



Labopharm

Q3

Quarterly Report
Third 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

In recent months, we have made solid progress toward our goal of becoming a fully integrated specialty pharmaceutical company, achieving a number of important milestones across our product development pipeline, expanding our product portfolio and building our infrastructure. Most notably, we made significant progress in moving our lead in-house product, once-daily Tramadol, closer to global commercialization, including completing the clinical stage of our Phase III trial in Europe, securing our first European marketing partner, and initiating Phase III clinical trials in the U.S. As planned, we expanded our pipeline to nine products with the addition of a new in-house candidate.

Once-Daily Tramadol Program On Track For First Commercial Launch By Year End

During the quarter, we secured our first marketing partner for once-daily Tramadol – Aventis France, which will have the exclusive right to market and sell once-daily Tramadol in France and French dependencies. Discussions are ongoing with other potential partners in Europe, the United States and around the world, and we look forward to reporting additional agreements in the short-term.

We remain on track to file our new drug registration dossier in Europe by the close of the current quarter – ending March 31 of this year – with France acting as the reference member state. Approval in France will facilitate subsequent approval in the other fifteen European Union member states through the mutual recognition laws. To reiterate the prospective timeline for the launch of once-daily Tramadol, we expect the approval process in France to take six to seven months from the date we file the registration dossier. Approval in the other European countries is anticipated approximately six months after French approval. As a result, once-daily Tramadol could be on the market in France as early as the end of calendar 2003.

In our parallel U.S. development program for once-daily Tramadol, we recently announced that we have initiated two Phase III clinical trials in that country to evaluate the efficacy of our drug. The results of these trials, together with the data from our European studies, will form our New Drug Application filing to the U.S. Food and Drug Administration, which we expect by the end of the year. Currently, Tramadol, which generates sales in the U.S. in excess of \$700 million, is available in the U.S. only in immediate-release formulations that require dosing four to six times daily.

Key Development Programs Moving Forward

We continued to advance our program to develop once-daily formulations of Aventis' flagship product, Allegra-D[®], initiating a pilot pharmacokinetic study. The study is scheduled for completion during the first quarter of calendar 2003. The once-daily Allegra-D[®] program remains on schedule and we continue to target an NDA for this drug before the end of 2003.

We also initiated a pilot pharmacokinetic study in our program to develop a controlled-release formulation of MODULON[®], Axcan Pharma's branded version of trimebutine maleate for irritable bowel syndrome. The study is scheduled for completion in the first quarter of calendar 2003.

Following on the Letter of Intent we signed with MedPointe in July of last year, we completed the feasibility study for the first product being developed under our partnership, DDS-2001. We have now initiated the formulation work for this product, which we expect to complete in the first half of this calendar year.

In addition to advancing our existing programs during the quarter, we expanded our pipeline to nine products with the initiation of a new, in-house development program for a product that we are referring to as DDS-2003. We have already begun feasibility and formulation on this new product, which represents a potential market opportunity in excess of \$1 billion.

As we expand our portfolio of products, we are also expanding our infrastructure and resources accordingly. Over the last eight months, we have continued to build our scientific team, doubling our laboratory staff. Construction began on our new leased facilities, which will house our corporate offices, as well as state-of-the-art laboratories and a GMP-grade pilot manufacturing plant. These two initiatives will ensure the capacity to develop an expanded number of products, more efficiently, and more economically.

Corporate Developments

Effective December 31, 2002, we changed our fiscal year-end to December 31, from February 28. As a result, the 10-month period from March 1, 2002 to December 31, 2002 becomes a truncated transition year for which we will prepare annual financial statements. We believe the change in fiscal year-end will better enable our shareholders and the investment community to track our progress going forward.

On Track to Deliver

As we begin our new fiscal year, we anticipate that this will be our most exciting and eventful yet. Our once-daily Tramadol program is scheduled to see registration filings in both Europe and the United States, followed by the launch of our product in France. Furthermore, we could file as many as two additional NDAs during the year as we rapidly move our other late-stage products towards market. At the same time, we will continue to aggressively advance our other programs towards commercialization, while identifying and evaluating new high potential, large market products to further expand our portfolio.

Moving forward, we remain firmly focused on achieving our goal of becoming a fully integrated, international specialty pharmaceutical company. We continue to execute on our business plan, building the product pipeline, the team and the infrastructure to continue our pattern of solid growth that will build value for our shareholders.



James R. Howard-Tripp
President and CEO
January 14, 2003



Highlights

Highlights of the Quarter

Treatment phase of European Phase III study for once-daily Tramadol completed ahead of schedule

- Planned filing of new drug registration dossier in Europe firmly on track

Secured marketing agreement for once-daily Tramadol for France with Aventis France SA

- Aventis France will have exclusive rights to market and sell once-daily Tramadol in France and related dependencies
- Labopharm will supply Aventis France with finished, packaged product through Labopharm Europe Limited
- France expected to act as reference member state (RMS), with approval in France enabling rapid acceptance across the European Union through the “mutual recognition” laws
- Labopharm is actively engaged in discussions with potential marketing partners for other jurisdictions in Europe, the United States, and globally

Controlled-Release Allegra-D® program continues to remain on track

- Labopharm initiated pilot pharmacokinetic study
- Completion of study scheduled for first quarter of calendar 2003

Once-Daily MODULON® program continues to advance

- Labopharm initiated pilot pharmacokinetic study
- Completion of study scheduled for first quarter of calendar 2003

Construction began on Labopharm's new corporate headquarters

- Located in the heart of Laval's biopharmaceutical industry
- Labopharm will lease facility from SITQ under a 15-year lease
- Will house corporate offices, state-of-the-art laboratories and GMP-grade pilot manufacturing plant and allow development of an expanded number of products more efficiently and economically

Highlights Subsequent to Quarter End

Phase III clinical trials for once-daily Tramadol in the U.S. initiated

- Will evaluate efficacy in pain reduction
- Completion expected towards end of calendar 2003
- With European data, will support U.S. New Drug Application (NDA) filing expected in calendar 2003



Management's Discussion and Analysis

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 biotech and pharma 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 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 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.

Product Development

The third quarter was marked by continued strong progress across Labopharm's development pipeline, highlighted by advancement of the Company's lead in-house product, a once-daily version of the analgesic Tramadol hydrochloride, towards global commercialization. The Company also added a new product to its portfolio, which it will develop in-house, bringing the number of products under development to nine.

In-house Projects

During the third quarter, Labopharm completed the treatment phase of the European Phase III study for its once-daily formulation of Tramadol, ahead of schedule. Labopharm expects to file a new drug registration dossier in Europe for once-daily Tramadol by the end of the first quarter of calendar 2003, with France expected to act as the reference member state (RMS). Approval in France would permit the Company to capitalize on the “mutual recognition” laws, enabling rapid acceptance across the European Union.

The European Phase III study to assess the efficacy and safety of once-daily Tramadol is part of the Company’s global regulatory strategy for the drug. This strategy involves conducting pharmacokinetic and efficacy studies in both Europe and the United States to more rapidly move Tramadol through regulatory filings and commercialization in key global markets.

During the quarter, Labopharm secured a marketing agreement for France with Aventis France SA 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.

In the U.S., Labopharm initiated two double blind, multi-centre, randomized Phase III studies to evaluate the efficacy of once-daily Tramadol in reducing moderate to moderately severe pain in patients suffering from osteoarthritis. The Company expects the trials to be completed towards the end of calendar 2003 with the results, supplemented by data from the European program, forming the U.S. New Drug Application (NDA) filing, which the Company anticipates by the end of calendar 2003.

Labopharm expanded its portfolio of in-house products with the addition of a product referred to as DDS-2003. DDS-2003 has global market potential in excess of one billion dollars. Labopharm believes it can apply its controlled-release technology to DDS-2003 to improve its release profile. During the quarter, Labopharm initiated feasibility and formulation for DDS-2003.

Partnership Projects

During the third quarter, pilot pharmacokinetic studies were initiated for two of the Company's partnered product programs, Axcan Pharma's trimebutine maleate (MODULON®) and Aventis' Allegra-D®, with clinical batches produced for both programs. Results of the pharmacokinetic studies are expected during the first quarter of calendar 2003.

Also during the third quarter, Labopharm completed the feasibility studies for DDS-2001, the first product under development under the Letter of Intent (LOI) with MedPointe Inc. Labopharm has initiated formulation for this product, which it expects to complete in the first half of calendar 2003.

New Facility

During the quarter, 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 us 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 by Spring 2003.

Change in Fiscal Year-End

Labopharm received regulatory approval to change its fiscal year-end to December 31 from February 28, effective December 31, 2002. As a result, the 10-month period from March 1, 2002 to December 31, 2002 will become a transition year, for which annual financial statements will be prepared. The change in fiscal year-end is intended to better enable investors and the financial community to track the Company's progress.

New Subsidiary

Subsequent to quarter end, Labopharm established a wholly owned subsidiary in Barbados. 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.

Operating Revenue

For the third quarter ended November 30, 2002, revenue was \$1,007,500 compared to \$751,900 for the same period last year. Revenue for the nine-month period ending November 30, 2002 was \$1,817,000 compared to \$1,161,800 for fiscal 2002.

For the quarter, research and development contracts accounted for \$701,000 of total revenue compared to \$561,000 for the corresponding quarter last year. Research and development contract revenue for the current quarter included revenue associated with the completion of the feasibility study under the Company's Letter of Intent with MedPointe Inc., as well as payments from Aventis for clinical batches of the Allegra-D[®] formulation for pharmacokinetic studies. For the nine-month period, research and development contracts accounted for \$839,700 of total revenue compared to \$619,100 for the same period last year.

Investment income for the quarter was \$306,500 compared to \$190,900 for the same period last year. For the nine-month period, investment income was \$977,300 compared to \$542,700 for the same period in fiscal 2002. The increases in investment income are a result of the increase in investments due to gross proceeds of \$40,365,000 from the equity financing concluded in November 2001.

Research and Development Expenses

Research and development expenses (net of tax credits) for the third quarter of fiscal 2003 were \$3,718,400 compared to \$1,451,800 for the same period last year. Research and development expenses (net of tax credits) for the first nine months of fiscal 2003 were \$8,867,400 compared to \$3,576,500 for the same period last year. The increases primarily reflect costs associated with the Phase III clinical trials for Tramadol, including manufacturing costs of clinical trial material.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of fiscal 2003 were \$1,488,400 compared to \$985,700 for the same period last year. For the first nine months of fiscal 2003, selling, general and administrative expenses were \$4,167,300 compared to \$2,637,600 for the same period last year. The increases reflect costs related to the creation of Labopharm's subsidiary in Ireland, Labopharm Europe Limited, as well as costs associated with the general increase in the activities of the Company, such as tax planning initiatives, corporate affairs, public relations, insurance, amortization of intellectual property, and the increase in personnel.

Net Loss

Net loss for the third quarter of fiscal 2003 was \$4.2 million, or \$0.14 per share, compared to \$1.7 million, or \$0.07 per share, for the same period last year. For the first nine months of fiscal 2003, net loss was \$11.2 million, or \$0.36 per share, compared to \$5.1 million, or \$0.20 per share, for the first nine months of last year. The increases reflect the intensification of clinical trials associated with advancing Tramadol to a later stage of development and general costs that vary accordingly, as well as the efforts by the Company to identify new products to expand its portfolio.

Cash Position

Cash and investments at the end of the third quarter were \$32.8 million compared to \$45.3 million at the end of fiscal 2002. Labopharm completed an equity financing in November 2001 that generated gross proceeds of \$40.4 million.

Consolidated statements of loss

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

For periods of:	3 months ended November 30 (Unaudited)		9 months ended November 30 (Unaudited)	
	2002	2001	2002	2001
	\$	\$	\$	\$
Operating revenue				
Research and development contracts	701.0	561.0	839.7	619.1
Investment income	306.5	190.9	977.3	542.7
	<u>1,007.5</u>	<u>751.9</u>	<u>1,817.0</u>	<u>1,161.8</u>
Operating expenses				
Research and development expenses (Note 3)	3,718.4	1,451.8	8,867.4	3,576.5
Selling and administrative expenses	1,488.4	985.7	4,167.3	2,637.6
Finance charges	12.9	2.7	24.4	8.0
	<u>5,219.7</u>	<u>2,440.2</u>	<u>13,059.1</u>	<u>6,222.1</u>
Net loss	(4,212.2)	(1,688.3)	(11,242.1)	(5,060.3)
Basic and diluted loss per share*	(0.1356)	(0.0654)	(0.3624)	(0.2043)
* Weighted average number of common shares outstanding	31,055,145	25,803,717	31,025,175	24,767,025

Consolidated statements of cash flows

(Thousands of dollars)

For periods of:	3 months ended November 30 (Unaudited)		9 months ended November 30 (Unaudited)	
	2002	2001	2002	2001
	\$	\$	\$	\$
Operating activities				
Net loss	(4,212.2)	(1,688.3)	(11,242.1)	(5,060.3)
Items not affecting cash				
Depreciation of capital assets	131.9	77.6	336.1	225.5
Amortization of intangible assets	25.2	6.2	75.5	18.7
	<u>(4,055.1)</u>	<u>(1,604.5)</u>	<u>(10,830.5)</u>	<u>(4,816.1)</u>
Net change in non-cash working capital items	262.2	(201.7)	242.1	107.4
	<u>(3,792.9)</u>	<u>(1,806.2)</u>	<u>(10,588.4)</u>	<u>(4,708.7)</u>
Investing activities				
Acquisition of investments	(7,589.3)	(36,641.5)	(20,506.9)	(36,641.5)
Disposal of investments	10,319.6	1,150.8	31,568.6	3,878.0
Acquisition of capital assets	(604.4)	(118.9)	(1,074.6)	(375.9)
Acquisition of intangible assets	(64.7)	(131.6)	(324.6)	(265.7)
	<u>2,061.2</u>	<u>(35,741.2)</u>	<u>9,662.5</u>	<u>(33,405.1)</u>
Financing activities				
Reimbursement of capital leases obligations	(16.1)	(1.5)	(62.5)	(4.5)
Proceeds from issuance of capital stock	37.9	41,145.0	475.2	41,666.1
Issuance costs of capital stock	(1.6)	(1,939.1)	(3.4)	(1,946.7)
	<u>20.2</u>	<u>39,204.4</u>	<u>409.3</u>	<u>39,714.9</u>
Increase (decrease) in cash and cash equivalents	(1,711.5)	1,657.0	(516.6)	1,601.1
Cash, beginning of period	2,565.8	201.2	1,370.9	257.1
Cash, end of period	<u>854.3</u>	<u>1,858.2</u>	<u>854.3</u>	<u>1,858.2</u>

Consolidated balance sheets

(Thousands of dollars)

	As at Nov. 30 (Unaudited)	As at Feb. 28 (Audited)
	2002	2002
	\$	\$
Assets		
Current assets		
Cash	854.3	2,264.1
Temporary investments	15,713.2	22,554.4
Accounts receivable	1,510.5	727.4
Tax credits receivable on research and development	1,251.3	1,298.8
Prepaid expenses	67.4	169.1
	<u>19,396.7</u>	<u>27,013.8</u>
Capital assets	1,960.0	1,221.5
Intangible assets	1,759.6	1,510.5
Investments	16,222.1	20,442.6
Future income taxes	176.2	176.2
	<u>39,514.6</u>	<u>50,364.6</u>
Liabilities		
Current liabilities		
Cheques issued in excess of bank deposits	–	893.2
Accounts payable and accrued liabilities	2,146.2	1,426.2
Deferred revenue	156.0	–
Current portion of obligations under capital leases	7.8	64.4
	<u>2,310.0</u>	<u>2,383.8</u>
Obligations under capital leases	14.2	20.1
	<u>2,324.2</u>	<u>2,403.9</u>
Shareholders' equity		
Capital stock (Note 4)	88,014.4	87,539.2
Deficit	<u>(50,824.0)</u>	<u>(39,578.5)</u>
	<u>37,190.4</u>	<u>47,960.7</u>
	<u>39,514.6</u>	<u>50,364.6</u>

Consolidated statements of deficit

(Thousands of dollars)

For periods of:	9 months ended November 30 (Unaudited)	
	2002	2001
	\$	\$
Balance, beginning of period	(39,578.5)	(28,088.6)
Issuance costs of capital stock	(3.4)	(1,946.7)
Net loss	<u>(11,242.1)</u>	<u>(5,060.3)</u>
Balance, end of period	<u>(50,824.0)</u>	<u>(35,095.6)</u>

1. Basis of presentation

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles (GAAP) in Canada for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements and should be read in conjunction with the audited consolidated financial statements for the year ended February 28, 2002.

The consolidated balance sheet as of February 28, 2002 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by GAAP for annual financial statements.

The accounting policies and methods followed in preparation of these interim consolidated financial statements are the same as those used in the audited financial statements for the year ended February 28, 2002, except as 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 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.

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 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. The adoption of these new recommendations did not have an impact on the Company's financial position or results of operations for the period. However, the Company has additional disclosure requirements (see Note 5).

3. Research and development expenses

Research and development expenses are presented net of tax credits of \$754,299 and \$527,347 for the nine months ended November 30, 2002 and 2001.

4. Capital stock

Authorized

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

Unlimited number of common shares, without par value

Issued: 31,058,081 common shares (February 28, 2002 - 30,908,681)

5. Stock-based compensation

On July 3, 2002, the maximum number of shares to be issued pursuant to the Company's stock option plan was increased to 4,650,000. As at November 30, 2002, 2,903,900 options were outstanding compared to 2,865,800 as at February 28, 2002. During the nine months ended November 30, 2002, 367,000 options were granted, 149,400 options were exercised and 179,500 options were cancelled.

No compensation cost has been recognized for stock options granted to employees and directors during the nine months ended November 30, 2002. The fair value of these options was estimated at the date of granting using a Black-Scholes option pricing model with the following assumptions for 2002 : expected volatility of 0.81; a 3.50% risk-free interest rate; and expected lives of 2.8 years. The weighted average grant date fair value of options granted during this period amounted to \$1.56 per option.

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 common share would have been amended as follows:

		Three months ended November 30, 2002	Nine months ended November 30, 2002
Net loss	As reported	\$(4,212,182)	\$(11,242,128)
	Pro forma	(4,343,042)	(11,664,045)
Loss per share	As reported	\$(0.1356)	\$(0.3624)
Basic and diluted	Pro forma	(0.1398)	(0.3760)

6. Comparative figures

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

Officers

Donald Buxton

Chairman of the Board

James R. Howard-Tripp

President and Chief Executive Officer

Sylvie Bouchard, MD, PhD

Vice-President, Clinical Development

Me Lisane Dostie, LLB

General Counsel and Corporate Secretary

Allan Mandelzys, PhD, MBA

Vice-President, Business Development

Damon Smith, PhD

Vice-President, Research and Development

Warren Whitehead, CMA

Chief Financial Officer

Investor Relations

James R. Howard-Tripp

President and Chief Executive Officer

Warren Whitehead, CMA

Chief Financial Officer

Stock Exchange Listing

Toronto Stock Exchange

Trading Symbol: DDS