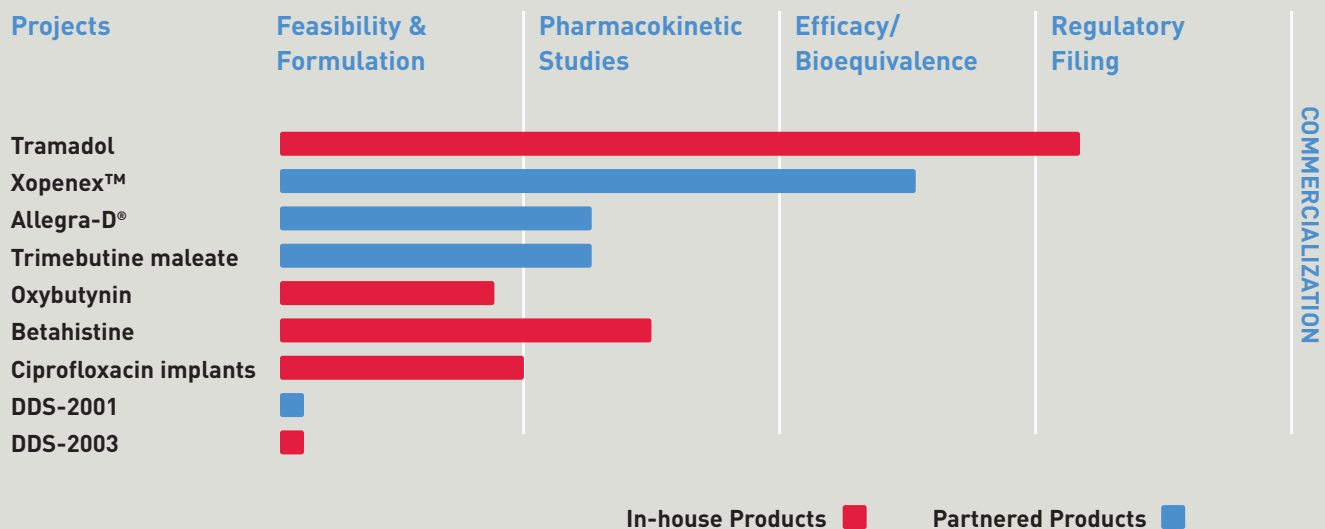
Me Lisane Dostie
General Counsel and
Corporate Secretary

These shelves
will soon be
home to new
products.



Labopharm is building a robust and diverse pipeline that capitalizes on the versatility of the Contramid® platform technology.

Labopharm’s Growing Pipeline



Labopharm’s Expanding Pipeline Will Fuel Growth With the Company’s focus on rapid product commercialization, full integration, and sustained long-term growth, it is critical that Labopharm continue to add promising new products into its pipeline. Labopharm currently has nine pipeline products, with five being developed in-house and four in partnership with other international pharmaceutical companies.

In-house Products Labopharm will expand its portfolio of in-house products by developing improved formulations of off-patent drugs and by acquiring the rights to reformulate late-stage clinical or currently marketed brands from other pharmaceutical companies. Developing products internally provides Labopharm with greater control over the pace of development and maximizes economic benefit upon product commercialization. In-house development also expands the Company’s skills and knowledge and strengthens its clinical development and regulatory capabilities as it drives toward becoming a fully integrated specialty pharmaceutical company.

Partnered Products As a complement to its internally developed product portfolio, Labopharm partners with other pharmaceutical companies to develop novel formulations of currently marketed brands – for example, Aventis’ Allegra-D® and Axcan Pharma’s MODULON®. Partnering permits low-cost expansion of the Company’s product pipeline and reduces development expense and risk, while allowing the Company to access and leverage the additional expertise specific to large, international pharmaceutical companies. Such intellectual collaboration is highly beneficial to Labopharm’s continued growth and evolution. The Company continues to identify additional opportunities to develop strategic partnerships for new formulations of well-known, market-leading brands.

In-house Products

Once-Daily Tramadol

Indication:	Moderate to moderately severe pain
Potential Market Opportunity:	More than US\$1 billion
Current Dosing:	Twice-daily (Europe) or four to six times daily (U.S.)
Recent Milestones:	<p>Initiated Phase III clinical trials in U.S.</p> <p>Announced positive European Phase III data</p> <p>Marketing Authorization Application in France</p> <p>Signed marketing agreement with Aventis France</p>
Next Steps:	<p>First market approval in Europe</p> <p>File NDA with the U.S. FDA</p> <p>Launch in Europe</p>

Tramadol is a centrally-acting analgesic indicated for moderate to moderately severe pain associated with a broad range of conditions such as osteoarthritis, lower back spasm, cancer, and other acute and chronic conditions, including those normally connected with aging. Chronic pain involves multiple biochemical pathway, and tramadol provides novel analgesia by binding to μ -opioid receptors and by inhibiting the re-uptake of the neurotransmitters norepinephrine and serotonin. Tramadol is well tolerated compared to anti-inflammatory drugs and can be used by patients who are at risk of developing gastrointestinal bleeding and those with kidney problems. Tramadol is currently available in a four to six times daily immediate release formulation in the U.S. and predominantly as a twice-daily extended release version in Europe. Global sales of tramadol have grown 34 % since 2000 with worldwide sales topping US\$1.3 billion in 2002.

European Phase III Results In late 2002, Labopharm completed pivotal European Phase III clinical trial for a once-daily formulation of tramadol. The results of the

trial were highly positive, and Labopharm's once-daily tramadol achieved the primary endpoint of the study, providing statistically and clinically significant reduction in pain associated with osteoarthritis. The study also clearly showed that Labopharm's once-daily tramadol:

- Demonstrated a superior adverse events profile compared with that of the comparator, a twice-daily formulation of tramadol currently marketed in Europe;
- Provided sustained pain relief for a full 24-hour period, matching the twice-daily formulation; and
- Required a dose of 200 mg or less per day to provide effective pain relief in two-thirds of the patients.

Subsequent to year-end, **Labopharm** submitted a Marketing Authorization Application (MAA) to regulatory authorities in France. The filing initiated the Mutual Recognition Procedure (MRP), under which approval in France will facilitate approval in the other member countries of the European Union.

Subsequent to December 31, 2002 Labopharm initiated two U.S. Phase III clinical trials for the product. Upon their completion, data from these U.S. trials will be combined with that of the European and other trials for a New Drug Application (NDA) filing at the FDA within the next 12 months. In the interim, Labopharm is preparing for commercial sales in Europe, having concluded a marketing agreement with Aventis France for France. To effect global commercialization and capitalize on mutual recognition laws in the European Union, subsequent to French approval, Labopharm is actively engaged in partnership discussions with additional European partners as well as with other groups in the U.S. and worldwide. The Company expects to sell once-daily tramadol in both Europe and the U.S. in 2004.

Once-Daily Betahistine

Indication:	Ménière's disease (vertigo)
Potential Market Opportunity:	~ US\$100 million
Current Dosing:	Three times daily
Next Step:	Complete clinical development

Labopharm is currently developing once-daily formulations of betahistine in-house. Betahistine resembles naturally occurring histamines.

It is indicated for the treatment of Ménière's disease, a disorder characterized by recurrent dizziness, tinnitus, and hearing loss caused by the pressure of excess fluid in the inner ear. Labopharm has completed pilot PK studies and is re-evaluating the market potential of the product, which was estimated to be valued at more than US\$100 million. Pending a positive outcome of the review, Labopharm anticipates completing the clinical development of betahistine in 2003.

Ciprofloxacin Implants

Indication:	Osteomyelitis (bone infection)
Potential Market Opportunity:	US\$100 - 200 million
Current Dosing:	Systemic oral
Recent Milestones:	Completed animal studies
Next Steps:	Initiate human development plan Partner for veterinary applications

Labopharm has applied its Contramid® Implant technology to a product containing the antibiotic ciprofloxacin. This alternative formulation can potentially be used to treat or prevent bone infection (osteomyelitis) resulting from open fractures and surgery. Using the Company's formulation, the antibiotic is delivered directly to the site of action, resulting in high local concentrations of the active ingredient in the bone and surrounding tissues, but requiring less than one-twentieth of the dose needed in oral delivery. After delivery is

complete, the Contramid® Implants biodegrade safely, avoiding the need for surgical removal and the associated risk of infection. Such targeted delivery minimizes systemic exposure and the potential for adverse events, significantly reduces dosing requirements, and drastically reduces the amount of drug needed for effective therapy. In animal studies, ciprofloxacin implants were shown to be effective and well tolerated. The implants provided controlled release of the antibiotic for more than 28 days at levels well above the minimum inhibitory concentration of the drug before dissolving and being eliminated from the body.

Labopharm's ciprofloxacin implants show great promise. In 2003, Labopharm will complete the development plan for human applications. The Company will seek registration for both veterinary and human applications and is looking to secure partnerships to commercialize the product in both areas.

Once-Daily Oxybutynin

Indication:	Urinary Incontinence
Potential Market Opportunity:	~ US\$400 million
Current Dosing:	Once-daily oral, transdermal patch
Recent Milestones:	Completed pilot pharmacokinetic (PK) studies Moved product development in-house
Next Steps:	Conduct pivotal PK studies File NDA in the U.S. with the FDA

In January 2000, **Labopharm** signed an agreement with an international pharmaceutical company to develop a bioequivalent, controlled-release formulation of Ditropan® XL (oxybutynin), a leading drug for the control of urinary incontinence, frequent urination, and muscle spasm in the bladder. In 2002, subsequent to the acquisition of its partner by a third party, Labopharm moved to dissolve the partnership and re-initiated the development of this product in-house. Labopharm is exploring several approaches to the development of oxybutynin. Oxybutynin represents a US\$400 million market opportunity.

DDS-2003

Indication:	Undisclosed
Potential Market Opportunity:	More than US\$1 billion
Next Step:	Complete feasibility and formulation studies

In 2002, **Labopharm** identified a new product for in-house development referred to as DDS-2003. The product is an existing drug and represents a market opportunity in excess of US\$1 billion.

Partnered Products

Once-Daily Allegra-D®

Partner:	Aventis
Indication:	Allergic rhinitis (seasonal allergies)
Potential Market Opportunity:	US\$300-500 million
Current Dosing:	Twice-daily
Recent Milestones:	Completed feasibility and formulation studies
Next Steps:	Complete pilot PK studies Initiate pivotal clinical trials

In 2002, **Labopharm** signed a definitive worldwide licensing agreement with Aventis to develop two new formulations of Aventis' flagship allergy medication, Allegra-D®. Allegra-D® combines medication for the treatment of seasonal allergies with a nasal decongestant. The oral antihistamine market is experiencing strong growth, and Allegra® had U.S. sales of more than US\$2 billion in 2002.

Labopharm is working toward commencing Phase III clinical trials, and Aventis may file an NDA with the FDA during the next 12 months.

Solid Oral Dosage Xopenex™

Partner:	Sepracor
Indication:	Asthma
Potential Market Opportunity:	~US\$300 million
Current Dosing:	Nebulizer (inhaler), as required
Recent Milestones:	Completed efficacy studies vs. marketed comparator
Next Steps:	Revise partnership agreement with Sepracor File NDA in the U.S. with the FDA

Labopharm has entered into a licensing and co-development agreement with Sepracor for the development of solid oral dosage forms of Xopenex™ (levalbuterol HCl). The drug is currently

dosed orally using a nebulizer that converts the medication into a fine mist for inhalation. A Phase II clinical trial on solid oral dosage (tablet) forms of Xopenex™, completed in 2001, established the drug's efficacy in the treatment of bronchospasm due to asthma in patients with moderate to moderately severe asthma. This drug shows interesting potential for patients who have difficulty using inhalers, such as the young and the elderly, and for those with severe asthma or chronic obstructive pulmonary disease (COPD) requiring frequent use of inhalers. Labopharm and Sepracor are currently revising the agreement on Xopenex™, building toward the initiation of Phase III clinical trials, and continue to target 2004 for an NDA filing with the FDA.

Controlled-Release Trimebutine maleate (MODULON®)

Partner:	Axcan Pharma
Indication:	Irritable Bowel Syndrome (spastic colon)
Potential Market Opportunity:	~US\$300 million
Current Dosing:	Three times daily
Recent Milestones:	Formalized new agreement with expanded scope
Next Steps:	Complete pilot PK study Initiate pivotal studies

In 1999, Labopharm signed an agreement with Axcan Pharma to develop a controlled-release formulation of MODULON® (trimebutine maleate),

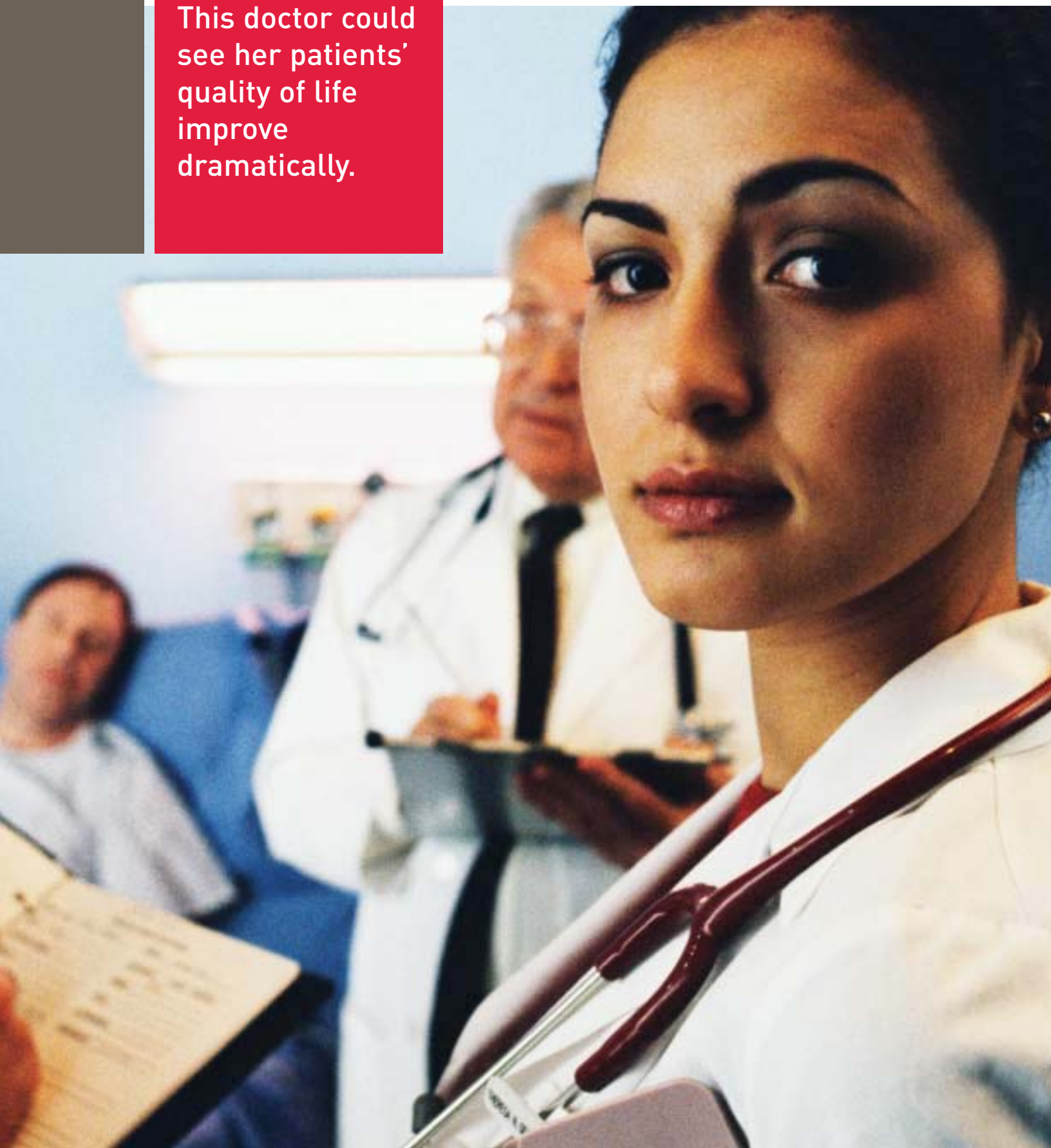
marketed for the treatment of irritable bowel syndrome, a disease present in 15% of the population. Trimebutine maleate is an anti-spasmodic agent that does not alter normal motility, but regulates abnormal intestinal activity. Labopharm's formulation will permit controlled-release delivery throughout the gastro-intestinal tract. Labopharm's product will reduce the daily dosing requirement, improve patient compliance and may provide for better efficacy and a superior adverse events profile. Labopharm and Axcan recently broadened their commercialization plans to include global markets. Worldwide demand for once-daily trimebutine maleate is estimated to be worth US\$300 million.

DDS-2001

Partner:	MedPointe Inc.
Indication:	Undisclosed
Potential Market Opportunity:	More than US\$300 million
Next Steps:	Complete feasibility and formulation studies Initiate pilot PK studies

Labopharm and MedPointe have identified the first product for joint development under the companies' formulation and licensing agreement. DDS-2001 represents a market opportunity in excess of US\$300 million.

This doctor could see her patients' quality of life improve dramatically.



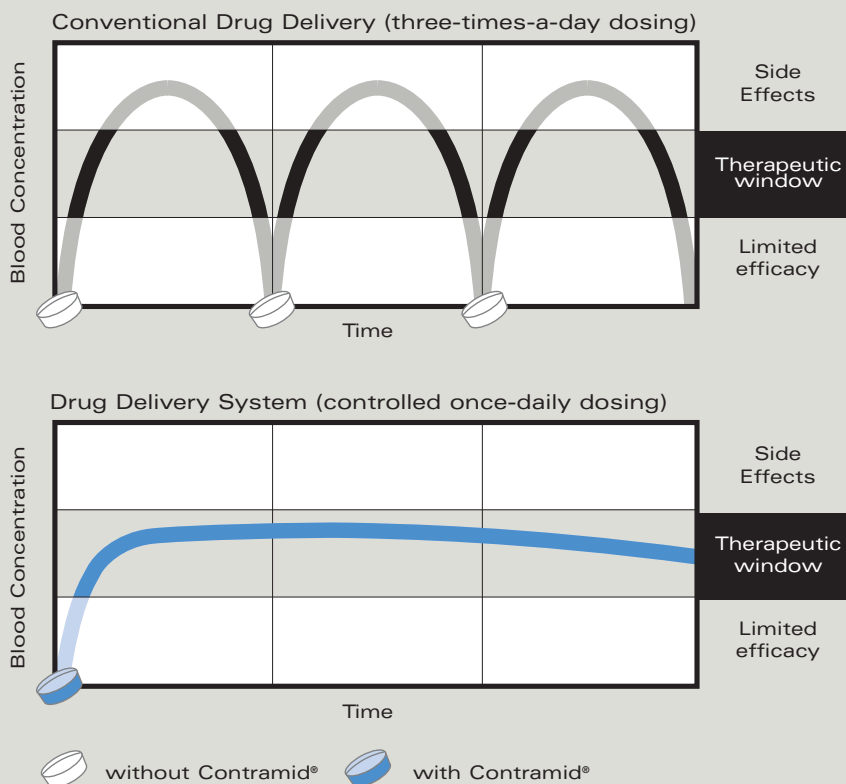
Labopharm's proprietary Contramid® technology was developed to improve the performance of orally administered drugs at a fraction of the cost of other delivery systems.

New Solutions in Drug Delivery

Contramid® is a versatile platform that allows controlled release of a wide variety of drugs with differing physico-chemical properties, including multi-actives. The technology recently received its most significant validation to date with Labopharm's announcement in January 2003 of positive results from pivotal European Phase III trial with its once-daily formulation of tramadol, a leading opioid analgesic.

Although developed initially for oral dosing, the Company has since expanded its Contramid® technology platform to include implantable formulations for the long-term administration of drugs, both locally and systemically. Labopharm is also developing novel polymeric, micelle nano-carriers for oral and systemic targeted delivery of insoluble drugs. With these complementary platforms, Labopharm offers a broad range of drug delivery solutions to the pharmaceutical industry.

Clinical Advantages of Contramid®



Three Delivery Platforms

Contramid® Oral – Our Validated Lead Technology Platform Contramid® Oral is a patented controlled-release drug delivery technology utilizing a novel cross-linked, high amylose starch for oral administration of solid dosage medications.

Contramid® is a highly compressible excipient with excellent flow and binding characteristics, ideal for efficient tablet and capsule manufacture. Once in contact with body fluids, Contramid® self-associates to form a semi-permeable, three-dimensional matrix that allows the controlled release of drugs at a constant rate. This ability is critical, since a drug's effect varies according to its concentration in the body. Too low a concentration means reduced efficacy, too high and side effects are seen.

For all drugs, however, there is a concentration range in the body in which the desirable effects are optimized – the “therapeutic window”. By controlling the rate of release of the active ingredients with Contramid®, Labopharm can maintain a drug's concentration within this window and safely extend its therapeutic effect over 12 or even 24 hours.

Contramid® overcomes the drawbacks of uncontrolled oral formulations in which drug levels in the body rise and fall rapidly, necessitating frequent dosing over the course of a day to maintain a therapeutic effect (e.g., dosing three or more times daily). Sustained release, by always keeping drug levels within the therapeutic window, also minimizes the possibility of adverse effects, since clinical efficacy can be achieved with a lower overall dose. The added convenience of once-daily oral dosing significantly increases patient convenience and compliance, and single dosing also helps manage manufacturing costs.

An Attractive Drug Delivery Method In addition to its controlled-release properties, Labopharm believes that Contramid® possesses other unique advantages:

- **High Drug Loading Capability:** The self-limiting, three-dimensional lattice that forms when Contramid® is exposed to fluids is foam-like and highly porous. These characteristics, along with the intimate and extensive interactions that occur between the lattice and the drug permit loading of up to 70%, without compromising the controlled-release characteristics. Dosage strengths of 700 mg and above should therefore be achieved within the constraints of an acceptable and marketable tablet size;
- **High Performance:** Classified as an excipient, Contramid® is highly compressible and possesses the efficient flow characteristics required for cost-effective tablet and capsule production. The low cost of Contramid® and its compatibility with standard manufacturing equipment combine to minimize the costs of production;
- **Broad Applications:** The versatility of the Contramid® platform, coupled with the in-house expertise of Labopharm's formulation scientists, enables the delivery of a wide variety of pharmaceutical actives (e.g. varying solubility) with difficult to produce pharmacokinetic profiles (e.g. delayed onset, release of dual actives);
- **Safety Profile:** While novel, Contramid® is starch-based and completely biodegradable. It is an extremely safe technology complying with both EU and North American regulatory requirements;

- **Patent Protection:** A strong portfolio of international use and process patents, including a product-by-process application, ensures patent protection of Contramid® technology through 2020. Labopharm maintains an active IP protection strategy; and,
- **Regulatory Status:** Contramid® is manufactured under cGMP's by Cerestar, a division of Cargill International. Labopharm's exclusive arrangement with Cerestar has yielded a proprietary manufacturing process that is reliable, reproducible and economical. Contramid® is currently manufactured on a metric ton scale and more than 150 tons have been produced to date.

Contramid® Implants – Extending the Platform Technology A novel application for Labopharm's Contramid® technology is biocompatible, sterile mini-tablets that can be implanted in the body to deliver safe, effective doses of poorly soluble, toxic, or rapidly metabolized drugs directly to their site of action over extended periods. This targeted form of delivery makes it possible to achieve therapeutic levels of active ingredients only where they are needed, permitting lower dosing and minimizing systemic exposure to the medication.

Labopharm's Contramid® implant technology program uses Contramid® mini-tablets to deliver the antibiotic ciprofloxacin. This new formulation is being developed as a prophylactic and curative treatment to prevent bone infection (osteomyelitis) resulting from open fractures and surgery. With Contramid® implants, the antibiotic is delivered directly to the site of action resulting in high local concentrations of drug in the bone and surrounding tissues. The approach uses less than one-twentieth of the dose required by oral delivery and, by minimizing systemic exposure, may drastically reduce side effects and the potential for bacterial resistance. Manufacturing costs are, of course, similarly reduced. After delivery is complete, the implants biodegrade safely and are eliminated from the body, avoiding the need for surgical removal and the associated potential for re-infection.

In animal studies conducted by Labopharm, the ciprofloxacin implants were shown to be effective and well tolerated providing controlled release of the antibiotic for more than 28 days at levels well above the minimum inhibitory concentration of the drug.

Further Development Implant technology may also be extended to systemic delivery of highly active compounds. In this context, depot formulations of Contramid® microparticles are under development for applications including both small and macromolecules.

Micelles – Delivery System for Biologics Labopharm is developing an exciting and novel polymeric micelle delivery technology for insoluble, poorly bio-available or highly toxic drugs. These dynamic nano-carriers can be used for both oral and parenteral (injected or topical) applications and have the potential to reduce toxic side effects and associated treatment costs significantly. The ability of polymeric micelles to deliver active ingredients directly to solid tumours suggests real promise in oncology applications.

In order to capitalize on this opportunity, Labopharm is developing several types of micelles along with proprietary and efficient drug loading processes that are scalable and suitable for commercial production. The Company is expanding its micelles research efforts and expects to begin development of its first micelle-based products in 2003.

Labopharm is
creating value
for all
stakeholders.

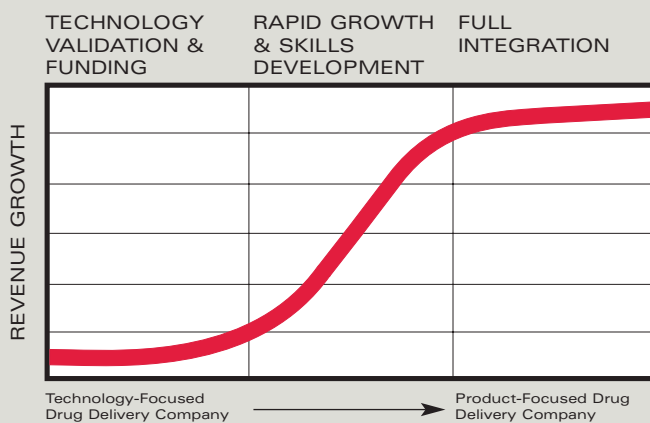


Labopharm’s business model is based on the ability to commercialize new formulations of existing drugs rapidly, at a fraction of the cost of new drug development, and with correspondingly reduced risk.

A Model for Success – Building Toward Full Integration

To maximize value at every stage from development to commercialization, Labopharm has articulated a growth strategy that emphasizes building critical mass and attaining full integration as a specialty pharmaceutical company. In the future, Labopharm will be able to develop fully its own products, from initial formulation through clinical development and regulatory approval to commercial-scale manufacturing, sales, and marketing. Accordingly, the Company should be able to bring its products to market more rapidly than traditional innovator companies, maximizing returns on commercial sales.

Corporate Lifecycle to Full Integration The industry recognizes three distinct stages in the growth of a specialty pharmaceutical company:



To date, Labopharm has already advanced into the intermediate stage on the road to full integration. In 2000 and 2001, the Company progressed through the *Technology Validation and Funding* stage, strengthening its patent position and core technology,

securing financing, concluding worldwide licensing agreements, and adding late-stage products to the pipeline. In 2002, Labopharm entered the *Rapid Growth and Skills Development* phase, investing in human capital and infrastructure, adding more new products to the pipeline, completing successful pivotal clinical trials, and concluding relationships to support commercialization.

Four Pillars Looking ahead, four pillars will form the foundation for Labopharm’s progression into a fully integrated, international specialty pharmaceutical company:

- **Broadening the product portfolio** through internally developed products, acquisitions, and licensing agreements to develop new formulations of existing products owned by partners;
- **Investing in human capital and building infrastructure**, adding expertise in R&D and clinical development, further expanding manufacturing capacity, and integrating research and administrative functions into a single facility;
- **Expanding the technology base** by further developing existing technologies and acquiring new ones; and,
- **Executing an acquisition strategy**, which will play an increasingly significant role in the years ahead as the Company adds new products, capabilities, and technologies.

In the year ahead, Labopharm is now well positioned to launch its first products and begin generating product-based revenues.

Corporate Governance

Labopharm believes that sound corporate governance is essential to the creation and maintenance of lasting shareholder value and the Company follows best practices in this regard. In accordance with the requirements of the Toronto Stock Exchange corporate governance guidelines (the "TSX Guidelines"), the Board of Directors initially adopted internal corporate governance guidelines in January 1997, which were subsequently modified in July 1997.

In 2002, following a series of recommended changes to the TSX Guidelines, the Company undertook a complete evaluation and overhaul of its corporate governance guidelines and practices to ensure that they met with evolving market and investor expectations. On February 26, 2003, the Board of Directors approved, on the recommendations of the Human Resources and Corporate Governance Committees:

- an updated formal mandate for the Board of Directors;
- a revised formal charter for the Audit Committee;
- a revised formal charter for the Human Resources and Corporate Governance Committee;
- a Disclosure and Confidentiality Policy; and,
- a new Trading Policy.

Where possible, Labopharm has implemented these changes in strict accordance with the revised TSX Guidelines, deviating only in areas where it was impractical to adopt them fully given the Company's current stage of development. The Company intends to regularly review and amend its practices to ensure they remain consistent with the TSX Guidelines and corporate governance best practices. The overall structure and operating methods of the Board of Directors and its committees are discussed in detail in the Management Proxy Circular.

Financial Report

Forward-Looking Statement

Except for historical information contained herein, the statements in this document are forward-looking. Forward-looking statements involve known and unknown risks and uncertainties, which may cause our actual results in future periods to differ materially from forecasted results. Those risks include, among others, business conditions in the pharmaceutical and related industries, as well as the general economy, changes in governmental regulation, changes in the healthcare industry, competitive factors such as those influencing expenditures for research and development, or the availability of markets for the Company's products. The Company disclaims any intention, and assumes no obligation, to update these forward-looking statements.

Management's Discussion & Analysis

The following information should be read in conjunction with Labopharm Inc.'s audited consolidated statements for the ten-month period ended December 31, 2002 and related notes, which are prepared in accordance with Canadian generally accepted accounting principles. The Management's Discussion and Analysis provides a review of the performance of the Company for the ten-month period ended December 31, 2002, and compares it with the year ended February 28, 2002, and discusses issues and risks that may impact future operations.

Overview

Labopharm specializes in the development of pharmaceutical products incorporating its proprietary controlled-release technologies. As a specialty pharmaceutical company focused on drug delivery, the Company's business model differs from conventional drug development business models. Many of Labopharm's potential products are drugs that are already on the market, to which the Company applies its technologies to form new products with improved release profiles and performance. As a result, Labopharm's products are expected to have shorter development timelines, lower development costs and achieve faster market penetration than products developed by conventional drug development companies.

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

The industry recognizes three distinct stages in the evolutionary path of specialty pharmaceutical companies:

- Technology Validation and Funding;
- Rapid Growth and Skills Development; and,
- Full Integration.

Labopharm's goal is to become a fully integrated, international specialty pharmaceutical company with the necessary skill sets to develop its own products from formulation, through clinical development, product registration, manufacturing, sales and marketing. Full integration should maximize the value of the Company by giving it greater control over the entire product development process, from feasibility through to sales and marketing, thereby reducing risk and time to market, and providing higher commercial returns. Furthermore, developing the Company's capabilities will make it a more attractive partner to other companies seeking alliances.

Labopharm has evolved from a technology-focused drug delivery company to a product-focused specialty pharmaceutical company that has entered the rapid growth and skills development phase of its evolution. This was achieved by building a portfolio of nine products that are

currently being developed and by adding to the Company's clinical development and manufacturing capabilities. The creation of a wholly owned European subsidiary, Labopharm Europe Limited, strengthened the Company's ability to register and market its products in Europe. It is expected that Labopharm Europe Limited will initially support the registration of tramadol in the European market, an important step in the Company's progress toward commercializing its first product.

Labopharm will focus on four areas that are critical in achieving its goal of becoming a fully integrated specialty pharmaceutical company:

- Broadening its product portfolio – by acquiring or organically developing in-house products and by signing new licensing agreements to develop products for partners;
- Strengthening its infrastructure – by adding expertise in R&D and clinical development, by further expanding pilot scale manufacturing capability and integrating the Company's research and administrative functions into one facility;
- Expanding its technology base – by further developing existing technologies and by seeking to acquire new technologies; and,
- Executing its acquisition strategy – in order to add new products, capabilities and technologies to the Company.

Labopharm is based in Laval, Quebec and has subsidiaries in Ireland (Labopharm Europe Limited) and Barbados (Labopharm (Barbados) Limited).

Technology and Intellectual Property

The Company's core technology, Contramid[®], is based on cross-linked, high amylose starch and is used to develop formulations with novel release profiles for new and existing pharmaceutical products. While Contramid[®] oral technology underpins Labopharm's first products, the Company is expanding its technology base to include new platforms such as Contramid[®] implants and nano-delivery systems (micelles). Contramid[®] implants are a biocompatible, biodegradable, mini-tablet system permitting sustained, local delivery of a drug using lower doses than conventional oral therapy, which minimizes systemic exposure. Micelle technology is being developed to deliver water-insoluble drugs, such as some existing anti-cancer agents, to improve their bioavailability, efficacy and safety profile. The development of three complementary platforms should enable Labopharm to offer a broad range of drug delivery solutions to the problem of optimal drug delivery in the pharmaceutical industry.

Labopharm protects its technologies and products through patent and trade secret laws, as well as through careful guarding of its confidential information. The Company has an aggressive intellectual property strategy under which it files patent applications in all major pharmaceutical markets to maximize patent protection and exclude others from utilizing its technology and expertise. Labopharm's patents, together with Contramid[®]'s ability to generate products with difficult to copy pharmacokinetic profiles, provides a significant barrier to entry for other pharmaceutical development companies. Labopharm typically files for patent protection first in the United States, followed by international applications approximately one year later under the Patent Cooperation Treaty (PCT). Additionally, the Company endeavours to continually strengthen its intellectual property through its ongoing leading-edge research and development program.

Labopharm holds U.S. and international patents and has many more U.S. and international patent applications on file for its core technology, Contramid[®]. The patents and patent applications cover Contramid[®]'s use in drug delivery, the process for its manufacture, and novel uses based on ongoing research efforts. The Company also holds patents and has patents pending for its micelles nano-delivery system, implants and other technologies.

Product Development

Labopharm ended the fiscal period with a pipeline of nine projects, five of which were being developed internally and four of which were being developed in partnership with international pharmaceutical companies. During the period, the Company added two products to its portfolio, DDS-2001 and DDS-2003. The Aventis #2 product was removed from the pipeline following Aventis and its unnamed partner's decision

to terminate the licensing agreement for the drug. The decision to terminate the licensing agreement was based on the results of the initial pharmacokinetic study not supporting the Aventis research hypothesis and was not related to the performance of Labopharm's technology.

In-house Projects

In the fiscal period ended December 31, 2002, Labopharm made significant progress in the development and commercialization of its most advanced and highest priority project, a once-daily formulation of the analgesic tramadol. Tramadol is indicated for the treatment of moderate to moderately severe pain and is currently available in immediate release (therapy requiring four to six doses per day) forms in the United States and predominantly as extended release, twice-daily forms in Europe. Currently marketed versions of tramadol have worldwide sales in excess of US\$1.3 billion, with approximately US\$750 million of the total coming from the United States.

During the fiscal period, Labopharm completed the treatment phase of the European Phase III clinical trial to assess the efficacy and safety of its once-daily formulation of tramadol.

Also during the fiscal period, Labopharm secured a marketing agreement for France with Aventis France for its once-daily version of tramadol. Under the terms of the revenue sharing agreement, Labopharm will grant Aventis France the exclusive right to market and sell once-daily tramadol in France and related French dependencies. Labopharm will supply Aventis France with finished, packaged product through its European subsidiary, Labopharm Europe Limited, and will be responsible for obtaining regulatory approval. Labopharm is actively engaged in discussion with potential marketing partners for other jurisdictions in Europe, the United States and globally.

Subsequent to fiscal period-end, Labopharm reported the positive results of the European Phase III clinical trial in which once-daily tramadol achieved the primary end point of the study, providing a statistically and clinically significant reduction in pain associated with osteoarthritis. Labopharm's once-daily tramadol also demonstrated a superior adverse events profile compared with that of the comparator, a twice-daily formulation of tramadol currently marketed in Europe. Importantly, Labopharm's once-daily tramadol provided sustained pain relief for a full 24-hour period, matching the twice-daily formulation. Two-thirds of the patients receiving Labopharm's once-daily tramadol required a dose of 200mg or less per day to achieve effective pain relief.

Based on the results of this and other studies, in March 2003 Labopharm initiated the European regulatory approval process with the submission of a Marketing Authorization Application (MAA) to regulatory authorities in France. Marketing approval in France will permit Labopharm to sell its once-daily formulation of tramadol in that country and to initiate the Mutual Recognition Procedure (MRP), which will allow for rapid marketing approval across the European Union (EU).

To comply with U.S. regulations, in the U.S., Labopharm initiated two double blind, multi-centre, randomized Phase III studies to evaluate the safety and efficacy of once-daily tramadol. The results of the studies will be supplemented by data from the European program, in addition to other studies, to form the U.S. New Drug Application (NDA) filing.

During the fiscal period, Labopharm initiated a new in-house program to develop once-daily formulations of Oxybutynin, a product for the treatment of overactive bladder, with a potential market opportunity of more than US\$400 million. Previously, in January 2000, Labopharm had signed an agreement with an international pharmaceutical company to develop a controlled-release version of Oxybutynin that is bioequivalent to Ditropan® XL. Labopharm's partner, however, was acquired by another company, resulting in uncertainty with respect to the partner's future commitment to the program. Labopharm is, therefore, in the process of dissolving the agreement. The Company expects to complete clinical development in 2003.

During the fiscal period, Labopharm completed several pre-clinical animal studies to assess the efficacy of Ciprofloxacin-loaded Implants for both the treatment and prevention of osteomyelitis infections in the bone. Results demonstrate the benefits of this technology in both the prevention and treatment of infection by increasing efficacy while reducing side effects. The Company's Ciprofloxacin Implants program is based on mini-tablets of Contramid® that can be implanted during surgery to deliver the antibiotic Ciprofloxacin locally.

Ciprofloxacin Implants can be valuable in the prevention of infection in post-surgical orthopedic care and in the treatment of post-traumatic infections. Studies have demonstrated that Ciprofloxacin Implants deposited between the bone and muscle deliver local concentrations of the drug, in both the bone and surrounding tissue, in excess of therapeutic levels for more than 28 days with minimal systemic exposure.

Labopharm expanded its portfolio of in-house products during fiscal 2002 with the addition of a product referred to as DDS-2003, a once-daily formulation of a currently marketed product that has global sales in excess of US\$1 billion. Labopharm believes it can apply its controlled-release technology to DDS-2003 to improve its release profile. During the fiscal period Labopharm initiated feasibility and formulation studies for DDS-2003.

Partnered Projects

In February 1999, Labopharm signed a Letter of Intent with Axcan Pharma to develop a controlled-release formulation of trimebutine maleate, marketed in Canada by Axcan as MODULON[®], which is indicated for the treatment of irritable bowel syndrome and has an estimated global market of US\$200-300 million. In the fiscal period, Labopharm and Axcan broadened their plans for the worldwide commercialization of the drug, signing a subsequent Letter of Intent to execute a global licensing agreement for the commercialization of a controlled-release version of trimebutine maleate. The agreement builds upon the existing relationship between the two companies. In the fourth quarter, a pharmacokinetic study for controlled-release trimebutine maleate was initiated.

In 1997, Labopharm concluded a licensing and co-development agreement with Sepracor Inc. for the development of solid oral dosage forms of levalbuterol HCl, trade-named Xopenex[™], a treatment for asthma and chronic obstructive pulmonary disease. Labopharm and Sepracor are discussing future developments.

In fiscal 2001, Labopharm signed a feasibility and formulation agreement with Aventis Pharmaceuticals Inc. (Aventis), the U.S. pharmaceuticals division of Aventis S.A., for the development of once-daily formulations of Allegra-D[®]. Allegra[®] has current sales of approximately US\$2 billion. Based on the successful completion of the feasibility and formulation study, Labopharm later secured a worldwide licensing agreement with Aventis for Allegra-D[®]. During the final quarter of the fiscal period, Labopharm initiated pilot pharmacokinetic studies for once-daily Allegra-D[®].

Labopharm expanded its portfolio of partnered products in the fiscal period signing a binding Letter of Intent (LOI) with MedPointe Inc., a privately held specialty pharmaceutical company, to execute a formal licensing agreement under which the two companies will jointly develop novel, sustained-release products using the Contramid[®] technology. The comprehensive LOI with MedPointe defines the terms for the feasibility and formulation work in addition to delineating many of the terms that will comprise the final licensing agreement. The first product to be developed under the agreement, referred to as DDS-2001, has an estimated market potential of more than US\$300 million. MedPointe will bear all costs in the development and commercialization of the product. Under the terms of the LOI, Labopharm immediately began feasibility and formulation studies on the new product. Labopharm completed feasibility work in the fiscal period and is currently doing formulation work. Labopharm and MedPointe are working to identify potential further opportunities for collaboration, deriving additional value from the relationship.

Manufacturing Agreement

Labopharm entered into an agreement with Cerestar in November 1998, to manufacture Contramid[®]. Cerestar, recently acquired by Cargill Incorporated, is a major global operating company in the starch and starch derivatives industry. As the leader in the European market and one of the largest producers of starch in North America, pharmaceutical companies regularly audit Cerestar's manufacturing facilities. Furthermore, Cerestar has extensive experience in producing Drug Master Files. To date, Cerestar has produced several multi-ton lots of Contramid[®] and demonstrated reproducible results on a commercial scale.

New Facility

During the fiscal period, construction began on the Company's new corporate headquarters in the Parc scientifique et de haute technologie de Laval. The facility will be built and owned by real estate developer SITQ Immobilier and Labopharm will lease the facility from SITQ under a 15-year lease. The 48,000 square-foot facility will house Labopharm's corporate offices as well as state-of-the-art laboratories and a GMP-grade (Good Manufacturing Practice) pilot plant. The facility will consolidate employees from three separate locations and will allow the Company to develop an expanded number of products more efficiently and more economically, potentially cutting as much as six months off product development times and lowering costs associated with the manufacture of drugs for clinical trials. The Company expects to move into its new facility during the Spring of 2003.

Change in Fiscal Year-End

Effective December 31, 2002, Labopharm changed its fiscal year-end to December 31 from February 28. As a result, the ten-month period from March 1, 2002 to December 31, 2002 became a transition period. The change in fiscal year-end was intended to better enable investors and the financial community to track the Company's progress.

Operating Revenue

Operating revenue for the ten-month period ended December 31, 2002 amounted to \$2,016,711 compared to \$1,580,334 for the twelve-month period ended February 28, 2002.

Revenue from research and development contracts for the ten-month period totalled \$935,711 compared to \$676,383 for the preceding twelve-month period. Contract revenue for the ten-month period was generated primarily from the agreement with MedPointe Inc. signed in July 2002 and from the ongoing contracts with Axcan Pharma for MODULON® and with Aventis France for Allegra-D®. For the twelve-month period ended February 2002, 83% of contract revenue was generated from the agreement with Sepracor for Xopenex™. Contract revenue fluctuates based on the stage of development and the number of partnered programs, as well as the achievement of specific milestones. Labopharm expects revenue from research and development contracts to increase for the fiscal year ended December 31, 2003 as the Company concludes partnership agreements for the commercialization of tramadol and achieves development milestones for other partnered programs.

Investment income for the ten-month period was \$1,081,000 compared to \$903,951 for the previous twelve-month period. The increase is attributable to a higher average cash and investment balance throughout the fiscal period, resulting from gross proceeds of \$40,365,000 from the equity financing concluded in November 2001. The Company invests its excess cash in high quality bonds and commercial paper, which allowed it to generate a return in excess of 3.5% over the current fiscal period.

Research and Development Expenses

Research and development expenses before investment tax credits for the ten-month period were \$11,551,974, compared to \$6,701,197 for the previous twelve-month period. The increase was primarily attributable to the European Phase III clinical trial for once-daily tramadol, as well as the associated manufacturing of clinical trial material. The increase was also the result of a 50% increase in research and development personnel during the period to support the continued expansion of the number of products in the Company's portfolio.

Tax credits for research and development for the ten-month period totalled \$825,771, compared to \$690,364, for the previous twelve-month period. The Company's recoverable tax credit rate on admissible expenses for the ten-month period was 50% less than that of the previous year as a result of the Company's higher asset base at February 28, 2002. As a result, research and development expenses, net of investment tax credits, for the ten-month period ended December 31, 2002 totalled \$10,726,203 compared to \$6,010,833 in the previous fiscal year.

The Company expects that research and development costs will further increase in the fiscal year ending December 31, 2003 as the Company engages in two Phase III clinical trials in the U.S. for once-daily tramadol, continues to expand its in-house product portfolio, and move its products closer to commercialization.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the ten-month period were \$4,864,558 compared to \$4,791,317 in the previous fiscal year. Included in selling, general and administrative expenses for the ten-month period were costs associated with the operations of the Company's wholly owned subsidiary in Ireland, Labopharm Europe Limited, the addition of personnel in order to manage the increasing activities of the Company and additional costs associated with the growth of the Company in areas such as corporate affairs, public relations and insurance costs. Professional fees also increased for various matters including consultation in regards to patents and protection of the Company's intellectual property, along with tax planning initiatives. The Company expects selling, general and administrative expenses to increase for the fiscal year ending December 31, 2003, reflecting growth in the size and complexity of the Company as it moves toward commercialization of its lead product, once-daily tramadol.

Prior to the ten-month period ended December 31, 2002, Labopharm established a wholly owned subsidiary in Barbados, Labopharm (Barbados) Limited. This initiative, in conjunction with the establishment of Labopharm Europe Limited in January 2002, is designed to prepare Labopharm for the global commercialization of its products and maximize shareholder value.

Net Loss

Net loss from operating activities for the ten-month period ended December 31, 2002 was \$13,803,260 compared to \$9,242,364 for the preceding fiscal year. The principal factors that contributed to the loss for the ten-month period were the European Phase III clinical trial for tramadol, initiation of the two U.S. Phase III trials, and the addition of resources to expand the Company's research and development capabilities required to support the introduction of new programs to its product portfolio.

Net loss also includes the reversal of future income tax assets recorded in previous years in the amount of \$176,154. Prior to the period-end, the Company sold an undivided interest in its intellectual property to its two wholly owned subsidiaries. Although having no impact in the consolidated financial statements, this transaction resulted in taxable income for the Company, thereby allowing it to use a portion of its tax losses from previous years.

The Company expects net loss for the fiscal year ending December 31, 2003 to increase as a result of increased research and development activities and increased, selling, general and administrative costs, which will outweigh the expected increase in revenue.

Quarterly Information (unaudited) (in thousands of dollars except per share data)

The following selected financial information is derived from the Company's unaudited quarterly financial statements for each of the last eight quarters, all of which cover periods of three months.

	Ten-month period ended December 31, 2002			Twelve-month period ended February 28, 2002				Three-month period ended February 28, 2001
	Q1	Q2	Q3	Q1	Q2	Q3	Q4	Q4
Revenue	372	436	1,007	185	224	752	419	965
Net loss	(3,538)	(3,491)	(4,212)	(1,237)	(2,135)	(1,688)	(4,182)	(814)
Basic and diluted net loss per share	(0.11)	(0.11)	(0.14)	(0.05)	(0.09)	(0.07)	(0.15)	(0.04)

Liquidity and Capital Resources

Since its creation, Labopharm has financed its activities by issuing equity, through the use of term loans, investment tax credits, collaborative research contracts and interest income. On December 21, 1994, the Company completed a private placement and realized net

proceeds of \$5,136,141. 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. On November 8, 2001, the Company completed a public offering for net proceeds of \$38,548,575.

Funds applied to operating activities in the ten-month period ended December 31, 2002 were \$10,613,974 compared to \$8,906,697 for the previous fiscal year and were required to move the Company toward its goal of becoming a fully integrated international specialty pharmaceutical company, as development progressed for key products in its portfolio, primarily its lead in-house product, tramadol.

Capital expenditures for the ten-month period were \$1,682,120 compared to \$804,013 for the previous fiscal year. Capital expenditures for the ten-month period were principally related to the acquisition of laboratory equipment, patent costs, and expenditures related to the new facilities, which the Company plans to move into in Spring 2003. According to the terms of the new lease, an additional \$800,000 of capital expenditures is planned during 2003 for the new facilities. The Company also plans to acquire additional laboratory equipment to maximize the use of its new laboratories.

Cash and cash equivalents, and investments including accrued interest totalled \$32,785,599 as at December 31, 2002 compared to \$44,760,109 at the end of the previous fiscal year, a decrease of \$11,974,510.

Labopharm's management believes that the Company's liquidity as of December 31, 2002 and anticipated revenue from partnerships, should be sufficient to finance operations and capital expenditures for approximately the next two years of operations. During the next fiscal year, liquidity is expected to diminish by approximately \$19 million, with respect to the 2003 operating activities, primarily because of the costs associated with the two U.S. Phase III clinical trials for tramadol. The Company aims to complete these studies by the end of 2003, although some costs for these clinical trials will be incurred in 2004.

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 good 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. Although 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 studies and clinical trials completed to date compare favorably with those of competing technologies. Furthermore, Contramid® is among the most economical drug delivery technologies. 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, there is no guarantee that these patents are valid, even if they are reputed to be, or that the Company's 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 with other pharmaceutical companies for products to which its drug delivery systems would be applied. This type of agreement or alliance is common in the pharmaceutical industry, and to date, the Company's technology has been well received by the industry. The Company has six agreements with pharmaceutical companies. There is no assurance that partners will not withdraw from agreements at a later date or that products 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 by partners and/or the Company for a variety of reasons 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 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 development and commercial needs.

Labopharm expects to generate significant revenue from the licensing agreements and alliances it has concluded and that it expects to conclude with pharmaceutical companies. The form in which revenue is generated could vary greatly depending on the conditions of the agreement. Labopharm expects that the principal forms of revenue will be through the achievement of milestones, which are lump-sum payments made at key stages of product development, as well as royalties on product sales.

Until it begins to generate significant revenue 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 periods, Labopharm has accumulated net losses of approximately \$26.7 million.

The Company may require supplementary, medium-term capital. The amount and the timing 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 continue 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 requires at the necessary time.

The Company operates internationally, however a substantial portion of its expense activities and capital expenditures are in Canadian dollars, whereas the Company's revenues (current and potential) are primarily in U.S. dollars or Euros. The Company does not believe it has a material exposure to foreign currency risk because of the relative stability of the Canadian dollar in relation to the U.S. dollar and the Euro.

The primary objective of the Company's investment policy is the protection of principal, and accordingly the Company invests in high-grade government and corporate securities with varying maturities, which are aimed to coincide with the Company's cash requirements. As it is the Company's intent to hold these investments until maturity, the Company does not have a material exposure to interest rate risk.

The price of Labopharm's common shares is subject to fluctuation. Factors such as 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.

To the extent any statements made in this document contain information that is not historical, these statements are essentially forward looking and are subject to the risks and uncertainties described above. Actual results, levels of activity, performance or achievements could differ materially from those projected herein and depend on a number of factors, including the successful and timely completion of clinical studies, the uncertainties related to the regulatory process and the commercialization of the drug thereafter.

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. Ernst & Young LLP, Chartered Accountants, 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, March 19, 2003

(signed)

Warren Whitehead
Chief Financial Officer

Auditors' Report

To the Shareholders of
Labopharm Inc.

We have audited the consolidated balance sheet of **Labopharm Inc.** as at December 31, 2002 and the consolidated statements of loss, deficit and cash flows for the ten-month period 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 audit.

We conducted our audit 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and the results of its operations and its cash flows for the ten-month period then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at February 28, 2002 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those financial statements in their report dated March 22, 2002.

(signed)

Ernst & Young LLP
Chartered Accountants

Montréal, Canada,
January 24, 2003

Consolidated Balance Sheets

As at	December 31, 2002 \$	February 28, 2002 \$
ASSETS		
Current		
Cash and cash equivalents	1,718,233	2,264,144
Short-term investments [note 4]	22,294,248	22,554,449
Accounts receivable [note 5]	1,251,643	727,409
Research and development tax credits receivable [note 13]	568,291	1,298,776
Prepays and other assets	426,774	169,133
Total current assets	26,259,189	27,013,911
Property, plant and equipment [note 7]	2,020,056	1,221,463
Intangible assets [note 8]	1,944,183	1,510,513
Long-term investments [notes 6 and 11]	8,468,076	20,442,558
Future income taxes [note 12]	—	176,154
	38,691,504	50,364,599
LIABILITIES		
Current		
Cheques issued in excess of bank deposits	—	893,244
Accounts payable and accrued liabilities	3,923,861	1,426,196
Deferred revenue	117,000	—
Current portion of obligations under capital leases [note 9]	7,827	64,355
	4,048,688	2,383,795
Obligations under capital leases [note 9]	13,543	20,146
	4,062,231	2,403,941
SHAREHOLDERS' EQUITY		
Capital stock [note 10]	88,014,403	87,539,149
Deficit	(53,385,130)	(39,578,491)
Total shareholders' equity	34,629,273	47,960,658
	38,691,504	50,364,599

Commitments and contingency [note 11]

See accompanying notes

On behalf of the Board:

(signed)

James R. Howard-Tripp
Director

(signed)

Gordon J. Fehr
Director

Consolidated Statements of Loss

	Ten-month period ended December 31, 2002 \$	Year ended February 28, 2002 \$
OPERATING REVENUE		
Research and development contracts	935,711	676,383
Investment income	1,081,000	903,951
	2,016,711	1,580,334
OPERATING EXPENSES		
Research and development expenses [note 13]	10,726,203	6,010,833
Selling, general and administrative expenses	4,864,558	4,791,317
Finance charges	25,470	20,548
	15,616,231	10,822,698
Loss before income taxes	(13,599,520)	(9,242,364)
Income taxes:		
Current	27,586	—
Future	176,154	—
Net loss for the period	(13,803,260)	(9,242,364)
Net loss per share – basic and fully diluted	(0.44)	(0.35)
Weighted average number of shares outstanding	31,028,509	26,426,129

See accompanying notes

Consolidated Statements of Deficit

	Ten-month period ended December 31, 2002 \$	Year ended February 28, 2002 \$
Balance, beginning of period	(39,578,491)	(28,088,647)
Issuance costs of capital stock [note 10]	(3,379)	(2,247,480)
Net loss	(13,803,260)	(9,242,364)
Balance, end of period	(53,385,130)	(39,578,491)

See accompanying notes

Consolidated Statements of Cash Flows

	Ten-month period ended December 31, 2002 \$	Year ended February 28, 2002 \$
OPERATING ACTIVITIES		
Net loss for the period	(13,803,260)	(9,242,364)
Items not affecting cash		
Depreciation of property, plant and equipment	365,934	309,841
Amortization of intangible assets	83,923	218,099
Reversal of future income taxes	176,154	—
Loss on disposal and write-off of property, plant and equipment	—	8,352
	(13,177,249)	(8,706,072)
Net change in non-cash working capital items	2,563,275	(200,625)
	(10,613,974)	(8,906,697)
INVESTING ACTIVITIES		
Acquisition of investments	(22,930,787)	(40,947,169)
Proceeds from maturities of investments	35,165,470	10,559,696
Acquisition of property, plant and equipment	(1,164,527)	(439,103)
Acquisition of intangible assets	(517,593)	(364,910)
	10,552,563	(31,191,486)
FINANCING ACTIVITIES		
Repayment of capital lease obligations	(63,131)	(6,138)
Proceeds from issuance of capital stock	475,254	43,465,575
Issuance costs of capital stock	(3,379)	(2,247,480)
	408,744	41,211,957
Increase in cash and cash equivalents during the period	347,333	1,113,774
Cash and cash equivalents, beginning of period	1,370,900	257,126
Cash and cash equivalents, end of period	1,718,233	1,370,900
Cash and cash equivalents consist of:		
Cash and cash equivalents	1,718,233	2,264,144
Cheques issued in excess of bank deposits	—	(893,244)
	1,718,233	1,370,900
Cash flows include the following items:		
Interest paid	2,612	3,889
Income taxes paid	27,586	—

See accompanying notes

Notes to Consolidated Financial Statements

December 31, 2002

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 controlled-release technologies and the development of pharmaceutical products incorporating its proprietary technologies. The Company carries on business in Canada and Ireland and substantially all of the Company's assets are located in Canada. In 2002, the Company changed its fiscal year end from February 28 to December 31.

The Company's strategy is to develop products internally in order 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. To date, the Company has financed its cash requirements primarily through share issuances, investment tax credits, collaborative research contracts and interest income. 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 the Company to obtain the necessary financing to complete its projects through licensing and research agreements. It may be necessary for the Company to raise additional funds until profitability is achieved.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The most significant accounting policies are summarized below.

Use of estimates

The preparation of financial statements in conformity 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 contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates and such differences could be material.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and those of its wholly owned subsidiaries, Labopharm Europe Limited and Labopharm (Barbados) Limited. All significant intercompany transactions and balances have been eliminated upon consolidation.

Revenue recognition

The Company recognizes revenues from various research agreements as the contracted services are performed or when milestones are achieved, in accordance with the terms of the specific agreements. Up front payments for the use of technology where further services are to be provided or fees received on the signing of research agreements are recognized over the period of performance of the related activities. Amounts received in advance of recognition are included in deferred revenue.

Cash and cash equivalents

Cash and cash equivalents consist of cash and all highly liquid short-term investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. The Company considers these highly liquid short-term investments with an original maturity of less than three months to be cash equivalents.

Notes to Consolidated Financial Statements

December 31, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Short-term and long-term investments

Short-term investments are recorded at the lower of amortized cost or fair market value on a portfolio basis. Long-term investments are accounted for at amortized cost less a provision for losses, if any, when there has been a loss in value that is other than a temporary decline. The determination of the provision is based on the potential to recover the carrying amount of the securities by holding it to maturity.

Property, plant and equipment

Property, plant and equipment are carried at cost less related investment tax credits for research and development equipment.

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

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

Laboratory equipment	Diminishing balance	20% to 30%
Computer hardware and software	Diminishing balance	30%
Furniture	Diminishing balance	20%
Leasehold improvements	Straight-line	3 to 5 years

Intangible assets

Intangible assets consist of patent and trademark costs and intellectual property rights which consist of fees paid to license technology. The patent costs include legal fees to obtain patents and patent application fees.

Amortization of intangible assets is calculated over their estimated useful life using the following methods and rates:

Patents and trademarks	Straight-line up to 20 years
Intellectual property rights	Straight-line over the life of the right

On an ongoing basis, management reviews the carrying value of intangible assets and considers whether there has been events or changes in circumstances that indicate that the carrying value may not be recoverable. The review is based on the assessment of technological changes, the Company's intended use and on the projected estimated undiscounted cash flows expected to be generated from the underlying intellectual property. Any impairment results in a write-down of intangible assets and a charge to income during the year.

Research and development expenses

Research expenses are charged to income in the year of expenditure less related tax credits. Development costs net of related tax credits are charged to income as incurred unless a development project meets generally accepted accounting principles for deferral and amortization. The Company has not deferred any such development costs to date.

Government assistance

Grant amounts resulting from government assistance programs, including investment tax credits on research and development expenses, are reflected as reductions of the cost of the assets or expenses to which they relate at the time the assistance becomes receivable.

Notes to Consolidated Financial Statements

December 31, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Foreign currency translation

The Company's foreign subsidiaries are considered to be integrated foreign entities and are accounted for in accordance with the temporal method, as are transactions in foreign currencies entered into by the Company. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end exchange rate, non-monetary assets are translated at the historical exchange rate, and revenue and expense items are translated in Canadian dollars at rates of exchange in effect at the related transaction dates. Exchange gains and losses arising from these transactions are included in the determination of net loss.

Stock-based compensation plan

The Company has a stock-based compensation plan, which is described in note 10. No compensation expense is recognized when stock options are granted to employees and directors under stock option plans with no cash settlement features. However, direct awards of stock to employees and stock and stock option awards granted to non-employees is accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of direct awards of stock is determined based on the quoted market price of the Company's stock and the fair value of stock options to non-employees is estimated at the date of grant using the Black-Scholes option pricing model [see note 3].

Net loss per share

Basic loss per share is calculated using the weighted average number of shares outstanding during the period.

Diluted earnings per share is calculated using the treasury stock method and is equal to the basic loss per share since the effect of exercising the warrants and options would be antidilutive for all periods presented.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

3. CHANGE IN ACCOUNTING POLICIES

Intangible assets

Effective March 1, 2002, the Company prospectively adopted the new recommendations published by the Canadian Institute of Chartered Accountants ["CICA"] relating to the method of valuation and the presentation and disclosure requirements for intangible assets. The new recommendations require recognized intangible assets to be amortized over their useful life to an enterprise, unless the life is determined to be indefinite. When an intangible asset is determined to have an indefinite useful life, it should not be amortized until its life is determined to be no longer indefinite. The amortization method and estimate of the useful life of an intangible asset should be reviewed annually. Intangible assets that are subject to amortization are tested for impairment by comparing the net carrying amount with the net recoverable amount whereas for intangible assets not subject to amortization, the net carrying amount is compared to the asset's fair value. The impact of the adoption of the new recommendations has not resulted in any change to the recognized intangible assets of the Company because its intangible assets are not considered to have an indefinite life. However, the Company has additional disclosure requirements relating to its intangible assets [see note 8].

Notes to Consolidated Financial Statements

December 31, 2002

3. CHANGE IN ACCOUNTING POLICIES (Cont'd)

Stock-based compensation and other stock-based payments

Effective March 1, 2002, the Company also adopted the new CICA recommendations relating to stock-based compensation and other stock-based payments. As permitted, the Company has applied this change prospectively for new awards granted on or after March 1, 2002. The Company does not recognize compensation expense when stock options are granted to employees, officers and directors under stock option plans at the prevailing market price and where there are no cash settlement features. However, direct awards of stock to employees and stock and other stock-based payments granted to non-employees are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of direct awards of stock is determined based on the quoted market price of the Company's stock and the fair value of stock options or other stock-based payments to non-employees is estimated at the date of grant using the Black-Scholes option pricing model. In periods prior to March 1, 2002, the Company did not recognize compensation expense when stock or stock options were issued to employees, officers and directors. In addition, no expense was recognized when options or other stock-based payments were made to non-employees. The adoption of these new recommendations did not have an impact on the Company's financial position or results of operations for the period. The Company has provided pro forma information regarding net loss as if the Company had accounted for stock options granted to employees after March 1, 2002 under the fair value method in note 10.

4. SHORT-TERM INVESTMENTS

Short-term investments comprise 14 investments [9 as at February 28, 2002] and include bonds issued by governments and public companies and commercial paper. These investments are all in investment grade instruments and will mature in the following year with an average weighted yield of 3.33% [February 28, 2002 – 2.98%]. The market value of short-term investments held as at December 31, 2002 is \$22,398,308 [February 28, 2002 - \$23,757,010].

5. ACCOUNTS RECEIVABLE

	December 31, 2002	February 28, 2002
	\$	\$
Trade	710,422	172,925
Sales taxes	236,179	162,282
Interest on investments	305,042	392,202
	1,251,643	727,409

6. LONG-TERM INVESTMENTS

Long-term investments comprise 6 investments [10 as at February 28, 2002] and include bond coupons, bonds issued by governments and public companies, and a guaranteed investment certificate [note 11]. The long-term investments are all in investment grade instruments which all mature in 2004 with an average weighted yield of 3.84% [February 28, 2002 – 3.70%]. The market value of the long-term investments held as at December 31, 2002 is \$8,587,539 [February 28, 2002 – \$20,738,877].

Notes to Consolidated Financial Statements

December 31, 2002

7. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated depreciation \$	Net book value \$
December 31, 2002			
Laboratory equipment	1,913,973	991,021	922,952
Computer hardware and software	443,374	288,549	154,825
Furniture	320,580	213,419	107,161
Leasehold improvements	360,061	329,037	31,024
Assets under construction	738,380	—	738,380
	3,776,368	1,822,026	1,954,342
Assets under capital leases			
Laboratory equipment	94,712	28,998	65,714
	3,871,080	1,851,024	2,020,056
February 28, 2002			
Laboratory equipment	1,571,136	802,451	768,685
Computer hardware and software	376,435	225,680	150,755
Furniture	310,045	178,850	131,195
Leasehold improvements	354,225	263,007	91,218
	2,611,841	1,469,988	1,141,853
Assets under capital leases			
Laboratory equipment	94,712	15,102	79,610
	2,706,553	1,485,090	1,221,463

No assets were acquired during the ten-month period ended December 31, 2002 through capital leases [February 28, 2002 – \$57,387].

Depreciation expense for property, plant and equipment was \$365,934 for the ten-month period ended December 31, 2002 and \$309,841 for the year ended February 28, 2002, and was included in operating expenses.

Notes to Consolidated Financial Statements

December 31, 2002

8. INTANGIBLE ASSETS

	Cost \$	Accumulated amortization \$	Net book value \$
December 31, 2002			
Intellectual property rights	500,000	195,833	304,167
Patents and trademarks	1,896,205	256,189	1,640,016
	2,396,205	452,022	1,944,183
February 28, 2002			
Intellectual property rights	500,000	175,000	325,000
Patents and trademarks	1,378,612	193,099	1,185,513
	1,878,612	368,099	1,510,513

9. CAPITAL LEASE OBLIGATIONS

	December 31, 2002 \$	February 28, 2002 \$
Laboratory equipment, repayable in monthly instalments of \$836 including interest calculated at 11.89%, with transfer of ownership at maturity on June 7, 2005	25,080	33,440
Laboratory equipment, paid in full	—	57,387
	25,080	90,827
Interest included in instalments	3,710	6,326
	21,370	84,501
Current portion	7,827	64,355
	13,543	20,146

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

	2002 \$
2003	10,032
2004	10,032
2005	5,016

Notes to Consolidated Financial Statements

December 31, 2002

10. CAPITAL STOCK

Authorized

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

Unlimited number of common shares, voting, without par value

Issued

	December 31, 2002	February 28, 2002
	\$	\$
31,058,081 Common shares [February 28, 2002 – 30,908,681]	88,014,403	87,539,149

Capital stock transactions

During the ten-month period ended December 31, 2002, 149,400 [February 28, 2002 – 711,200] options were exercised for a total cash consideration of \$475,254 [February 28, 2002 – \$3,080,575]. The share issue expenses amounted to \$3,379 [February 28, 2002 - \$7,520].

On November 8, 2001, the Company issued 5,200,000 common shares and on November 29, 2001, the over-allotment option was exercised on 780,000 additional common shares. The total consideration was \$40,365,000 in cash. The share issue expenses amounted to \$2,239,960.

Warrants

During the year ended February 28, 2000, the Company has issued 200,000 warrants to the former supplier of Contramid® which can be exercised at the average market price of \$2, expiring in May 2004. During the year ended February 28, 2002, 10,000 warrants were exercised for a total of 10,000 shares for a cash consideration of \$20,000. As of December 31, 2002, 190,000 warrants are outstanding.

Stock option plan

In May 1995, the Company established a stock option plan for directors, executive officers, employees and consultants of the Company. The plan was amended in July 2002 to increase the maximum number of common shares that are issuable under the plan from 3,000,000 to 4,650,000 common shares. 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 December 31, 2002, may be exercised no later than December 2007. Options generally vest over a three-year period except for options to Board of Directors which vest immediately.

Notes to Consolidated Financial Statements

December 31, 2002

10. CAPITAL STOCK (Cont'd)

The changes in the number of stock options granted by the Company, and their weighted average exercise prices are as follows:

	Ten-month period ended		Year ended	
	December 31, 2002		February 28, 2002	
	#	\$	#	\$
Balance, beginning of period	2,865,800	4.70	2,482,250	3.36
Granted	923,925	2.99	1,015,750	7.82
Exercised	(149,400)	3.18	(611,200)	4.48
Expired	(70,000)	4.38	—	—
Forfeited	(109,500)	7.04	(21,000)	2.65
Balance, end of period	3,460,825	4.24	2,865,800	4.70
Options eligible to be exercised	2,279,200	3.54	1,765,200	3.79

Additional information concerning stock options as at December 31, 2002 is as follows:

Range of exercise price \$	Options outstanding			Options exercisable		
	Number of options	Weighted-average remaining contractual life	Weighted-average exercise price	Number of options	Weighted-average exercise price	
		years	\$		\$	
1.56 to 2.92	1,202,550	2.54 years	2.23	977,650	2.21	
3.00 to 4.31	1,501,025	3.03 years	3.48	1,013,700	3.64	
6.02 to 7.00	256,250	3.65 years	6.45	189,550	6.25	
9.10 to 10.79	501,000	4.09 years	10.25	98,300	10.53	
	3,460,825			2,279,200		

No compensation cost has been recognized for stock options granted to employees and directors during the ten-month period ended December 31, 2002. The fair value of option grants during the ten-month period ended December 31, 2002 was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions: weighted average expected volatility factor of 0.94; a weighted average risk-free interest rate of 3.50%; a dividend yield of nil; and a weighted average expected life of the options of 3.4 years. The weighted average fair-value of stock options granted during the period ended December 31, 2002 under the Black-Scholes option pricing model and the above assumptions amounted to \$1.91 per option.

Notes to Consolidated Financial Statements

December 31, 2002

10. CAPITAL STOCK (Cont'd)

Had compensation cost been determined based on the fair value at the date of grant of the options granted, the fair value of the options would have been amortized over the vesting period of the options and the Company's net loss and loss per share basic and diluted for the ten-month period ended December 31, 2002 would have been amended as follows:

		Ten-months ended December 31, 2002
		\$
Net loss	As reported	(13,803,260)
	Pro forma	(14,695,424)
Loss per share – basic and diluted	As reported	(0.44)
	Pro forma	(0.47)

11. COMMITMENTS AND CONTINGENCY

The Company occupies certain facilities under lease arrangements and leases certain equipment. Future minimum lease payments under these operating leases for the years ending December 31 are as follows:

	\$
2003	150,523
2004	32,127
2005	32,127
2006	11,496
	226,273

In September 2002, the Company signed a 15-year lease for new facilities presently under construction and anticipates that it will be accounted for as a capital lease at the inception of the lease term in fiscal 2003. Future minimum payments under this lease amount to \$637,500 for the year ending December 31, 2003, \$850,000 for each of the years in the four-year period ending December 31, 2007 and a total of \$10,962,500 for the remaining ten-year and three-month period thereafter.

A letter of credit in the amount of \$1,200,000 was issued to the lessor of the Company's new facilities as a security for the Company's performance of obligations under the lease. This letter of credit is collateralized by a specific investment in the amount of \$1,880,000 which has been classified as long-term. In addition, under the new lease, the Company is required to reimburse the lessor an amount of \$800,000 in construction costs for various leasehold improvements, during the first quarter of 2003.

In 1994, concurrently with the purchase of a controlled-release technology, the Company acquired a right of first refusal with respect to an improved technology for which it agreed to pay royalties of 4% on net revenues generated from the commercialization of the 1994 purchased technology. The Company considers that, as at December 31, 2002, no amounts are owing, however, this matter is currently under discussion.

Notes to Consolidated Financial Statements

December 31, 2002

12. INCOME TAXES

The income tax expense reported differs from the amount computed by applying Canadian federal and the applicable provincial income tax rates to income or loss before income taxes. The reasons for the difference and the related tax effects are as follows:

	Ten-month period ended December 31, 2002 %	Year ended February 28, 2002 %
Combined statutory federal and provincial rates	35.2	37.1
Decrease in taxes recoverable resulting from:		
Non-deductible expenses	(0.1)	(0.3)
Foreign tax rate differences	(0.5)	—
Unrecognized tax benefits of operating losses and other temporary differences	(34.6)	(36.8)
Write-down of future tax assets	(1.3)	—
Large Corporation Tax	(0.2)	—
Tax expense	(1.5)	—

The tax effects of temporary differences and net operating losses that give rise to future income tax assets are as follows:

	December 31, 2002 \$	February 28, 2002 \$
Future income tax assets		
Tax bases of capital assets in excess of carrying values	450,000	1,573,610
Net operating losses carried forward	3,113,000	7,166,440
Capital losses carried forward	—	937,035
Research and development expenditures	4,845,000	5,666,593
Tax credits related to scientific research and development	—	690,766
Other	596,000	1,044,950
Total future income tax asset	9,004,000	17,079,394
Valuation allowance	(9,004,000)	(16,903,240)
Net future income tax asset	—	176,154

Notes to Consolidated Financial Statements

December 31, 2002

12. INCOME TAXES (Cont'd)

The Company has accumulated loss carryforwards for Federal and Québec purposes which are available to reduce future taxable income, the benefits of which have not been recognized in these financial statements. These losses carryforwards expire as follows:

	Federal \$	Provincial \$
2006	1,896,000	—
2007	1,771,000	411,000
2008	7,345,000	6,763,000
	11,012,000	7,174,000

The Company has approximately \$13,462,000 of research and development expenditures for Federal tax purposes and \$20,772,000 for Québec purposes that are available to reduce taxable income in future years and have an unlimited carryforward period, the benefit of which has not been reflected in these financial statements. Research and development expenditures are subject to audit by the taxation authorities and accordingly, these amounts may vary.

The Company also has accumulated share issue costs which have not been deducted for income tax purposes amounting to approximately \$1,915,000. The benefits of these expenses have not been recorded in the financial statements.

13. GOVERNMENT ASSISTANCE

The Company incurred research and development expenditures which are eligible for investment tax credits. The investment tax credits recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by the taxation authorities and, accordingly, these amounts may vary. A portion of these amounts, have been recorded as a reduction of research and development expenditures as follows:

	December 31, 2002 \$	February 28, 2002 \$
Research and development tax credits	825,771	690,364

Notes to Consolidated Financial Statements

December 31, 2002

13. GOVERNMENT ASSISTANCE (Cont'd)

The Company has non-refundable tax credits available amounting to \$3,251,000 related to research and development expenditures which may be utilized to reduce federal income taxes payable in the future years and expire as follows:

	\$
2006	218,000
2007	345,000
2008	369,000
2009	497,000
2010	489,000
2011	564,000
2012	769,000
	3,251,000

The benefits of these non-refundable investment tax credits have not been recognized in the financial statements.

14. FINANCIAL INSTRUMENTS

Fair value

Given their short-term maturity, the fair value of cash and cash equivalents, accounts receivable, cheques issued in excess of bank deposits and accounts payable approximate the carrying value.

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

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 December 31, 2002, approximately 86% [February 28, 2002 – 95%] of accounts receivable are due from two customers.

15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

Board of Directors, Labopharm Inc.

Donald Buxton

Chairman of the Board

James R. Howard-Tripp

President and Chief Executive Officer

Gordon J. Fehr (1) (2)

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

Richard J. MacKay (1)

President and Chief Executive Officer, Stiefel Canada Inc.

Jim McDonald (2)

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

Anthony C. Playle

Chief Executive Officer, Acpharma Limited

Frédéric Porte

President, Medipress Management Inc.

Jacques L. Roy (2)

Vice-President, Fonds de solidarité FTQ

James S. Scibetta

Executive Vice-President and Chief Financial Officer Merrimack Biopharmaceuticals Inc.

Percy Skuy (1)

Corporate Director, Former President, Ortho-McNeil Inc.

1. Member of the Human Resources & Corporate Governance Committee

2. Member of the Audit Committee

Board of Directors, Labopharm Europe Limited

James R. Howard-Tripp

President and Chief Executive Officer, Labopharm Inc.

James F.X. Fahy

Partner, Schiff Hardin & Waite (Attorneys)

Anthony C. Playle

Managing Director, Labopharm Europe Limited
Chief Executive Officer, Acpharma Limited

Officers, Labopharm Inc.

Donald Buxton

Chairman of the Board (Non-Executive)

James R. Howard-Tripp

President and Chief Executive Officer

Sylvie Bouchard, MD, PhD.

Vice-President, Clinical Development

Lisane Dostie, LLB

General Counsel and Corporate Secretary

Allan Mandelzys, PhD., MBA

Vice-President, Business Development

Damon Smith, BSc., PhD.

Vice-President, Research and Development

Warren Whitehead, CMA

Chief Financial Officer

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May 14, 2003, 10 a.m.
Hotel Omni, Montreal

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