

MANAGEMENT'S REPORT

The accompanying consolidated financial statements of Cangene Corporation are the responsibility of management and have been approved by the Board of Directors. The financial statements necessarily include some amounts that are based on management's best estimates, which have been made using careful judgment. Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles. Financing and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

In fulfilling its responsibilities, management of Cangene Corporation maintains internal accounting controls. While no system will prevent or detect all errors or irregularities, the controls are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded, and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility with respect to the consolidated financial statements primarily through its Audit Committee. The Audit Committee meets periodically with management and the external auditors to discuss the annual audit, accounting policies and practices, and other financial reporting matters.

The most recent financial statements have been audited by Ernst & Young LLP, Chartered Accountants, who have full access to the Audit Committee, with and without the presence of management. Their report follows hereafter.

(signed)

John Langstaff,
President and CEO

(signed)

Michael Graham,
Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of Cangene Corporation

We have audited the consolidated balance sheets of **Cangene Corporation** as at July 31, 2007 and 2006 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at July 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed)

Ernst & Young LLP
Chartered Accountants
Winnipeg, Canada
September 28, 2007 [except as to note 20[b],
which is as of October 2, 2007]

As at July 31

in thousands of Canadian dollars

	2007	2006
Assets [notes 6 and 7]		
Current		
Cash	\$ —	\$ 7,691
Accounts receivable [note 18]	20,475	26,956
Income and other taxes recoverable	16,144	3,291
Inventories [note 3]	60,753	27,170
Prepaid expenses and deposits	3,105	2,640
Total current assets	100,477	67,748
Property, plant and equipment, net [notes 4 and 13]	103,571	105,392
Future income taxes [note 8]	9,373	9,941
Goodwill [note 5]	40,514	40,514
Other assets	2,815	1,559
	\$ 256,750	\$ 225,154
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness [note 6]	\$ 2,136	\$ —
Accounts payable and accrued liabilities	23,140	16,009
Income and other taxes payable	450	—
Current portion of deferred income	3,623	4,532
Current portion of long-term debt [note 7]	1,636	5,674
Total current liabilities	30,985	26,215
Long-term debt [note 7]	1,112	26,854
Incentive plan liability [note 10[a]]	226	760
Deferred income	2,931	3,770
Future income taxes [note 8]	10,831	1,618
Total liabilities	46,085	59,217
Commitments [notes 16, 17 and 18]		
Shareholders' equity		
Share capital [note 9]	66,894	32,250
Contributed surplus	3,239	3,239
Cumulative translation adjustment	(4,467)	(4,467)
Retained earnings	144,999	134,915
Total shareholders' equity	210,665	165,937
	\$ 256,750	\$ 225,154

See accompanying notes

On behalf of the Board:

(signed)

John Langstaff
Director

(signed)

J. Robert Lavery
Director

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Years ended July 31

in thousands of Canadian dollars except share-related data

	2007	2006
Revenues [note 18]		
Product sales and services	\$ 58,844	\$ 68,899
R&D services [note 12]	25,281	33,925
Royalties	8,271	6,512
	92,396	109,336
Cost of sales		
Product sales and services	27,021	40,637
R&D services [notes 12 and 13]	15,370	20,278
	42,391	60,915
Gross profit	50,005	48,421
Expenses		
Independent R&D [notes 12 and 13]	6,709	4,674
Selling, general and administrative	12,957	12,763
Amortization	10,314	9,188
Interest		
Short-term [note 6]	(471)	433
Long-term [note 7]	259	175
Gain on sale of building [note 19]	—	(739)
Foreign exchange loss (gain)	1,484	(720)
	31,252	25,774
Income before income taxes	18,753	22,647
Income tax expense [note 8]		
Current	1,910	9,338
Future	6,759	166
	8,669	9,504
Net income for the year	10,084	13,143
Retained earnings, beginning of year	134,915	121,772
Retained earnings, end of year	\$ 144,999	\$ 134,915
Earnings per share [note 11]		
Basic and diluted	\$ 0.15	\$ 0.20

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended July 31

in thousands of Canadian dollars

	2007	2006
Operating Activities		
Net income for the year	\$ 10,084	\$ 13,143
Add (deduct) items not involving cash		
Amortization	10,314	9,188
Deferred income	(1,748)	(538)
Net investment tax credits <i>[note 14[b]]</i>	(9,122)	(532)
Incentive plan liability	(534)	760
Future income tax expense	6,759	166
Gain on disposal of building <i>[note 19]</i>	—	(739)
Unrealized foreign exchange loss on future income tax asset	568	929
	16,321	22,377
Net change in non-cash working capital balances related to operations <i>[note 14[a]]</i>	(21,558)	1,016
Cash provided by (used in) operating activities	(5,237)	23,393
Investing Activities		
Purchase of property, plant and equipment	(9,454)	(29,922)
Proceeds on disposal of building <i>[note 19]</i>	—	1,867
Cash used in investing activities	(9,454)	(28,055)
Financing Activities		
Increase (decrease) in bank indebtedness, net	2,136	(12,172)
Issuance of long-term debt	—	24,000
Repayment of long-term debt	(29,780)	(2,579)
Issuance of common shares, net of share issuance costs <i>[note 9[a]]</i>	33,501	—
Proceeds on exercise of stock options <i>[note 9[a]]</i>	1,143	3,104
Cash provided by financing activities	7,000	12,353
Net increase (decrease) in cash during the year	(7,691)	7,691
Cash, beginning of year	7,691	—
Cash, end of year	\$ —	\$ 7,691
Interest paid	\$ 563	\$ 1,657
Income taxes received	\$ (160)	\$ (2,938)

See accompanying notes

July 31, 2007 and 2006

1. Description of Business

Cangene Corporation (“the Corporation” or “Cangene”) is a biopharmaceutical company in the business of developing, manufacturing, and commercializing products and technologies for global markets. Revenues are generated by product sales, contract manufacturing, contract research and development, and royalties. The Corporation manages its business and evaluates performance based on two operating segments: biopharmaceutical operations and contract services.

Cangene has two different categories of products in development: hyperimmune products, which are concentrated specialty antibody preparations made from plasma; and recombinant biopharmaceuticals, which are therapeutic proteins made by introducing a particular gene into a host organism, which in turn produces the protein of interest.

The Apotex Group (“Apotex”) is Cangene’s majority shareholder and holds 61% of Cangene’s common stock. The Apotex Group includes Apotex Holdings Inc., Apotex Inc., Apotex Research Inc., Apotex Corp. and other subsidiaries, and Sherman Foundation, a related charitable foundation.

2. Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applied on a consistent basis. The significant accounting policies are summarized below:

Consolidation

These financial statements consolidate the accounts of Cangene Corporation and its wholly owned subsidiaries, Cangene U.S. Incorporated, Chesapeake Biological Laboratories, Inc. (“Chesapeake”), Biotherapeutic Laboratories, Inc. and Mid-Florida Biologicals, Inc.

Use of estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from these estimates.

Inventories

Inventories are valued at the lower of average cost and net realizable value. Cost for work-in-process and finished-goods inventories includes materials, direct labour and an allocation of overhead.

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of investment tax credits and impairment. Design, construction, installation and interest costs related to assets under construction, including all costs for preparing a facility for its intended use, are recorded as construction in progress and are not subject to amortization until the asset is placed into service. Management assesses the carrying value of all property, plant and equipment, using its best estimate of undiscounted future cash flows, whenever conditions arise that could indicate a possible impairment. Any impairment is recognized as a reduction in cost when identified, and the asset is written down to estimated fair value. Amortization is provided on a straight-line basis over the following periods based on the estimated useful lives of the assets:

Buildings	25–30 years
Building improvements	3–25 years
Equipment, furniture and fixtures	5–10 years
Computer systems	3–5 years
Leasehold improvements	Term of lease

Goodwill

Goodwill represents the difference between the purchase price, including acquisition costs, of businesses acquired and the fair value of the identifiable net assets acquired. Goodwill is not amortized, but rather is subject to at least annual impairment tests by comparing the fair value of the Corporation’s reporting units to their respective carrying value. Any impairment in carrying value is recognized when it is identified.

Income taxes

Income taxes are provided for using the liability method. Under this method, future tax assets and liabilities are recognized for the difference between the financial statement and income tax bases of assets or liabilities, and for operating losses and tax credit carryforwards. Future tax assets or liabilities are measured using the substantively enacted tax rates anticipated to be in effect when these assets and liabilities are expected to be realized or settled. A valuation allowance is provided for the portion of future tax assets that is more likely than not to remain unrealized. The Corporation is required to make significant estimates and assumptions regarding future taxable income in order to assess the likelihood of tax asset utilization.

Foreign currency translation

Assets and liabilities in foreign currencies related to domestic and integrated foreign operations are translated into Canadian dollars using current exchange rates at the consolidated balance sheet dates for monetary assets and liabilities, historical exchange rates for non-monetary assets

Significant Accounting Policies *continued*

and liabilities, and the average monthly exchange rate for revenues and expenses, except for amortization, which is translated at the historical exchange rate of the corresponding non-monetary assets. Exchange gains and losses arising on translation are included in income in the period incurred.

The cumulative translation adjustment comprises unrealized translation adjustments that arose on the translation of assets and liabilities of the Corporation's previously self-sustaining foreign operation to Canadian dollars and on the translation of related foreign currency debt designated as a hedge of the net investment in Chesapeake to April 30, 2004, that being the date that Chesapeake was determined to be an integrated foreign operation.

Revenue recognition

The Corporation recognizes revenue from product sales, net of trade discounts and allowances, when persuasive evidence of an agreement exists, delivery has occurred, price is fixed or determinable and ultimate collection is reasonably assured.

The Corporation has agreements with distributors for the marketing and distribution of its WinRho[®] SDF, HepaGam B[™] and VariZIG[™] products. The Corporation's share of the revenue from sales of these products by the distributors is recognized by the Corporation upon shipment by the distributors from their warehouses to wholesalers or customers.

The Corporation's distributors estimate allowances for revenue dilution items using a combination of information received from third parties, including market data, inventory reports from major wholesalers, historical information and analyses that they perform. Their estimates are subject to the inherent limitations of estimates that rely on third-party data, as certain third-party information may itself rely on estimates and reflect other limitations. Provisions for estimated rebates, and other allowances such as discounts, and promotional and other credits are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and contract terms, and actual discounts offered. Management believes that such provisions are determinable due to the limited number of assumptions involved and the consistency of historical experience. Provisions for chargebacks involve more subjective judgments and are more complex in nature.

The provision for chargebacks is a significant and complex estimate used in the recognition of revenue and is calculated by the distributors. The Corporation's distributors market products directly to wholesalers and indirectly to group purchasing organizations, physician practice management groups and hospitals, collectively referred to as "indirect

customers". The distributors enter into agreements with indirect customers to establish contract pricing for products. The indirect customers then purchase the products from wholesalers at these contracted prices. Under this arrangement, the Corporation's distributors provide credit to the wholesaler for any difference between the contracted price with the indirect party and the wholesaler's invoice price. Such credit is called a chargeback. The distributors estimate the provision for chargebacks based upon historical chargeback experience and estimated wholesaler inventory levels, as well as expected sell-through levels by their wholesale customers to indirect customers. Their estimates of inventory at wholesale customers and in the distribution channels are subject to the inherent limitations of estimates that rely on third-party data. The Corporation receives regular reports from distributors, and continually assesses the reasonability of chargebacks and evaluates the estimates as new information becomes available. Adjustments to these provisions are made periodically to reflect new facts and circumstances that may indicate that historical experience may not be indicative of current and/or future results. In consultation with its distributors, the Corporation makes subjective judgments based primarily on its evaluation of current market conditions and trade inventory levels related to the products. This evaluation may result in an increase or decrease in the experience rate that is applied to current and future sales, or as an adjustment to past sales or both.

Revenue under contract-manufacturing agreements is for commercial manufacturing and development services. Revenue is recognized when goods are shipped or services are provided in accordance with the terms of the related agreements.

Revenue from research contracts is recognized when the related costs are incurred and includes amounts received in respect of equipment used for research, which is recorded as deferred income when received and recognized over the useful life of the related asset.

The Corporation has certain collaborative agreements with third parties that may include multiple deliverables. A delivered item should be accounted for as a separate unit of accounting when:

- a) the delivered item(s) has stand-alone value to the customer,
- b) there is objective and reliable evidence of the fair value of the remaining undelivered item(s),
- c) the arrangement includes a general right of return relative to the delivered item(s) and delivery or performance of the undelivered item(s) is considered probable and substantially in control of the vendor.

Revenues associated with multiple-deliverable arrangements are attributed to the various deliverables based on their relative fair value. Where a deliverable does not qualify as a separate unit of accounting, revenue attributed to the delivered item(s) is combined with revenue attributed to undelivered items within the arrangement.

Payments received under collaborative arrangements may include non-refundable up-front fees, funding for services performed and milestone payments for specific achievements. Non-refundable up-front fees are deferred and amortized into income on a systematic basis over the appropriate elements within the agreements. Non-refundable milestone payments are recognized into income upon the achievement of the specified milestones when the Corporation has no further involvement or obligation to perform related to that specific element of the arrangement. Milestone payments received that require the ongoing involvement of the Corporation are recorded as deferred income and amortized over the period of ongoing involvement.

Royalty revenue is recorded when the amount of the royalty fee is earned and determinable, and collection is reasonably assured.

Research and development expenses

Research expenses are charged to income in the year they are incurred, net of related tax credits. Development costs are charged to operations in the period of the expenditure unless a development project meets the criteria under Canadian generally accepted accounting principles for deferral and amortization.

Government assistance

Government assistance in connection with research activities is recognized as an expense reduction in the year that the related expenditure is incurred. Government assistance in connection with capital expenditures is treated as a reduction of the cost of the applicable asset.

Federal and provincial investment tax credits are accounted for as a reduction of the cost of the related assets or expenditures in the year in which the credits are earned and when there is reasonable assurance that the credits can be used to recover taxes.

Earnings per share

The calculation of earnings per share is based on net income divided by the weighted-average number of common shares outstanding during the year. Diluted earnings per share reflects the assumed conversion of all dilutive securities using the treasury stock method. Under the treasury stock method, the weighted-average number of common shares

outstanding is calculated assuming that the proceeds from the exercise of options are used to repurchase common shares at the average price during the year.

Stock-based compensation plans

[a] Stock option plan

The Corporation has a stock option plan as described in *note 9[b]*. Under the fair-value-based method, compensation cost is determined by calculating fair value at the date of grant using the Black-Scholes option pricing model with assumptions described in *note 9[b]*. Compensation cost is expensed over the award's vesting period. Any consideration paid by employees upon exercise of stock options is recorded as an increase to share capital.

[b] Phantom-stock incentive plan

The Corporation is recording compensation expense as it relates to the phantom-stock incentive plan [*note 10[a]*]. The Corporation records a related liability in any accounting period when the 90-day weighted-average market price of the Corporation's common shares as at the end of the accounting period exceeds the grant price of the phantom-stock units. This liability could increase or decrease from one period to the next resulting in compensation expense or recovery in any given period. Compensation expense and related liabilities are calculated using the graded-vesting approach in accordance with the Canadian Institute of Chartered Accountants ("CICA") Handbook *Section 3870 – Stock-Based Compensation and Other Stock-Based Payments* and are adjusted in each subsequent accounting period to reflect the current 90-day weighted-average market price of the Corporation's common shares at the end of the applicable accounting period.

Financial instruments

The Corporation's financial instruments as at July 31, 2007 consist of cash, accounts receivable, income and other taxes recoverable, bank indebtedness, accounts payable and accrued liabilities, and long-term debt.

Unless otherwise stated in these consolidated financial statements, the fair value of the Corporation's financial instruments approximates their carrying value.

A significant portion of revenues is denominated in U.S. currency. Forward foreign exchange contracts and foreign exchange option collars are utilized by the Corporation to manage its foreign currency exposures. The Corporation does not enter into forward foreign exchange contracts and foreign exchange option collars for trading or speculative purposes. These instruments are not accounted for as hedges and are marked to market at the consolidated balance sheet date. The gains and losses are recognized in income as a foreign exchange loss (gain) during the period.

The Corporation is not exposed to significant interest-rate risk and therefore did not employ interest-rate hedging during the year, allowing outstanding bank debt to generally float at short-term market rates of interest.

The Corporation is not exposed to significant credit risk. The majority of the Corporation's sales are made to governments and large, well-established companies. The Corporation, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of each new customer. An allowance for doubtful accounts is established to correspond to the specific credit risk of its customers, historical trends and economic circumstances.

On August 1, 2007, the Corporation will adopt Section 3855 of the CICA accounting standards. Section 3855 establishes standards for recognizing and measuring financial instruments and embedded derivatives in the balance sheet, and reporting gains and losses in the financial statements. Under the new standards, all financial assets are classified as one of these four categories: held to maturity, loans and receivables, held for trading, or available for sale. All financial liabilities are classified as held for trading or other liabilities. Initially, all financial assets and liabilities must be recorded on the consolidated balance sheet at fair value. Subsequent measurement is determined by the classification of each financial asset and liability. Financial assets held to maturity, loans and receivables, and financial liabilities other than those held for trading are measured at amortized cost based on the effective interest method. Financial assets and liabilities held for trading, and derivative financial instruments, whether part of a hedging relationship or not, have to be measured at fair value with gains and losses recognized in earnings. Available for sale instruments are measured at fair value with gains and losses, net of tax, recognized in other comprehensive income.

Effective August 1, 2007, the Corporation has classified its cash as held for trading. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities, bank indebtedness, and long-term debt are classified as other liabilities and measured at amortized cost.

Derivative financial instruments, including forward foreign exchange contracts and foreign exchange collars, are classified as held for trading and measured at fair value.

All derivatives, including embedded derivatives that must be separately accounted for, are recorded at fair value in the consolidated balance sheet. The Corporation has reviewed all significant contractual arrangements and determined that there are no material embedded derivatives that must be separated from the host contract and accounted for separately.

On August 1, 2007, the Corporation will also adopt Section 3861 of the CICA accounting standards that replaces Section 3860 and establishes standards for presentation of financial instruments and non-financial derivatives, and identifies information that should be disclosed.

Comprehensive income

On August 1, 2007, the Corporation will adopt Section 1530 of the CICA accounting standards. This Section establishes the standards for reporting and disclosure of comprehensive income and its components. Comprehensive income is the change in equity (net assets) of an enterprise, during a period, from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Equity

On August 1, 2007, the Corporation will adopt Section 3251 of the CICA accounting standards, which replaces Section 3250 and establishes standards for the presentation of equity and changes in equity during the reporting period. The main feature of this section is a requirement for an enterprise to present separately each of the changes in equity during the period, including comprehensive income, as well as components of equity at the end of the period.

Accounting changes

On August 1, 2007, the Corporation will adopt Section 1506 of the CICA standards. This Section allows an entity to change an accounting policy only if the change is required by a primary source of GAAP or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Hedges

Section 3865 of the CICA accounting standards establishes standards for when and how hedge accounting may be applied. This optional Section of the standards applies to the Corporation commencing August 1, 2007. The purpose of hedge accounting is to ensure that counterbalancing gains, losses, revenues and expenses (including the effects of counterbalancing changes in cash flows) are recognized in net income in the same period or periods. Hedge accounting is applied only when gains, losses, revenues and expenses on a hedging item would otherwise be recognized in net income in a different period than gains, losses, revenues and expenses on the hedged item. The Corporation does not currently use hedge accounting.

3. Inventories

in thousands of Canadian dollars

	2007	2006
Raw materials	\$ 16,885	\$ 8,434
Raw materials – long-term contracts	16,126	814
Work in process – product costs	1,450	7,418
Work in process – product costs, long-term contracts	1,878	–
Work in process – development costs, long-term contracts	16,312	1,372
Finished goods	8,102	9,132
	\$ 60,753	\$ 27,170

As at July 31, 2007, the Corporation has included in its inventory \$34.3 million [July 31, 2006 – \$2.2 million] that consists of raw materials, work in process – product costs and work in process – development costs, which will begin to be billed to the U.S. government under long-term contracts when “Usable Product” requirements are achieved and “Usable Product” has been delivered (see notes 17 and 20).

4. Property, Plant and Equipment

in thousands of Canadian dollars

	2007			2006		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Land	\$ 705	\$ –	\$ 705	\$ 705	\$ –	\$ 705
Buildings	75,177	14,365	60,812	72,884	11,609	61,275
Equipment	71,177	33,932	37,245	66,159	28,142	38,017
Furniture and fixtures	3,002	2,135	867	2,826	1,925	901
Computer systems	11,598	7,986	3,612	10,669	6,595	4,074
Leasehold improvements	1,675	1,345	330	1,675	1,255	420
	\$ 163,334	\$ 59,763	\$ 103,571	\$ 154,918	\$ 49,526	\$ 105,392

The Corporation completed, during the second quarter of fiscal 2007, a capital expansion project for the purpose of expanding its plasma fractionation and production capacity to meet future demand for hyperimmune development and production. At July 31, 2007, \$36.9 million [July 31, 2006 – \$33.1 million] related to this project, excluding the impact of provincial investment tax credits that were recorded net against these expenditures, was capitalized to property, plant and equipment; this amount includes \$0.7 million of interest capitalized in 2007 [2006 – \$0.7 million]. Amortization expense is now being recognized on this capital expansion project.

Equipment and computer systems in the amount of \$0.4 million [2006 buildings and equipment – \$34.3 million] are currently under development and not being amortized.

5. Goodwill

Goodwill at July 31, 2007 amounted to \$40.5 million [2006 – \$40.5 million], net of accumulated amortization and writedowns of \$11.1 million [2006 – \$11.1 million].

At July 31, 2007 and 2006, the Corporation conducted an annual review of the carrying value of goodwill and determined that there was no impairment.

6. Operating Lines of Credit

In addition to the long-term non-revolving credit facilities described in note 7, the Corporation has available a \$20.0-million [2006 – \$20.0 million] revolving term loan from a Canadian chartered bank, of which \$2.1 million was utilized at July 31, 2007 [2006 – \$Nil], collateralized by a general security agreement in respect to all assets. Interest is payable at LIBOR plus 1.25%. The effective rate of interest during the year was 6.2% [2006 – 5.4%]. The agreement expires on December 31, 2007 and is extendable at the bank’s option.

The Corporation also had available a US\$1.0-million U.S. revolving line-of-credit facility, which expired in February 2007, none of which was utilized at July 31, 2006, collateralized by a subsidiary’s inventory and accounts receivable. Interest was payable at LIBOR plus 2.25%. The effective rate of interest for the year was 7.6% [2006 – 6.4%]. This credit facility was not renewed by the Corporation.

7. Long-term Debt

<i>in thousands of Canadian dollars</i>	2007	2006
Canadian non-revolving facility-expansion loan, bearing interest at bankers acceptance rates plus 1.5%, repayable in monthly instalments of \$500,000 commencing October 31, 2006, collateralized by a general security agreement over all assets. The effective rate of interest during the year was 5.8% [2006 – 5.3%].	\$ 1,000	\$ 30,000
U.S. bond maturing August 1, 2018, bearing interest at LIBOR, quarterly principal repayments of US\$150,000 ¹ , collateralized by a subsidiary's real property. The effective rate of interest during the year was 5.3% [2006 – 4.8%].	1,748	2,528
	2,748	32,528
Less current portion	1,636	5,674
	\$ 1,112	\$ 26,854

1. Beginning November 2008, principal repayments will become US\$25,000 quarterly and beginning November 2013, they will become US\$20,000 quarterly.

Scheduled future repayment of long-term debt in the next five years and thereafter is as follows:

<i>in thousands of Canadian dollars</i>	
2008	\$ 1,636
2009	238
2010	106
2011	106
2012	106
Thereafter	556
	\$ 2,748

8. Income Taxes

The Corporation's income tax provision is determined as follows:

<i>in thousands of Canadian dollars</i>	2007	2006
Combined statutory federal and provincial tax rate at 36.3% [2006 – 36.3%]	\$ 6,808	\$ 8,220
Adjusted for:		
Unrecognized losses and temporary differences of U.S. subsidiaries	1,485	1,166
Unrecognized temporary difference for unrealized foreign exchange loss on advances to U.S. subsidiaries	2,266	2,995
Non-taxable foreign exchange gain on translation of U.S. subsidiaries' monetary assets and liabilities	(1,350)	(2,726)
Effect of tax rate changes	(346)	—
Other	(194)	(151)
Income tax expense	\$ 8,669	\$ 9,504

The Corporation's future income tax asset at July 31, 2007, in the amount of \$9.4 million [2006 – \$9.9 million], reflects the recognition of the potential future benefit of \$23.5 million [2006 – \$24.8 million] of tax losses and temporary differences in the U.S. operations. The Corporation has provided for a valuation allowance of \$8.5 million [2006 – \$8.5 million] representing the potential benefit of \$21.3 million [2006 – \$21.4 million] in U.S. tax losses and temporary differences that are more likely than not to remain unrealized. Non-capital losses and their expiry dates as well as other temporary differences in the U.S. operations are as follows:

in thousands of Canadian dollars

Year of loss	Year of expiry	Amount of tax attributes
1999	2018	\$ 462
2000	2019	242
2000	2020	1,111
2001	2020	4,509
2002	2021	269
2004	2023	8,906
2005	2024	7,530
2006	2025	1,429
Total tax losses		24,458
Temporary differences		20,292
		\$ 44,750

Temporary differences are due mainly to an impairment loss on Chesapeake's viral-vaccine-filling facility, recorded in a previous year, as well as cumulative interest on loans to U.S. subsidiaries, recorded but not deducted for tax purposes.

The future income tax liability at July 31, 2007, in the amount of \$10.8 million [2006 – \$1.6 million], reflects the tax effect of the temporary differences between the net book value of assets and the related cost for tax purposes in the Canadian operations.

9. Share Capital

[a] Authorized and issued

The Corporation's authorized share capital comprises an unlimited number of non-voting preferred shares with a 4% non-cumulative dividend entitlement; Class A preferred shares, issuable in series with rights to be determined at issuance by the Board of Directors; and an unlimited number of common shares with no par value.

Issued share capital comprises common shares as follows:

<i>in thousands of Canadian dollars except share-related data</i>	Number of shares	Share capital
July 31, 2005	65,020,970	\$ 29,037
Stock options exercised	754,700	3,104
Transfer from contributed surplus	—	109
July 31, 2006	65,775,670	32,250
Issuance of shares	4,375,000	33,501
Stock options exercised	258,800	1,143
July 31, 2007	70,409,470	\$ 66,894

On December 14, 2006, the Corporation closed a transaction with a syndicate of underwriters for the purchase, on a bought-deal basis, of 4,375,000 common shares issued from the treasury of the Corporation and 5,625,000 common shares in the capital of Cangene sold by Sherman Foundation (the "Selling Shareholder") at a purchase price of \$8.10 per common share, for aggregate gross proceeds of \$35,437,500 to the Corporation and \$45,562,500 to the Selling Shareholder. The Corporation received from the sale net proceeds of \$33.5 million after the payment of underwriters' fees of \$1.6 million and additional offering expenses of \$0.3 million. The Corporation used the net proceeds to repay \$24.0 million of its outstanding non-revolving facility-expansion loan and used the remainder of the net proceeds for general corporate purposes, including working capital.

[b] Stock options

The Board of Directors may authorize the issuance of options to acquire up to 8 million common shares under the stock option plan, provided that the number of options outstanding to any one individual at any time does not exceed 5% of the outstanding shares. At July 31, 2007, 1.2 million [2006 – 1.1 million] options remain available to be granted under the existing plan. The exercise price of options granted under the plan cannot be lower than the market price of the Corporation's common shares on the date that the options are granted. These options expire no later than five and eight years after the date they are granted for non-employee directors and employees, respectively, and vest over four fiscal years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *continued*

A summary of the status of the Corporation's stock option plan as at July 31, 2007 and 2006, and changes during the years ended on those dates, is presented below:

	2007		2006	
	Number of shares	Weighted-average exercise price	Number of shares	Weighted-average exercise price
Stock options				
Outstanding at beginning of year	2,307,750	\$ 7.91	3,108,850	\$ 7.02
Granted	—	—	2,500	8.68
Exercised	(258,800)	4.42	(754,700)	4.11
Forfeited, expired and cancelled	(109,650)	9.62	(48,900)	9.54
Outstanding at end of year	1,939,300	\$ 8.28	2,307,750	\$ 7.91
Exercisable at end of year	1,937,425	\$ 8.28	2,303,375	\$ 7.91

The following table summarizes information about share options outstanding at July 31, 2007:

Exercise price	Fiscal year of grant	Number outstanding	Options outstanding		Options exercisable	
			Weighted-average remaining contractual life	Weighted-average exercise price	Number outstanding	Weighted-average exercise price
\$ 4.65	2000	92,700	0.2 years	\$ 4.65	92,700	\$ 4.65
8.03	2000	389,000	0.9	8.03	389,000	8.03
6.25	2001	515,700	1.7	6.25	515,700	6.25
7.04	2001	48,100	1.8	7.04	48,100	7.04
9.31	2002	397,800	2.7	9.31	397,800	9.31
10.60	2003	486,000	3.1	10.60	486,000	10.60
9.33	2004	5,000	5.0	9.33	5,000	9.33
9.33	2005	2,500	5.0	9.33	1,875	9.33
8.68	2006	2,500	6.0	8.68	1,250	8.68
\$ 4.65–10.60		1,939,300	2.0 years	\$ 8.28	1,937,425	\$ 8.28

A nominal amount of stock-based compensation expense, as per the accounting policy described in *note 2*, was required in 2007 and 2006 as nearly all options had vested in prior years.

No stock options were granted in 2007. The estimated fair value of stock options issued during the year ended July 31, 2006 was determined using the Black-Scholes option pricing model using the following weighted average assumptions: annualized volatility of 45%, risk-free interest rate of 4%, expected life of five years and a dividend yield of 0%. The resulting weighted-average fair value per option issued during the year ended July 31, 2006 was \$4.95.

10. Other Employee Benefit Plans

[a] Phantom-stock incentive plan ("PSIP")

Phantom-stock units mature three years and 90 days after the effective date of grant. Phantom-stock units are valued based on the weighted-average market price of the Corporation's common shares for the 90 days preceding the maturity date. Participants in the plan will receive cash awards equal to any increase in value of the phantom-stock units between the effective date of grant and the date of maturity.

The PSIP provides for vesting of the phantom-stock units evenly over three years and, in the event of retirement, death or termination without cause, participants may be entitled to receive early cash awards for vested phantom-stock units based on the weighted-average market price of the Corporation's common shares for the 90 days preceding the applicable date of retirement, death or termination.

Participation in the PSIP requires mandatory participation in the stock ownership plan.

The stock ownership plan stipulates that the participants must acquire a minimum investment in Cangene shares by a pre-determined future date.

The following table summarizes information about phantom-stock units outstanding as at July 31, 2007:

Grant price	Fiscal year of grant	Number of units outstanding	Weighted-average remaining contractual life	<i>in thousands of Canadian dollars</i>	
				Liability at July 31, 2007	Liability at July 31, 2006
\$ 8.76	2005	950,679	0.3 years	\$ —	\$ 554
6.99	2006	122,500	1.3	226	206
8.42	2007	636,759	2.3	—	—
\$ 6.99–8.76		1,709,938	1.1 years	\$ 226	\$ 760

[b] Employee share purchase plan

Under the terms of the Corporation's employee share purchase plan, employees can choose to have up to 5.0% of their annual gross earnings, to a yearly maximum of \$10,000, withheld to purchase common shares of the Corporation on the open market. The Corporation will match 20% of all contributions made by employees. The total contribution vests immediately. During fiscal 2007, the Corporation's contribution was \$0.1 million [2006 – \$0.1 million], which is recorded as compensation expense. Under the plan, employees acquired 48,131 common shares in 2007 [2006 – 31,010].

[c] Defined-contribution pension plan

The Corporation has a defined-contribution pension plan. The Corporation contributes to the plan at rates up to 4.0% of the employee's salary. The expense and payments for the year were \$0.8 million [2006 – \$0.8 million].

11. Earnings per Share

The following is a reconciliation between basic and diluted earnings per share:

<i>in thousands of Canadian dollars except share-related data</i>	2007	2006
Net income	\$ 10,084	\$ 13,143
Weighted-average number of common shares outstanding	# 68,610,995	# 65,332,540
Dilutive effect of stock options	166,334	413,826
Diluted weighted-average number of shares outstanding	# 68,777,329	# 65,746,366
Earnings per share:		
Basic	\$ 0.15	\$ 0.20
Diluted	\$ 0.15	\$ 0.20

For the year ended July 31, 2007, 893,800 options [July 31, 2006 – 1,000,150 options] were excluded from the calculation of diluted earnings per share based upon the treasury stock method, under which options are excluded from the calculation when their exercise price exceeds the average market price of the Corporation's common shares for the year.

12. Research and Development

Research revenues are earned under terms of agreements with Apotex and through research agreements with third parties, including government institutions.

R&D expenditures, net of applicable investment tax credits and government assistance, consist of:

- expenditures under R&D agreements funded by Apotex, where Cangene will hold the product licences and will pay Apotex certain royalties and profit sharing,
- expenditures under R&D contracts with Apotex, where Apotex will hold the product licence and Cangene will provide contract R&D services, and may ultimately provide contract manufacturing,

- expenditures under third-party contract R&D agreements funded by the third party, where Cangene retains primary intellectual property rights (e.g., U.S. government R&D contracts for vaccinia immune globulin ("VIG"), anthrax immune globulin ("AIG") and botulism antitoxin ("BAT"),
- expenditures under third-party contract R&D agreements funded by the third party, where the third party holds the intellectual property rights and
- expenditures on independent R&D funded entirely by Cangene and for which Cangene holds all intellectual property rights.

The following table provides details of R&D revenues and expenditures:

<i>in thousands of Canadian dollars</i>	2007	2006
R&D revenues		
Apotex agreements – Cangene holds licence	\$ 11,595	\$ 15,644
Apotex agreements – Apotex holds licence	6,374	6,845
Third-party contracts – Cangene holds licence	3,805	9,395
Third-party contracts – third party holds licence	3,507	2,041
	\$ 25,281	\$ 33,925
R&D expenditures		
Apotex agreements – Cangene holds licence	\$ 7,397	\$ 10,078
Apotex agreements – Apotex holds licence	2,848	3,626
Third-party contracts – Cangene holds licence	2,726	5,728
Third-party contracts – third party holds licence	2,399	846
Total cost of sales – R&D	15,370	20,278
Cangene independent R&D	6,709	4,674
	\$ 22,079	\$ 24,952

13. Government Assistance

Federal and provincial investment tax credits, relating to scientific research and experimental development ("SR&ED") activities and amounting to \$7.6 million [2006 – \$9.9 million], were included in the determination of income as a reduction of research and development expenses, while \$3.6 million [2006 – \$Nil] were recorded as a reduction of long-term contract costs in inventory. In addition, investment tax credits relating to SR&ED capital expenditures amounted to \$0.4 million [2006 – \$0.2 million] while provincial investment tax credits relating to manufacturing and processing capital expenditures amounted to \$0.6 million [2006 – \$2.7 million]. Both were accounted for as a reduction of the cost of the applicable assets.

To qualify for the federal and provincial SR&ED investment tax credits, the work must advance the understanding of scientific relations or technologies, address scientific or technological uncertainty, and incorporate a systematic investigation by qualified personnel. To qualify for the Manitoba manufacturing investment tax credit, the building, machinery and equipment must be purchased for first-time use in manufacturing or processing in Manitoba.

Government funding for research projects recorded as a reduction of research and development expenses was \$0.7 million [2006 – \$0.8 million].

Conditions related to Canadian government funding include a 10% holdback receivable upon completion of the research project, completion and submission to the Canadian government of regular progress reports, and ongoing monitoring and acceptance of the deliverables by Canadian government technical authorities. Conditions related to the U.S. government funding include submission of a performance plan to the program officer that details specific milestones and timelines for achieving each milestone, and submission of an annual progress report and an updated product development plan.

14. Supplementary Information for Consolidated Statements of Cash Flows

[a] Effect on cash flow of net change in non-cash working capital balances related to operations:

<i>in thousands of Canadian dollars</i>	2007	2006
Accounts receivable	\$ 6,481	\$ (3,246)
Inventories	(32,693)	6,694
Income and other taxes recoverable	(316)	3,173
Prepaid expenses and deposits	(2,611)	(2,570)
Income and other taxes payable	450	—
Accounts payable and accrued liabilities	7,131	(3,035)
	\$ (21,558)	\$ 1,016

[b] Net investment tax credits utilized associated with research activities:

<i>in thousands of Canadian dollars</i>	2007	2006
Investment tax credits recorded as a reduction of R&D expenditures	\$ (11,185)	\$ (9,870)
Income tax expense not requiring a current cash payment due to the utilization of investment tax credits	2,063	9,338
	\$ (9,122)	\$ (532)

15. Segment Information

The Corporation manages its business and evaluates performance based on two operating segments: biopharmaceutical operations and contract services.

The products and services provided by biopharmaceutical operations include product sales and royalties as well as related-party research and development on follow-on products. Contract services provides manufacturing and R&D services to related and unrelated parties.

The accounting policies of the Corporation's operating segments are the same as those described in *note 2*. There are no significant inter-segment transactions. The following presents segment operating results for the years ended July 31, 2007 and July 31, 2006, and identifiable assets as at July 31, 2007 and July 31, 2006:

<i>in thousands of Canadian dollars</i>	2007			2006		
	Biopharma- ceutical operations	Contract services	Total	Biopharma- ceutical operations	Contract services	Total
Revenues						
Product sales and services	\$ 41,749	\$ 17,095	\$ 58,844	\$ 52,236	\$ 16,663	\$ 68,899
R&D services	11,594	13,687	25,281	15,645	18,280	33,925
Royalties	8,271	—	8,271	6,512	—	6,512
	61,614	30,782	92,396	74,393	34,943	109,336
Cost of sales						
Product sales and services	14,618	12,403	27,021	21,353	19,284	40,637
R&D services	7,398	7,972	15,370	10,078	10,200	20,278
	22,016	20,375	42,391	31,431	29,484	60,915
Gross profit	39,598	10,407	50,005	42,962	5,459	48,421
Income (loss) before income taxes	19,519	(766)	18,753	23,681	(1,034)	22,647
Income tax expense	7,684	985	8,669	8,818	686	9,504
Net income (loss) for the year	\$ 11,835	\$ (1,751)	\$ 10,084	\$ 14,863	\$ (1,720)	\$ 13,143
Total assets	\$ 109,405	\$ 147,345	\$ 256,750	\$ 117,279	\$ 107,875	\$ 225,154
Additions to property, plant and equipment, and goodwill, net	\$ 5,665	\$ 3,789	\$ 9,454	\$ 17,618	\$ 9,369	\$ 26,987

Geographic information about the Corporation's revenue is based on the product shipment destination or the location of the contracting organization. Assets are based on their physical location as at July 31, 2007 and July 31, 2006.

<i>in thousands of Canadian dollars</i>	2007		2006	
	Revenues	Property, plant and equipment, and goodwill	Revenues	Property, plant and equipment, and goodwill
Canada	\$ 33,379	\$ 85,412	\$ 35,371	\$ 85,910
United States	47,470	58,673	45,623	59,996
Eurasia	11,547	—	28,342	—
	\$ 92,396	\$ 144,085	\$ 109,336	\$ 145,906

Sales to two customers represent 77% [2006 – three customers, 78%] of the revenue of the biopharmaceutical operating segment. Sales to one customer represent 21% [2006 – two customers, 38%] of the revenue of the contract-services segment.

16. Commitments

[a] Operating leases

At July 31, 2007, the Corporation had commitments under operating leases requiring minimum annual payments as follows:

in thousands of Canadian dollars

2008	\$	902
2009		577
2010		553
2011		358
2012		234
Thereafter		834
	\$	3,458

[b] Forward foreign exchange contracts

At July 31, 2006, the Corporation had entered into forward foreign exchange contracts to sell U.S. dollars totalling US\$5.0 million. The unrealized gain on these contracts at July 31, 2006 was \$0.2 million, which was recorded in the foreign exchange loss (gain) on the consolidated statements of income and retained earnings. No forward foreign exchange contracts were outstanding as at July 31, 2007.

17. Significant Agreements

On May 31, 2006, Cangene was awarded a five-year development and supply contract by the U.S. Department of Health and Human Services (“HHS”) for the supply of 200,000 doses of BAT that will be available for treating individuals who have been exposed to the toxins that cause botulism. In addition to the base contract, there is a possibility of optional task orders that may be awarded at HHS’s discretion.

The base contract provides for revenue of US\$362 million, which includes a potential supplementary payment based upon achieving U.S. Food and Drug Administration (“FDA”) approval for the product. The price per dose will be a discounted fixed price with the discount representing the supplemental payment. Cangene will begin to receive payment once it has produced and delivered a quantity of “Usable Product” to the U.S. Strategic National Stockpile (“SNS”). To meet the Usable Product requirement, the product must be manufactured under licensable conditions, and meet certain safety and regulatory conditions. The base contract also requires that the Corporation apply for and receive a licence from the FDA for the use of this product. If FDA licensure is received during the term of the contract, the Corporation will receive the supplementary payment.

The optional task orders are worth up to an additional US\$234 million in revenue. These tasks include ongoing testing to support long-term product shelf life, maintaining product manufacturing and additional clinical testing in special populations.

On July 28, 2006, HHS exercised its option to purchase 10,000 doses of AIG under a modification to an earlier development and supply contract, which was originally signed in 2005. In addition to the base contract, there is a possibility of optional task orders that could increase the final value of the contract.

The AIG is to be made available if necessary for treating inhalational anthrax. This modification to the contract will provide approximately US\$143 million, which includes a potential supplementary payment based upon achieving FDA licensure. Cangene previously delivered a small number of doses to the SNS under this contract. Cangene will receive payments following the delivery of Usable Product into the SNS. The contract also requires that Cangene apply for and receive product licensing from the FDA. Under the contract, the price per dose will be a discounted fixed price with the discount representing the supplemental payment. To meet the Usable Product requirement, the product must be manufactured under licensable conditions and meet certain safety and regulatory conditions. If FDA licensure is received during the term of the contract, the Corporation will receive the remainder of the supplementary payment.

Optional task orders could include maintaining product manufacturing and additional clinical testing in special populations.

The Corporation has not yet recognized any revenues related to these agreements as the requirement to deliver “Usable Product” had not been met as of July 31, 2007. Costs incurred to July 31, 2007 of \$38.0 million have been charged to inventories, prepaid expenses and other assets. The work in process – development costs, long-term contracts costs will be invoiced to HHS and the related revenue recognized once delivery of Usable Product has occurred. Subsequent to July 31, 2007, the regulatory requirements of Usable Product were met and product was delivered (see *note 20*).

On March 13, 2007, the Corporation announced that Apotex Corp., its U.S. distributor for HepaGam B™, had signed an agreement with Novation, LLC, a healthcare contract-services company in the United States. Under the five-year agreement, Novation will exclusively carry HepaGam B™, Cangene’s hepatitis B immune globulin, under the NOVAPLUS® private-label program.

18. Related-party Transactions

The Corporation has an agreement whereby Apotex funds Cangene's development of certain biopharmaceutical products up to and including post-licensure research and development. Research revenue received pursuant to this contract is based on the direct research costs plus a contribution to overhead. The Corporation is recognizing the investment tax credits associated with these costs as a reduction of R&D services expense. Under this agreement, Apotex will be entitled to receive a 12% royalty on net sales of certain biopharmaceutical products developed by the Corporation and a right to distribute the products. Apotex and the Corporation will share profits equally after deducting royalty payments. No sales of biopharmaceutical products developed pursuant to this agreement have been made to July 31, 2007.

The Corporation also had a separate agreement with Apotex to conduct contract R&D and contract manufacturing of a biopharmaceutical product. This agreement concluded subsequent to the year-end.

On November 5, 1996, the Corporation acquired royalty rights on the drug Ferriprox™ (deferiprone) from Apotex. The Corporation receives 50% of any net profits from sales of the drug worldwide.

On May 1, 2006, the Corporation entered into a distribution agreement with Apotex to market and distribute HepaGam B™ in the U.S. Under the terms of the agreement, the Corporation will manufacture and hold licence to the product. Profits will be shared between the two parties.

During 2007, Cangene recorded revenues of \$27.5 million [2006 – \$29.7 million] from sales to Apotex and at July 31, 2007 \$5.0 million, representing revenue earned in the fourth quarter [July 31, 2006 – \$9.3 million], was included in accounts receivable. These transactions occurred in the normal course of operations and were recorded at their exchange amount.

19. Sale of Building

On February 27, 2006, the Corporation finalized the sale of a warehouse at its Chesapeake subsidiary. The net proceeds on the sale were \$1.9 million and a pre-tax gain on disposal of this asset of \$0.7 million was recorded in the year ended July 31, 2006.

20. Subsequent Events

[a] On August 13, 2007, the Corporation announced that it has met all the regulatory and manufacturing requirements for the "Usable Product" milestone on contracts with the

U.S. government for products to treat botulism and inhalational anthrax [note 17]. Meeting the Usable Product requirements means the Corporation has met specific regulatory and manufacturing requirements that allow it to deliver the products to the SNS and begin invoicing once delivery has been accepted. Meeting this milestone allows the Corporation to receive ongoing revenue for product deliveries and project costs. The initial payments, expected to be in the range of US\$18–22 million, will include reimbursable development costs incurred to date, as well as payment for the initial product delivery.

On August 28, 2007, the Corporation announced that it had completed delivery of the initial order for anthrax immune globulin and that the drug had been formally received into the SNS.

On September 27, 2007, the Corporation announced that it had completed delivery of the initial order for botulism antitoxin and that the drug had been formally received into the SNS.

On August 16, 2007, the Corporation announced that its contract with the U.S. Centers for Disease Control and Prevention for the supply of VIG had been extended for five more years. The original five-year contract was signed in August 2002, and under that contract Cangene developed and delivered VIG product to the SNS. Although a supply of product is already maintained within the SNS, the extended contract supports licensing requirements, ongoing stability studies, further clinical testing and development projects, and could provide for future orders.

On August 28, 2007, the Corporation entered into foreign exchange collars in anticipation of U.S. dollar cash flows resulting from the achievement of Usable Product criteria for BAT and AIG contracts with the U.S. government. The foreign exchange collars have a nominal value of US\$15 million, and exercise prices between \$1.04 and \$1.07 Canadian dollars per U.S. dollar, and expire during the first and second quarters of fiscal 2008.

[b] On October 2, 2007, the Corporation announced it was closing its R&D facility in Mississauga, Ontario and consolidating all its research and development within the Manitoba head office location. This re-organization resulted in a reduction in staff of approximately 4% and the Corporation anticipates that there will be severance and facilities costs recorded in the first quarter of 2008.

21. Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's presentation.