



Labopharm

Q1

Quarterly Report
First Quarter Fiscal 2003





Grow

Growing the Company



Drive

Driving product development



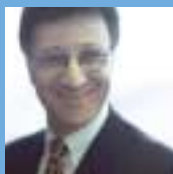
Find

Finding new opportunities



Join

Joining for the future



President's Message to Shareholders

The first quarter of fiscal 2003 was marked by solid progress in our key development programs and continued advancement toward our goal of becoming a fully integrated specialty pharmaceutical company. Our momentum continued in the second quarter as we completed enrolment for the Phase III study in Europe for once-daily Tramadol ahead of schedule, formalized our agreement with Axcan Pharma for sustained-release formulations of trimebutine maleate (MODULON®), and expanded our portfolio with the addition of a new partnered product with MedPointe Inc.

Once-Daily Tramadol: Enrolment for European Phase III Study Completed Ahead of Schedule

I am pleased to report that Labopharm has completed enrolment of patients in the Company's Phase III study in Europe for our lead in-house product, a once-daily formulation of Tramadol, ahead of schedule. The multi-center, pan-European Phase III study to assess the efficacy and safety of controlled-release Tramadol is part of the Company's global regulatory strategy for the drug. The strategy involves conducting pharmacokinetic and efficacy studies in both Europe and the United States, enabling us to efficiently and cost-effectively move Tramadol through to regulatory filings and eventual global commercialization. We remain on track to file a new drug registration dossier in Europe in the fourth quarter of this fiscal year. At the same time, we continue to see considerable interest from potential partners for this product and are currently actively engaged in discussions towards securing such agreements. We anticipate concluding our first partnership in the near future.

In the U.S., we are currently initiating the relevant pivotal efficacy studies and we expect clinical enrolment in these studies to begin in the third quarter of this fiscal year. The combined results of the U.S. and European studies will support the filing of a new drug application (NDA) with the U.S. Food and Drug Administration, which is expected in the second half of the 2003 calendar year.

As previously announced, in Phase IIB efficacy studies for our once-daily formulations of Tramadol, pain relief was maintained for a full 24-hour period, thus demonstrating true once-a-day efficacy. We strongly believe that a once-daily formulation of Tramadol will be preferred over multiple-dose (four- to six-times daily) versions, including the recently approved multiple-dose generic and flash dose versions, and that there exists a significant market for a true once-daily product.

Other Key Developments

Labopharm's program to develop once-daily formulations of Aventis SA's Allegra-D® continues to progress as planned. We remain on schedule to initiate the first pharmacokinetic study in the first half of this fiscal year with potential completion of clinical studies in the first half of next fiscal year. Allegra® is Aventis' flagship brand indicated for the treatment of seasonal allergic rhinitis, with global sales of more than US\$ 1.6 billion. Aventis continues to be a key partner for Labopharm and, as we move ahead, we look forward to opportunities for collaboration on other programs.

Subsequent to the end of the quarter, we signed a Letter of Intent with Axcan Pharma Inc. to execute a global licensing agreement for the commercialization of trimebutine maleate, which Axcan markets in Canada under the brand name MODULON®, in the U.S., Europe and other global markets. The agreement builds upon our existing relationship with Axcan and represents a significant step forward in our shared plans to market a sustained-release version of MODULON®. With Axcan's expanded access to global markets, our relationship represents a much larger opportunity than originally anticipated.

Consistent with our strategy to add new, large market opportunity products to our portfolio, we recently signed a Letter of Intent with MedPointe Inc., a specialty prescription pharmaceutical and medical diagnostics company, to execute a formulation and licensing agreement under which we will jointly develop novel, sustained-release products. The agreement brings the number of products in our pipeline to eight, five of which are partnered programs. In accordance with the agreement, we expect to immediately begin feasibility and formulation studies.

Finally, we strengthened our corporate resources with the addition of Dr. Damon Smith to Labopharm as Vice-President, Research and Development. Dr. Smith brings to the Company more than 12 years experience directing research and development programs for growth-oriented pharmaceutical companies, including taking three products from development through to commercialization. Dr. Smith will play a key role for Labopharm as we shift our focus from technology to products.

Positioned for Growth

The remainder of fiscal 2003 promises to be a very exciting and eventful year for Labopharm. We have truly entered a new phase in our evolution towards becoming a fully integrated specialty pharmaceutical company – one that we expect will be characterized by significant growth as we aggressively move our existing products towards commercialization and expand our pipeline through the addition of new products.

We expect to achieve a number of critical milestones over the remainder of the year as we prepare to file up to four new drug applications in the 2003 calendar year. We anticipate our first products will reach the market in calendar 2004. With respect to expanding our pipeline, we have established a target of adding three products to our portfolio by year-end. With our recent agreement with MedPointe, we are well on our way to achieving this goal.

Our ability to drive development of our products forward is key to capitalizing on the tremendous growth opportunity before us and enhancing shareholder value. As we move ahead, our efforts will focus on strengthening our clinical development, regulatory and manufacturing capabilities to allow us to take our products further in the commercialization process, move them forward more quickly and realize a higher return.

A handwritten signature in black ink, appearing to read "Jim Howard-Tripp". The signature is fluid and cursive, with a large loop at the beginning and end.

James R. Howard-Tripp
President and CEO
July 22, 2002



Management's Discussion and Analysis

Overview

Labopharm specializes in controlled-release drug delivery and the development of pharmaceutical products incorporating its proprietary technologies. As a specialty pharmaceutical company focused on drug delivery, the Company's business model differs from the conventional biotech and pharma business models. Labopharm's potential products are often drugs that are already on the market to which are added new drug delivery profiles. As a result, those products should have shorter development timelines, lower development costs and, through the marketing resources of the Company's partners, could achieve faster market penetration.

The Company presently 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.

Product Development

During the first quarter of fiscal 2003, Labopharm focused its attention on a pipeline of seven projects. Following the close of the first quarter, Labopharm added one partnered product (MedPointe Inc.) to its portfolio and formalized the existing agreement with Axcan Pharma Inc. for MODULON®. The Company now has five products being developed in partnership with international pharmaceutical companies and three products that are being developed in-house.

In-house Projects

After the close of the first quarter, Labopharm completed enrolment of patients in the Company's Phase III study in Europe for its lead in-house product, a once-daily formulation of Tramadol. The multi-center, pan-European Phase III study to assess the efficacy and safety of controlled-release Tramadol is part of the Company's global regulatory strategy for the drug. The strategy involves conducting pharmacokinetic and efficacy studies in both Europe and the United States to move Tramadol through to regulatory filings and commercialization in key global markets.

Partnership Projects

Subsequent to the end of the first quarter, the Company signed a Letter of Intent (LOI) with Axcan Pharma Inc. building upon the existing relationship between the two companies under which Labopharm will develop sustained-release formulations of Axcan's trimebutine maleate (MODULON®). The LOI is expected to lead to a global licensing agreement for the commercialization of this product in the U.S., Europe and other global markets. Labopharm and Axcan have broadened their plans for the worldwide commercialization of the drug and plan to initiate pilot pharmacokinetic studies in the third quarter of this year.

Also subsequent to the end of the first quarter, Labopharm signed a Letter of Intent with MedPointe Inc. to execute a formulation and licensing agreement under which the two companies will jointly develop novel, sustained-release products. The two companies formed a joint committee to oversee and guide the development and commercialization effort. According to the terms of the LOI, Labopharm will immediately begin feasibility and formulation studies for which it will receive a fee from MedPointe. MedPointe will bear all costs of the development and commercialization program. The agreement is expected to be finalized within 90 days of the signing of the LOI in accordance with its terms.

Operating Revenue

Revenue for the first quarter of fiscal 2003 ended May 31, 2002 was \$372,700 compared to \$185,100 for the same period last year. Investment income accounted for \$345,500 of revenue compared to \$185,100 for the first quarter of fiscal 2002. Contract revenue fluctuates based on the stage of partnered programs in development.

Research and Development Expenses

Research and development expenses (net of tax credits) for the first quarter were \$2.7 million compared to \$733,800 for the corresponding quarter last year. The increase is primarily the result of costs associated with the Company's Phase III clinical trials for its lead in-house product, Tramadol.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the first quarter were \$1.2 million compared to \$685,200 for the same period last year. The increase reflects incorporation fees and daily operations associated with the Company's new subsidiary Labopharm Ireland Ltd., as well as external contracts for business development and market research.

Net Loss

Net loss for the first quarter of fiscal 2003 was \$3.5 million, or \$0.11 per share, compared to \$1.2 million, or \$0.05 per share, for the same period last year.

Cash Position

Cash and investments at the end of the first quarter were \$42 million compared to \$12 million at the end of the first quarter of fiscal 2002. The increase reflects net proceeds from the financing completed in November 2001.



Highlights

Highlights of the Quarter

Continued to Advance Key Programs Towards Commercialization

Once-daily Tramadol Development Continues as Expected

- Currently initiating relevant pivotal efficacy studies in U.S.
- Studies part of Company's global regulatory strategy for Tramadol

Controlled-Release Allegra-D® Program Remains on Schedule

- Initiation of first pharmacokinetic study expected in the first half of fiscal 2003

Highlights Subsequent to End of Quarter

Completed enrolment for Phase III Tramadol study in Europe

- Enrolment completed ahead of schedule
- Multi-centre, pan-European study to assess the efficacy and safety of controlled-release Tramadol
- Company remains on track to file new drug registration dossier in Europe in fourth quarter of this fiscal year

Signed Letter of Intent with Axcan Pharma to execute global licensing agreement for the commercialization of trimebutine maleate (MODULON®)

- Formalized existing agreement with Axcan Pharma
- Licensing agreement will cover U.S., Europe and other international markets
- Partnership with Axcan Pharma represents larger opportunity than originally expected

Signed Letter of Intent with MedPointe Inc. to execute formulation and licensing agreement to develop novel, sustained-release products

- Consistent with strategy to add large market opportunity products to portfolio
- Expands pipeline to eight products, five of which are partnered programs
- Feasibility and formulation studies expected to begin immediately

Dr. Damon Smith appointed as Vice-President, Research and Development

- More than 12 years experience directing research programs for growth-oriented pharmaceutical development companies
- Has successfully taken three products from development through to commercialization

Consolidated statements of loss

(Thousands of dollars except for per share data and number of shares)

For periods of:	3 months ended May 31	
	(Unaudited)	
	2002	2001
	\$	\$
Operating revenue		
Research and development contracts	27.2	—
Investment income	345.5	185.1
	<u>372.7</u>	<u>185.1</u>
Operating expenses		
Research and development expenses (Note 3)	2,713.7	733.8
Selling and administrative expenses	1,193.7	685.2
Finance charges	3.4	2.8
	<u>3,910.8</u>	<u>1,421.8</u>
Net loss	(3,538.1)	(1,236.7)
Net loss per share*	(0.1142)	(0.0511)
* Weighted average number of shares outstanding	30,995,217	24,210,851
Amortization for the period is:	122.1	76.4

Consolidated statements of cash flows

(Thousands of dollars)

For periods of:	3 months ended May 31	
	(Unaudited)	
	2002	2001
	\$	\$
Operating activities		
Net loss	(3,538.1)	(1,236.7)
Items not affecting cash		
Amortization	122.1	76.4
	<u>(3,416.0)</u>	<u>(1,160.3)</u>
Net change in non-cash working capital items	853.6	230.6
	<u>(2,562.5)</u>	<u>(929.7)</u>
Investing activities		
Acquisition of investments	(3,340.4)	—
Proceeds of investments	4,796.2	893.7
Acquisition of capital assets	(472.6)	(183.6)
	<u>983.2</u>	<u>710.1</u>
Financing activities		
Reimbursement of capital lease obligations	(30.4)	(1.5)
Proceeds from issuance of capital stock	414.4	22.0
Issue costs of capital stock	—	(7.5)
	<u>384.1</u>	<u>13.0</u>
Increase (decrease) in cash	(1,195.2)	(206.6)
Cash, beginning of year	1,370.9	257.1
Cash, end of year	<u>175.7</u>	<u>50.5</u>

Consolidated Balance sheets

(Thousands of dollars)

	May 31, 2002 (Unaudited)	February 28, 2002 (Audited)
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	175.7	2,264.1
Temporary investments	25,252.8	22,554.4
Accounts receivable	781.7	727.4
Research and development tax credits receivable	1,441.1	1,298.8
Prepaid expenses	160.8	169.1
	<u>27,812.1</u>	<u>27,013.8</u>
Capital assets	3,082.4	2,732.0
Investments	16,288.8	20,442.6
Future income taxes	176.2	176.2
	<u>47,359.5</u>	<u>50,364.6</u>
Liabilities		
Current liabilities		
Cheques issued in excess of bank deposits	–	893.2
Accounts payable and accrued liabilities	2,468.4	1,426.2
Current portion of obligations under capital leases	42.6	64.4
	<u>2,511.0</u>	<u>2,383.8</u>
Obligations under capital leases	11.5	20.1
	<u>2,522.5</u>	<u>2,403.9</u>
Shareholders' equity		
Capital stock (Note 3)	87,953.6	87,539.2
Deficit	(43,116.6)	(39,578.5)
	<u>44,837.0</u>	<u>47,960.7</u>
	<u>47,359.5</u>	<u>50,364.6</u>

Consolidated statements of deficit

(Thousands of dollars)

For periods of	3 months ended May 31	
	(Unaudited)	
	2002	2001
	\$	\$
Balance, beginning of year	(39,578.5)	(28,088.6)
Issue costs of capital stock	–	(7.5)
Net loss	(3,538.1)	(1,236.7)
Balance, end of year	<u>(43,116.6)</u>	<u>(29,332.8)</u>

1. Basis of presentation

Information with respect to the February 28, 2002 balance sheet is derived from the Company's annual financial statements. These interim financial statements should be read in conjunction with the Company's annual financial statements for the year ended February 28, 2002. These financial statements have been prepared using the same accounting principles used in the audited financial statements for the year ended February 28, 2002, except for the changes in accounting policies described in note 2.

2. Changes in accounting policies

i) 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 will not result 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 will have additional disclosure requirements relating to its intangible assets.

ii) 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 has chosen to recognize no compensation 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 will be accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of direct awards of stock are to be determined based on the quoted market price of the Company's stock and the fair value of stock options are to be determined as if the Company had accounted for its employee stock options granted after February 28, 2002 under the fair value method. The fair value of these options is to be estimated at the date of grant using a Black-Scholes Option Pricing Model. A non-material number of options was granted during the first quarter and the fair value of these options will be disclosed in the proforma net loss with the second quarter results.

3. Research and development expenses

Research and development expenses are presented net of tax credits of \$142,282 and \$124,142 for the periods ended May 31, 2002 and 2001 respectively.

4. 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: 31,030,981 common shares (February 28, 2002 – 30,908,681)

During the period ending May 31, 2002, 122,300 options were exercised for \$414,414 cash.

5. Comparative figures

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

Officers

Donald Buxton

Chairman of the Board

Allan Mandelzys, PhD, MBA

Vice-President, Business Development

James R. Howard-Tripp

President and Chief Executive Officer

Damon Smith, PhD**

Vice-President, Research and Development

Sylvie Bouchard, MD, PhD

Vice-President, Clinical Development

Warren Whitehead, CMA

Chief Financial Officer

Vincent Lenaerts, PhD*

Chief Scientific Officer,

Vice-President, Research and Development

Me Lisane Dostie, LLB

Director, Corporate Affairs and Secretary

* V. Lenaerts left the Company in July 2002

**D. Smith was appointed Vice-President in July 2002

Investor Relations

James R. Howard-Tripp

President and Chief Executive Officer

Warren Whitehead, CMA

Chief Financial Officer

Vincent Lavigne

Director, Communications and Investor Relations

Stock Exchange Listing

Toronto Stock Exchange

Trading Symbol: DDS