AXCAN PHARMA

Interim Report

First Quarter

December 31ST, 2005

Q1

OUR EXPERTISE

Focus on gastroenterology, our core area of knowledge

OUR PEOPLE

Foundation of our future success

OUR PIPELINE

Promise for better treatments

Dear Fellow Shareholders:

"As we begin fiscal 2006, we are pleased with the progress we have made so far. Our record revenues reflect the strength of our current product portfolio. We estimate that increases in wholesaler inventory levels positively impacted our revenue by less than $1.5 million, which confirms our previous assumptions that wholesaler inventory levels have stabilized in our currently desired eight-to-twelve-week target range."

"On the research and development front, we reached another important milestone by completing randomization for the Itopride North American pivotal Phase III trial with more than 600 patients randomized in this study."

Frank A.G.M. Verwiel, M.D.
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION

and analysis of financial condition and results of operations

This discussion should be read in conjunction with the information contained in Axcan's consolidated financial statements and the related notes thereto. All amounts are in U.S. dollars.

OVERVIEW

Axcan is a leading speciality pharmaceutical company concentrating in the field of gastroenterology, with operations in North America and Europe. Axcan markets and sells pharmaceutical products used in the treatment of a variety of gastrointestinal diseases and disorders. The Company seeks to expand its gastrointestinal franchise by in-licensing products and acquiring products or companies, as well as developing additional products and expanding indications for existing products. Axcan's current products include ULTRASE, PANZYTRAT and VIOKASE for the treatment of certain gastrointestinal symptoms, related to cystic fibrosis in the case of ULTRASE and PANZYTRAT; URSO/URSO 250, URSO FORTE/URSO DS and DELURSAN for the treatment of certain cholestatic liver diseases; SALOFALK and CANASA for the treatment of certain inflammatory bowel diseases; and CARAFATE/SULCRATE for the treatment of gastric duodenal ulcers. Axcan has a number of pharmaceutical projects in all phases of development, including ITAX for the treatment of functional dyspepsia.

For the three-month period ended December 31, 2005, revenue was $70.6 million, operating income was $14.2 million and net income was $9.2 million. Revenue from sales of Axcan's products in the United States was $46.2 million (65.5% of total revenue) for the three-month period ended December 31, 2005, compared to $38.2 million (62.0% of total revenue) for the corresponding period of fiscal 2005. In Canada, revenue was $10.2 million (14.4% of total revenue) for the three-month period ended December 31, 2005, compared to $9.2 million (14.9% of total revenue) for the corresponding period of fiscal 2005. In Europe, revenue was $14.2 million (20.1% of total revenue) for the three-month period ended December 31, 2005, compared to $14.2 million (23.1% of total revenue) for the corresponding period of fiscal 2005.

Axcan's revenue historically has been and continues to be principally derived from sales of pharmaceutical products to large pharmaceutical wholesalers and large chain pharmacies. Axcan utilizes a "pull-through" marketing approach that is typical of pharmaceutical companies. Under this approach, Axcan's sales representatives demonstrate the features and benefits of its products to gastroenterologists who may write their patients prescriptions for Axcan's products. The patients, in turn, take the prescriptions to pharmacies to be filled. The pharmacies then place orders with the wholesalers or, in the case of large chain pharmacies, their distribution centers, to whom Axcan sells its products.

Axcan's expenses are comprised primarily of selling and administrative expenses (including marketing expenses), cost of goods sold (including royalty payments to those companies from whom Axcan licenses some of its products), research and development expenses as well as depreciation and amortization.

Axcan's annual and quarterly operating revenues are primarily affected by three factors: the level of acceptance of Axcan's products by gastroenterologists and their patients; the ability of Axcan to convince practitioners to use Axcan products for approved indications; and wholesaler buying patterns.

Historically, wholesalers' business models in the U.S. were dependent on drug price inflation. Their profitability and gross margins were directly tied to speculative purchasing pharmaceutical products at pre-price increase prices and selling their product inventory to the trade at the new higher price. This inventory price arbitrage was predominantly how wholesalers were compensated for the distribution services they provided and had a dramatic effect on wholesaler buying patterns as they invested in inventories in anticipation of generating higher gross margins from price increases from manufacturers. More recently, for a number of reasons, pharmaceutical manufacturers have not been increasing drug prices as frequently and the increases as a percentage have been lower. For these and other reasons, some wholesalers moved to a fee-for-service type arrangement where fees are now typically expressed as a percentage of the wholesaler's purchases from the manufacturer or as an amount per piece or per unit. For wholesalers, fee-for-service means their compensation will be periodic and volume activity based as opposed to price increase based.

As a result of the move to a fee-for-service business model, many wholesalers are no longer investing in inventory ahead of anticipated price increases and are reducing their carrying levels of inventory from their historical norms. Under the new model, manufacturers will now realize the benefit of price increase more rapidly and pay wholesalers for the services they provide on a fee-for-service basis. This change in wholesaler's business model has affected Axcan's revenue since fiscal 2005.

Most importantly, the level of patient and physician acceptance of Axcan's products, as well as the availability of similar therapies, which may be less effective but also less expensive than some of Axcan's products, impact Axcan's revenues by driving the level and timing of prescriptions for its products.

CRITICAL ACCOUNTING POLICIES

Axcan's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"), applied on a consistent basis. Axcan's critical accounting policies include the use of estimates, revenue recognition, the recording of research and development expenses and the determination of the useful lives or fair value of goodwill and intangible assets. Some of our critical accounting policies require the use of judgment in their application or require estimates of inherently uncertain matters. Although our accounting policies are in compliance with U.S. GAAP, a change in the facts and circumstances of an underlying transaction could significantly change the application of our accounting policies to that transaction, which could have an effect on our financial statements. Discussed below are those policies that we believe are critical and require the use of complex judgment in their application.

USE OF ESTIMATES

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of financial statements and the disclosure of recognized amounts of revenues and expenses during the year. Significant estimates and assumptions made by management include the allowance for accounts receivable and inventories, reserves for product returns, rebates and chargebacks, the classification of intangible assets between finite and indefinite life, useful lives of long-lived assets, the expected cash flows used in evaluating long-lived assets, goodwill and investments for impairment, contingency provisions and other accrued charges. These estimates were made using the historical information and various other factors related to each circumstance available to management. The Company reviews all significant estimates affecting the financial statements on a recurring basis and records the effect of any adjustments when necessary. Actual results could differ from those estimates based upon future events, which could include, among other risks, changes in regulations governing the manner in which we sell our products, changes in health care environment and managed care consumption patterns.

REVENUE RECOGNITION

Revenue is recognized when the product is shipped to the Company's customer, provided the Company has not retained any significant risks of ownership or future obligations with respect to the product shipped. Provisions for sales discounts and estimates for chargebacks, managed care and Medicaid rebates and product returns are established as a reduction of product sales revenues at the time such revenues are recognized. These revenue reductions are established by us as our best estimate at the time of sale based on historical experience adjusted to reflect known changes in the factors that impact such reserves. These revenue reductions are generally reflected as an addition to accrued expenses.

We do not provide any forms of price protection to our wholesale customers and permit product returns only if the product is returned within 12 months after expiration. Credit for returns is issued to the original purchaser at current net pricing less 10%. Accrued liabilities include reserves of $7.6 million and $7.5 million as of December 31, 2005, and September 30, 2005, respectively for estimated product returns.

In the United States, we establish and maintain reserves for amounts payable by us to managed care organizations and state Medicaid programs for the reimbursement of portions of the retail price of prescriptions filled that are covered by the respective programs. We also establish and maintain reserves for amounts payable by us to wholesale distributors for the difference between their regular sale price and the contract price for the products sold to our contract customers. The amounts estimated to be paid relating to products sold are recognized as revenue reductions and as additions to accrued expenses at the time of sale based on our best estimate of the product's utilization by these managed care and state Medicaid patients and sales to our contract customers, using historical experience adjusted to reflect known changes in the factors that impact such reserves. Accrued liabilities include reserves of $6.3 million and $4.8 million as of December 31, 2005, and September 30, 2005, respectively, for estimated rebates and chargebacks.

If the levels of chargebacks, managed care and Medicaid rebates, product returns and discounts fluctuate significantly and/or if our estimates do not adequately reserve for these reductions of net product revenues, our reported revenue could be negatively affected.

GOODWILL AND INTANGIBLE ASSETS

We have in the past acquired products and businesses that include goodwill, trademarks, license agreements and other identifiable intangible assets. Axcan's goodwill and intangible assets are stated at cost, less accumulated amortization. Since October 1, 2001, the Company has not amortized goodwill and intangible assets with an indefinite life. However, management assesses the impairment of goodwill and intangible assets at least annually and whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable, by comparing the carrying value of the unamortized portion of goodwill and intangible assets to the future benefits of the Company's activities or expected sales of pharmaceutical products. Should there be a permanent impairment in value or if the unamortized balance exceeds recoverable amounts, a write-down will be recognized, for the current year. To date, Axcan has not recognized any significant impairment in value.

Intangible assets with finite life are amortized over their estimated useful lives according to the straight-line method at annual rates varying from 4% to 15%. The straight-line method of amortization is used because it reflects, in the opinion of management, the pattern in which the intangible assets with finite life are used. In determining the useful life of intangible assets, the Company considers many factors including the intention of management to support the asset on a long-term basis by maintaining the level of expenditure necessary, the use of the asset, the existence and expiration date of a patent, the existence of a generic or competitor and any legal or regulatory provisions that could limit the use of the asset.

As a result of acquisitions, we included $27.5 million of goodwill on our consolidated balance sheets as of December 31, 2005, and September 30, 2005.

Also as a result of acquisitions of product rights and other identifiable intangible assets, we included $383.0 million and $388.9 million as net intangible assets on our consolidated balance sheets as of December 31, 2005, and September 30, 2005, respectively. Estimated annual amortization expense for intangible assets with a finite life, which have a weighted-average remaining amortization period of approximately 17 years, for the next five fiscal years, is approximately $16.9 million.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses are charged to operations in the year they are incurred. Acquired in-process research and development having no alternative future use is written off at the time of acquisition. The cost of intangibles that are acquired from others for a particular research and development project, with no alternative use, is written off at the time of acquisition.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentage of revenue represented by items in Axcan's consolidated statements of operations:

	For the three-month periods ended December 31	
	2005	2004
	%	%
Revenue	**100.0**	100.0
Cost of goods sold	**25.8**	27.2
Selling and administrative expenses	**33.4**	34.0
Research and development expenses	**12.6**	10.4
Depreciation and amortization	**8.0**	8.7
	79.8	80.3
Operating income	**20.2**	19.7
Financial expenses	**2.5**	2.9
Interest income	**(1.1)**	(0.1)
Gain on foreign exchange	**(0.3)**	(0.4)
	1.1	2.4
Income before income taxes	**19.1**	17.3
Income taxes	**6.0**	4.7
Net income	**13.1**	12.6

THREE-MONTH PERIOD ENDED DECEMBER 31, 2005 COMPARED TO THE THREE-MONTH PERIOD ENDED DECEMBER 31, 2004

REVENUE

For the three-month period ended December 31, 2005, revenue was $70.6 million compared to $61.6 million for the corresponding period of the preceding fiscal year, an increase of 14.6%. This increase in revenue primarily resulted from higher sales in the United States. The end-customer prescription demand resulted in positive growth for most of our products sold in the United States, which was reflected in sales to our major wholesalers as they work towards reaching their targeted inventory levels. Major wholesalers in the United States reduced their inventory levels in fiscal 2005.

Revenue is stated net of deductions for product returns, chargebacks, contract rebates, discounts and other allowances of $11.7 million (14.2% of gross revenue) for the three-month period ended December 31, 2005, and $8.2 million (11.7% of gross revenue) for the three-month period ended December 31, 2004.This increase of total deductions as a percentage of gross revenue is primarily due to an increase in returns and chargebacks.

COST OF GOODS SOLD

Cost of goods sold consists principally of costs of raw materials, royalties and manufacturing costs. Axcan outsources most of its manufacturing requirements. For the three-month period ended December 31, 2005, cost of goods sold increased $1.4 million (8.3%) to $18.2 million from $16.8 million for the corresponding period of the preceding fiscal year. As a percentage of revenue, cost of goods sold for the three-month period ended December 31, 2005 decreased as compared to the corresponding period of the preceding fiscal year from 27.2% to 25.8%. This decrease in the cost of goods sold as a percentage of revenue was due mainly to the increase in sales of products with a higher margin.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses consist principally of salaries and other costs associated with Axcan's sales force and marketing activities. Selling and administrative expenses increased $2.6 million (12.4%) to $23.6 million for the three-month period ended December 31, 2005, from $21.0 million for the corresponding period of the preceding fiscal year. The adoption of the new accounting rule concerning the compensation cost for share based awards resulted in an increase in selling and administrative expenses of $0.9 million. The increase was also due to marketing preparations for new products, including ITAX, additional marketing efforts with respect to our current products, increased distribution costs following the signing of a new agreement with a major wholesaler, consulting fees for Information Technology implementation and regulatory compliance.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist principally of fees paid to outside parties that Axcan uses to conduct clinical studies and to submit governmental approval applications on its behalf, as well as the salaries and benefits paid to its personnel involved in research and development projects. Research and development expenses increased $2.5 million (39.1%) to $8.9 million for the three-month period ended December 31, 2005, from $6.4 million for the corresponding period of the preceding fiscal year. This increase was mainly due to the Phase III development of ITAX, acquired in August 2003, for the treatment of functional dyspepsia. Phase III is the most expensive stage of clinical development.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization consist principally of the amortization of intangible assets with a finite life. Intangible assets include trademarks, trademark licenses and manufacturing rights. Depreciation and amortization increased $0.2 million (3.7%) to $5.6 million for the three-month period ended December 31, 2005, from $5.4 million for the corresponding period of the preceding fiscal year. The increase was mainly due to the amortization of LACTÉOL and ADEKs which were reclassified from intangible assets with an indefinite life to intangible assets with a finite life on October 1, 2005.

FINANCIAL EXPENSES

Financial expenses consist principally of interest and fees paid in connection with money borrowed for acquisitions. Financial expenses remained stable at $1.8 million for the three-month periods ended December 31, 2005 and 2004.

INCOME TAXES

Income taxes amounted to $4.2 million for the three-month period ended December 31, 2005, compared to $2.9 million for the corresponding period of the preceding fiscal year. The effective tax rates were 31.4% for the three-month period ended December 31, 2005 and 27.2% for the three-month period ended December 31, 2004.

NET INCOME

Net income was $9.2 million or $0.20 of basic income per share and $0.19 of diluted income per share, for the three-month period ended December 31, 2005, compared to $7.8 million or $0.17 of basic income per share and $0.16 of diluted income per share for the corresponding period of the preceding year. Net income for the three-month period ended December 31, 2005 takes into account the expensing of stock-based compensation which amounted to $0.9 million after taxes. Had stock-based compensation been recorded in the prior year, the impact to net income for the three-month period ended December 31, 2004 would have been $1.1 million or $0.02 per share of basic and diluted income per share thus reducing net income to $6.7 million or $0.15 of basic income per share and $0.14 of diluted income per share. The change in net income for the three-month period ended December 31, 2005 resulted mainly from an increase in revenue of $9.0 million and an increase in interest income of $0.7 million, which were offset by a $6.9 million increase in operating expenses and an increase in income taxes of $1.3 million. The weighted average number of common shares outstanding used to establish the basic per share amounts increased from 45.6 million for the three-month period ended December 31, 2004 to 45.7 million for the three-month period ended December 31, 2005, following the exercise of options previously granted pursuant to Axcan's stock option plan. The weighted average number of common shares used to establish the diluted per share amounts decreased from 55.3 million for the three-month period ended December 31, 2004 to 55.0 million for the three-month period ended December 31, 2005.

CANADIAN GAAP

The differences (in thousands of dollars) between U.S. and Canadian GAAP which affected net income for the three-month periods ended December 31, 2005 and 2004 are summarized in the following table:

	For the three-month periods ended December 31	
	2005	2004
	$	$
Net income in accordance with U.S. GAAP	**9,245**	7,754
Implicit interest on convertible debt	**(1,229)**	(1,123)
Stock-based compensation expense	**–**	(1,300)
Amortization of new product acquisition costs	**(14)**	(14)
Income tax impact of the above adjustments	**(163)**	5
Net earnings in accordance with Canadian GAAP	**7,839**	5,322

On March 5, 2003, the Company closed an offering of $125.0 million aggregate principal amount of 4.25% convertible subordinated notes due April 15, 2008. As a result of the terms of the notes, under Canadian GAAP, an amount of $24.2 million was included in shareholders' equity as equity component of the convertible debt and an amount of $100.8 million was included in long-term debt, as the liability component of the convertible notes. For the three-month period ended December 31, 2005, implicit interest in the amount of $1.2 million ($1.1 million in 2004) was accounted for and added to the liability component.

Since October 1, 2004, under Canadian GAAP, the effect of stock-based compensation has to be accounted for using the fair value method. Under U.S. GAAP, the effect of stock-based compensation has to be accounted for using the fair value method since October 1, 2005.

Under Canadian GAAP, research and development expenses are stated net of related tax credits which generally constitute between 5% and 10% of the aggregate amount of such expenses. Under U.S. GAAP, these tax credits are applied against income taxes.

LIQUIDITY AND CAPITAL RESOURCES

Axcan's cash, cash equivalents and short-term investments increased $28.3 million (29.0%) to $125.9 million at December 31, 2005 from $97.6 million at September 30, 2005. As of December 31, 2005, working capital was $146.6 million, compared to $132.0 million at September 30, 2005. These increases were mainly due to the cash flows from operating activities for the three-month period ended December 31, 2005.

Total assets increased $8.3 million (1.3%) to $649.7 million as of December 31, 2005 from $641.4 million as of September 30, 2005. Shareholders' equity increased $8.2 million (2.0%) to $425.8 million as of December 31, 2005 from $417.6 million as of September 30, 2005.

Historically, Axcan has financed research and development, operations, acquisitions, milestone payments and investments out of the proceeds of public and private sales of its equity and convertible debt, cash flows from operating activities, and loans from joint venture partners and financial institutions. Since it went public in Canada in December 1995, Axcan has raised approximately $243.0 million from sales of its equity and $125.0 million from sales of convertible notes. Furthermore, Axcan has borrowed and since repaid funds from financial institutions to finance the acquisition of Axcan Scandipharm Inc. and from Schwarz Pharma Inc., a former joint venture partner, to finance the acquisition of URSO.

Axcan's research and development expenses totalled $19.9 million for fiscal 2004 and $31.9 million for fiscal 2005. Axcan believes that cash, cash equivalents and short-term investments, together with funds provided by operations, will be sufficient to meet its operating cash requirements, including the development of products through research and development activities, capital expenditures and repayment of its debt. Axcan believes that regulatory approvals of future products and extension of products indications, stemming from its research and development efforts, will significantly contribute to an increase in funds provided by operations. However, Axcan regularly reviews product and other acquisition opportunities and may therefore require additional debt or equity financing. Axcan cannot be certain that such additional financing, if required, will be available on acceptable terms, or at all.

LINE OF CREDIT

Effective September 22, 2004, the Company amended its existing credit facility with a banking syndicate. The amended credit facility consists of a $125.0 million 364-day extendible revolving facility with a two-year term-out option maturing on September 21, 2008.

The credit facility is secured by a first priority security interest on all present and future acquired assets of the Company and its material subsidiaries, and provides for the maintenance of certain financial ratios. Among the restrictions imposed by the credit facility is a covenant limiting cash dividends, share repurchases (other than redeemable shares issued in connection with a permitted acquisition) and similar distributions to shareholders to 10% of the Company's net income for the preceding fiscal year. As of December 31, 2005, Axcan was in compliance with all covenants under the credit facility.

The interest rate varies, depending on the Company's leverage, between 25 basis points and 100 basis points over Canadian prime rate or U.S. base rate, and between 125 basis points and 200 basis points over the LIBOR rate or bankers acceptances. The line of credit also provides for a stand-by fee of between 25 and 37.5 basis points. The credit facility may be drawn in U.S. dollars, in Canadian dollar or Euros equivalents. As of December 31, 2005, there was no amount outstanding under this credit facility.

CONVERTIBLE SUBORDINATED NOTES AND OTHER LONG-TERM DEBT

Long-term debt, including instalments due within one year, totaled $127.4 million as of December 31, 2005 compared to $127.8 million as of September 30, 2005. As of December 31, 2005, the long-term debt included $1.1 million of bank loans, $1.3 million of obligations under capital leases contracted by Axcan's French subsidiary and the $125.0 million 4.25% convertible subordinated notes due 2008, which were issued on March 5, 2003.

The notes are convertible into 8,924,113 common shares during any quarterly conversion period if the closing price per share for at least 20 consecutive trading days during the 30 consecutive trading-day period ending on the first day of the conversion period exceeds 110% of the conversion price in effect on that thirtieth trading day. The notes are also convertible during the five business-day period following any 10 consecutive trading-day period in which the daily average of the trading prices for the notes was less than 95% of the average conversion value for the notes during that period. The noteholders may also convert their notes upon the occurrence of specified corporate transactions or if the Company has called the notes for redemption. On or after April 20, 2006, the Company may at its option, redeem the notes, in whole or in part at redemption prices varying from 101.70% to 100.85% of the principal amount plus any accrued and unpaid interest to the redemption date. The notes also include provisions for the redemption of all the notes for cash at the option of the Company following certain changes in tax treatment.

CASH FLOWS

Cash flows from operating activities increased $20.5 million from $8.8 million of cash provided by operating activities for the three-month period ended December 31, 2004 to $29.3 million for the three-month period ended December 31, 2005. This increase is mainly due to the increase in income and the fact that accounts receivable decreased by $12.9 million during the three-month period ended December 31, 2005 compared to the corresponding period of the previous fiscal year when they remained relatively stable. Cash flows used by financing activities were $0.3 million for the three-month period ended December 31, 2005. Cash flows provided by investment activities for the three-month period ended December 31, 2005 were $6.4 million mainly due to the disposal of short-term investments of $7.0 million less the cash used for the acquisition of property, plant and equipment for $0.6 million. Cash flows provided by investment activities for the three-month period ended December 31, 2004 were $11.0 million mainly due to the disposal of short-term investments of $12.8 million less the cash used for the acquisition of property, plant and equipment for $1.8 million.

OFF-BALANCE SHEET ARRANGEMENTS

Axcan does not have any transactions, arrangements and other relationships with unconsolidated entities that are likely to affect its operating results, its liquidity or capital resources. Axcan has no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity or market or credit risk support, engage in leasing, hedging, research and development services, or other relationships that expose the Company to liability that is not reflected on the face of the consolidated financial statements.

CONTRACTUAL OBLIGATIONS

The following table summarizes Axcan's significant contractual obligations (in thousands of dollars) as of December 31, 2005 and the effect such obligations are expected to have on our liquidity and cash flows in future years. This table excludes amounts already recorded on the balance sheet as current liabilities at December 31, 2005 or certain other purchase obligations as discussed below:

	For the twelve-month periods ending December 31,				
	2006	2007	2008	2009	2010 and thereafter
	$	$	$	$	$
Long-term debt	1,401	801	125,193	53	–
Operating leases	1,413	817	545	30	–
Other commitments	225	475	716	250	–
	3,039	2,093	126,454	333	0

Purchase orders for raw materials, finished goods and other goods and services are not included in the above table. Management is not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders may represent authorizations to purchase rather than binding agreements. For the purpose of this table, contractual obligations for purchase of goods or services are defined as agreements that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Axcan's purchase orders are based on current needs and are fulfilled by our vendors with relatively short timetables. The Company does not have significant agreements for the purchase of raw materials or finished goods specifying minimum quantities or set prices that exceed its short-term expected requirements. Axcan also enters into contracts for outsourced services; however, the obligations under these contracts are not significant and the contracts generally contain clauses allowing for cancellation without significant penalty except for a sales management services contract included in the above table. As milestone payments are primarily contingent on receiving regulatory approval for products under development, they do not have defined maturities.

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services, or for some obligations, changes to agreed-upon amounts.

EFFECT OF RECENTLY ISSUED U.S. ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment". SFAS No. 123R requires all entities to recognize compensation cost for share-based awards, including options, granted to employees. The Statement eliminates the ability to account for share-based compensation transactions using APB No. 25, "Accounting for Stock Issued to Employees", and generally requires instead that such transactions be accounted for using a fair-value based method. Public companies are required to measure stock-based compensation classified as equity by valuing the instrument the employee receives at its grant-date fair value. Previously, such awards were measured at intrinsic value under both APB No. 25 and SFAS 123, "Accounting for Stock-Based Compensation". The Company applied the Statement beginning in fiscal 2006 using the modified prospective transition approach. The adoption resulted in an increase in compensation cost of $1.1 million for the three-month period ended December 31, 2005.

EARNINGS COVERAGE

Under U.S. GAAP, for the twelve-month period ended December 31, 2005, our interest requirements amounted to $6.2 million on a pro-forma basis and our earnings coverage ratio, defined as the ratio of earnings before interest and income taxes to pro-forma interest requirements, was 7.04 to one.

Under Canadian GAAP, for the twelve-month period ended December 31, 2005, our interest requirements amounted to $11.4 million on a pro-forma basis, and our earnings coverage ratio was 3.73 to one. The principal difference between the earnings coverage ratios under Canadian GAAP and U.S. GAAP is attributable to the inclusion of implicit interest of $5.2 million as required by Canadian GAAP.

RISK FACTORS

Axcan is exposed to financial market risks, including changes in foreign currency exchange rates and interest rates. Axcan does not use derivative financial instruments for speculative or trading purposes. Axcan does not use off-balance sheet financing or similar special purpose entities. Inflation has not had a significant impact on Axcan's results of operations. Risks other than those described below can be found in the Part III - Business of Axcan, of the Company's Annual Information Form.

FOREIGN CURRENCY RISK

Axcan operates internationally; however, a substantial portion of the revenue and expense activities and capital expenditures are transacted in U.S. dollars. Axcan's exposure to exchange rate fluctuation is reduced because, in general, Axcan's revenues denominated in currencies other than the U.S. dollar are matched by a corresponding amount of costs denominated in the same currency. Axcan expects this matching to continue.

INTEREST RATE RISK

The primary objective of Axcan's investment policy is the protection of capital. Accordingly, investments are made in high-grade government and corporate securities with varying maturities, but typically, less than 180 days. Therefore, Axcan does not have a material exposure to interest rate risk, and a 100 basis-point adverse change in interest rates would not have a material effect on Axcan's consolidated results of operations, financial position or cash flows. Axcan is exposed to interest rate risk on borrowings under the credit facility. The credit facility bears interest based on LIBOR, U.S. dollar base rate, Canadian dollar prime rate, or Canadian dollar Bankers' Acceptances. Based on projected advances under the credit facility, a 100 basis-point adverse change in interest rates would not have a material effect on Axcan's consolidated results of operations, financial position, or cash flows.

SUPPLY AND MANUFACTURE

Axcan depends on third parties for the supply of active ingredients and for the manufacture of the majority of its products. Although Axcan looks to secure alternative suppliers, Axcan may not be able to obtain the active ingredients or products from such third parties, the active ingredients or products may not comply with specifications, or the prices at which Axcan purchases them may increase and Axcan may not be able to locate alternative sources of supply in a reasonable time period, or at all. If any of these events occur, Axcan may not be able to continue to market certain of its products, and its sales and profitability would be adversely affected.

VOLATILITY OF SHARE PRICES

The market price of Axcan's shares is subject to volatility. Deviations in actual financial or scientific results, as compared to expectations of securities analysts who follow our activities can have a significant effect on the trading price of Axcan's shares.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements, which reflect the Company's current expectations regarding future events. To the extent that any statements in this document contain information that is not historical, the statements are essentially forward-looking and are often identified by words such as “anticipate”, “expect”, “estimate”, “intend”, “project”, “plan” and “believe”. These forward-looking statements include, but are not limited to, the expected sales growth of the Company's products and the expected increase in funds from operations resulting from the Company's research and development expenditures. The forward-looking statements involve risks and uncertainties. Actual events could differ materially from those projected herein and depend on a number of factors, including but not limited to the successful and timely completion of clinical studies, the difficulty of predicting FDA or other regulatory approvals, the commercialization of a drug or therapy after regula tory approval is received, the difficulty of predicting acceptance and demand for pharmaceutical products, the impact of competitive products and pricing, costs associated with new product development and launch, the availability of raw materials, the protection of our intellectual property, fluctuations in our operating results and other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission and the Canadian Securities Commissions. The reader is cautioned not to rely on these forward looking statements. The Company disclaims any obligation to update these forward-looking statements.

This MD&A has been prepared as of February 9, 2006. Additional information on the Company is available through regular filing of press releases, quarterly financial statements and the Annual Information Form on the SEDAR website.

On behalf of Management,

Jean Vézina
(signed)
Vice President, Finance and Chief Financial Officer

CONSOLIDATED
FINANCIAL STATEMENTS

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Consolidated Balance Sheets

(in thousands of U.S. dollars, except share related data)	**December 31, 2005** *(unaudited)* **$**	September 30, 2005 $
Assets		
Current assets		
Cash and cash equivalents	**115,238**	79,969
Short-term investments available for sale	**10,622**	17,619
Accounts receivable, net	**24,485**	37,587
Income taxes receivable	**7,912**	8,351
Inventories (Note 3)	**35,799**	36,016
Prepaid expenses and deposits	**3,514**	1,771
Deferred income taxes	**7,934**	9,044
Total current assets	**205,504**	190,357
Property, plant and equipment, net	**30,618**	31,673
Intangible assets, net (Note 4)	**382,985**	388,921
Goodwill, net	**27,467**	27,467
Deferred debt issue expenses, net	**2,302**	2,577
Deferred income taxes	**781**	412
Total assets	**649,657**	641,407
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**51,198**	52,990
Income taxes payable	**4,943**	3,247
Instalments on long-term debt	**1,401**	1,497
Deferred income taxes	**1,327**	602
Total current liabilities	**58,869**	58,336
Long-term debt	**126,047**	126,332
Deferred income taxes	**38,929**	39,135
Total liabilities	**223,845**	223,803
Shareholders' Equity		
Capital stock		
Preferred shares, without par value; unlimited shares authorized; no shares issued	**–**	–
Series A preferred shares, without par value; shares authorized: 14,175,000; no shares issued	**–**	–
Series B preferred shares, without par value; shares authorized: 12,000,000; no shares issued	**–**	–
Common shares, without par value; unlimited shares authorized; 45,688,344 issued as at December 31, 2005 and 45,682,175 as at September 30, 2005.	**261,780**	261,714
Retained earnings	**148,032**	138,787
Additional paid-in capital	**2,401**	1,329
Accumulated other comprehensive income	**13,599**	15,774
Total shareholders' equity	**425,812**	417,604
Total liabilities and shareholders' equity	**649,657**	641,407

See the accompanying notes to the Consolidated Financial Statements.

These interim financial statements should be read in conjunction with the annual Consolidated Financial Statements.

Consolidated Shareholders' Equity

(in thousands of U.S. dollars, except share related data) *(unaudited)*	**For the three-month period ended December 31, 2005**	For the three-month period ended December 31, 2004
Common shares (number)		
Balance, beginning of period	**45,682,175**	45,562,336
Shares issued pursuant to the stock option plan	**6,169**	18,714
Balance, end of period	**45,688,344**	45,581,050
Common shares		
Balance, beginning of period	**261,714**	260,643
Shares issued pursuant to the stock option plan	**66**	156
Balance, end of period	**261,780**	260,799
Retained earnings		
Balance, beginning of period	**138,787**	112,362
Net income	**9,245**	7,754
Balance, end of period	**148,032**	120,116
Additional paid-in capital		
Balance, beginning of period	**1,329**	–
Stock-based compensation expense	**1,072**	–
Income tax deductions on stock options exercise	**–**	980
Balance, end of period	**2,401**	980
Accumulated other comprehensive income		
Balance, beginning of period	**15,774**	19,071
Foreign currency translation adjustments	**(2,175)**	10,848
Balance, end of period	**13,599**	29,919
Total shareholders' equity	**425,812**	411,814
Comprehensive income		
Foreign currency translation adjustments	**(2,175)**	10,848
Net income	**9,245**	7,754
Total comprehensive income	**7,070**	18,602

See the accompanying notes to the Consolidated Financial Statements.

These interim financial statements should be read in conjunction with the annual Consolidated Financial Statements.

Consolidated Cash Flows

(in thousands of U.S. dollars)
(unaudited)

	For the three-month period ended December 31, 2005 $	For the three-month period ended December 31, 2004 $
Operations		
Net income	**9,245**	7,754
Non-cash items		
Amortization of deferred debt issue expenses	**275**	275
Other depreciation and amortization	**5,634**	5,364
Stock-based compensation expense	**1,072**	–
Foreign currency fluctuation	**(283)**	(16)
Deferred income taxes	**1,279**	601
Changes in working capital items		
Accounts receivable	**12,876**	(138)
Income taxes receivable	**406**	(682)
Inventories	**322**	(1,125)
Prepaid expenses and deposits	**(1,724)**	(722)
Accounts payable and accrued liabilities	**(1,569)**	(5,249)
Income taxes payable	**1,727**	2,755
Cash flows from operating activities	**29,260**	8,817
Financing		
Repayment of long-term debt	**(368)**	(469)
Deferred debt issue expenses	**–**	(589)
Issue of shares	**66**	156
Cash flows from financing activities	**(302)**	(902)
Investment		
Disposal of short-term investments	**6,997**	12,822
Acquisition of property, plant and equipment	**(566)**	(1,834)
Acquisition of intangible assets	**–**	(8)
Cash flows from investment activities	**6,431**	10,980
Foreign exchange gain (loss) on cash held in foreign currencies	**(120)**	175
Net increase in cash and cash equivalents	**35,269**	19,070
Cash and cash equivalents, beginning of period	**79,969**	21,979
Cash and cash equivalents, end of period	**115,238**	41,049
Additional information		
Interest received	**897**	99
Interest paid	**2,680**	2,698
Income taxes paid	**814**	1,269

See the accompanying notes to the Consolidated Financial Statements.

These interim financial statements should be read in conjunction with the annual Consolidated Financial Statements.

Consolidated Operations

(in thousands of U.S. dollars, except share related data)
(unaudited)

	For the three-month period ended December 31, 2005 $	For the three-month period ended December 31, 2004 $
Revenue	**70,639**	61,583
Cost of goods sold excluding depreciation and amortization	**18,229**	16,757
Selling and administrative expenses	**23,642**	20,957
Research and development expenses	**8,894**	6,389
Depreciation and amortization	**5,634**	5,364
	56,399	49,467
Operating income	**14,240**	12,116
Financial expenses	**1,758**	1,787
Interest income	**(786)**	(86)
Gain on foreign currency	**(210)**	(233)
	762	1,468
Income before income taxes	**13,478**	10,648
Income taxes	**4,233**	2,894
Net income	**9,245**	7,754
Income per common share		
Basic	**0.20**	0.17
Diluted	**0.19**	0.16
Weighted average number of common shares		
Basic	**45,686,661**	45,571,370
Diluted	**55,042,690**	55,303,339

See the accompanying notes to the Consolidated Financial Statements.

These interim financial statements should be read in conjunction with the annual Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(amounts in tables are stated in thousands of U.S. dollars, except share related data)
(unaudited)

1. Significant Accounting Policies

The accompanying unaudited financial statements are prepared in accordance with U.S. GAAP for interim financial statements and do not include all the information required for complete financial statements. They are consistent with the policies outlined in the Company's audited financial statements for the year ended September 30, 2005 except for the change mentioned in note 2. The interim financial statements and related notes should be read in conjunction with the Company's audited financial statements for the year ended September 30, 2005. When necessary, the financial statements include amounts based on informed estimates and best judgements of management. The results of operations for the interim periods reported are not necessarily indicative of results to be expected for the year.

2. Change in Accounting Policies

In December 2004, The Financial Accounting Standards Board issued the Statement of Financial Accounting Standards ("SFAS") No. 123R, *"Share-Based Payment"*. SFAS No. 123R requires all entities to recognize compensation cost for share-based awards, including options, granted to employees. The Statement eliminates the ability to account for share-based compensation transactions using the Accounting Principles Board Opinion ("APB") No. 25, *"Accounting for Stock Issued To Employees"*, and generally requires instead that such transactions be accounted for using a fair-value based method. Public companies are required to measure stock-based compensation classified as equity by valuing the instrument the employee receives at its grant-date fair value. Previously such awards were measured at intrinsic value under both APB No. 25 and SFAS No. 123, *"Accounting for Stock-Based Compensation"*. The Company applied the Statement beginning in fiscal 2006 using the modified prospective transition approach.

If this change in accounting policy had been applied to the previous fiscal year, the Company's net income, basic income per share and diluted income per share for the three-month period ended December 31, 2004 would have been reduced on a pro-forma basis as follows:

	For the three-month period ended December 31, 2004	
	As reported	Pro-forma
	$	$
Net income	7,754	6,657
Basic income per share	0.17	0.15
Diluted income per share	0.16	0.14

The estimated fair value of granted stock options for the periods ended December 31, 2005 and 2004 using the Black-Scholes model was as follows:

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
Fair value per option	**$6.47**	$6.98
Assumptions used		
Expected volatility	**44%**	44%
Risk-free interest rate	**4.01%**	4.16%
Expected options life (years)	**6**	6
Expected dividend	**–**	–

(amounts in tables are stated in thousands of U.S. dollars, except share related data)

3. Inventories

	December 31, 2005 $	September 30, 2005 $
Raw materials and packaging material	**17,317**	18,710
Work in progress	**1,716**	1,547
Finished goods	**16,766**	15,759
	35,799	36,016

4. Intangible Assets

	December 31, 2005		
	Cost	**Accumulated amortization**	**Net**
	$	**$**	**$**
Trademarks, trademark licenses and manufacturing rights with a:			
Finite life	**344,796**	**49,943**	**294,853**
Indefinite life	**100,585**	**12,453**	**88,132**
	445,381	**62,396**	**382,985**

	September 30, 2005		
	Cost	Accumulated amortization	Net
	$	$	$
Trademarks, trademark licenses and manufacturing rights with a:			
Finite life	334,749	45,841	288,908
Indefinite life	112,430	12,417	100,013
	447,179	58,258	388,921

The cost of the products LACTÉOL and ADEKs has been transferred from intangible assets with an indefinite life to intangible assets with a finite life following changes in the regulatory rules applicable to these products and resulting in the modification of their useful life. The net cost of these products as of October 1, 2005, which amounted to $13,520,565, is therefore amortized over a 15-year period.

(amounts in tables are stated in thousands of U.S. dollars, except share related data)
(unaudited)

5. Segmented Information

The Company considers that it operates in a single reportable segment, the pharmaceutical industry, since its other activities do not account for a significant portion of segment assets.

The Company operates in the following geographic areas:

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Revenue		
Canada		
Domestic sales	**10,184**	9,190
Foreign sales	**–**	–
United States		
Domestic sales	**44,909**	37,028
Foreign sales	**1,346**	1,157
Europe		
Domestic sales	**12,145**	11,743
Foreign sales	**2,022**	2,423
Other	**33**	42
	70,639	61,583

	December 31, 2005	September 30, 2005
	$	$
Property, plant, equipment, intangible assets and goodwill		
Canada	**39,042**	39,506
United States	**126,843**	127,915
Europe	**247,408**	252,509
Other	**27,777**	28,131
	441,070	448,061

Revenue is attributed to geographic segments based on the sales country of origin.

(amounts in tables are stated in thousands of U.S. dollars, except share related data)

6. Financial Information Included in the Consolidated Statement of Operations

a) Financial expenses

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Interest on long-term debt	**1,375**	1,434
Bank charges	**29**	7
Financing fees	**79**	71
Amortization of deferred debt issue expenses	**275**	275
	1,758	1,787

b) Selling and administrative expenses
Selling and administrative expenses include the followings:

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Shipping and handling expenses	**1,258**	1,004
Advertising expenses	**4,069**	4,625

c) Other information

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Rental expenses	**290**	287
Depreciation of property, plant and equipment	**1,406**	1,301
Amortization of intangible assets	**4,228**	4,063

d) Income per common share
The following tables reconcile the numerators and the denominators of the basic and diluted income per common share computations:

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Net income available to common shareholders		
Basic	**9,245**	7,754
Interest and amortization of deferred debt issue expenses relating to the convertible subordinated notes, net of income taxes	**1,121**	1,079
Net income available to common shareholders on a diluted basis	**10,366**	8,833

(amounts in tables are stated in thousands of U.S. dollars, except share related data)

6. Financial Information Included in the Consolidated Statement of Operations (Continued)

d) Income per common share (Continued)

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
Weighted average number of common shares		
Weighted average number of common shares outstanding	**45,686,661**	45,571,370
Effect of dilutive stock options	**431,916**	807,856
Effect of dilutive convertible subordinated notes	**8,924,113**	8,924,113
Adjusted weighted average number of common shares outstanding	**55,042,690**	55,303,339
Number of common shares outstanding as at January 31, 2006	**45,710,879**	

Options to purchase 1,180,874 and 283,000 common shares were outstanding as at December 31, 2005 and 2004 respectively but were not included in the computation of diluted income per share as exercise price of the options was greater than the average market price of the common shares.

The $125,000,000 subordinated notes are convertible into 8,924,113 common shares. The noteholders may convert their notes during any quarterly conversion period if the closing price per share for at the least 20 consecutive trading days during the 30 consecutive trading-day period ending on the first day of the conversion period exceeds 110% of the conversion price in effect on that thirtieth trading day. The noteholders may also convert their notes during the five business-day period following any 10 consecutive trading-day period in which the daily average of the trading prices for the notes was less than 95% of the average conversion value for the notes during that period. Finally, the noteholders may also convert their notes upon the occurrence of specified corporate transactions or, if the company has called the notes for redemption. On or after April 20, 2006, the Company may at its option, redeem the notes, in whole or in part at redemption prices varying from 101.70% to 100.85% of the principal amount plus any accrued and unpaid interest to the redemption date. The notes also include provisions for the redemption of all the notes for cash at the option of the Company following some changes in tax treatment.

e) Employee benefit plan

A subsidiary of the Company has a defined contribution plan (“The Plan”) for its U.S. employees. Participation is available to substantially all U.S. employees. Employees may contribute up to 15% of their gross pay and up to limits set by the U.S. Internal Revenue Service. For the three-month period ended December 31, 2005, the Company made matching contributions to the Plan totalling $100,456 ($122,183 in 2004).

(amounts in tables are stated in thousands of U.S. dollars, except share related data)
(unaudited)

7. Summary of Differences Between Generally Accepted Accounting Principles in the United States and in Canada

The consolidated interim financial statements have been prepared in accordance with U.S. GAAP which, in the case of the Company, conform in all materials respects with Canadian GAAP, except as set forth below:

	For the three-month period ended December 31, 2005	For the three-month period ended December 31, 2004
	$	$
Operations adjustments		
Net income in accordance with U.S. GAAP	**9,245**	7,754
Implicit interest on convertible debt	**(1,229)**	(1,123)
Stock-based compensation expense	**–**	(1,300)
Amortization of new product acquisition costs	**(14)**	(14)
Income tax impact of the above adjustments	**(163)**	5
Net earnings in accordance with Canadian GAAP	**7,839**	5,322
Earnings per share in accordance with Canadian GAAP		
Basic	**0.17**	0.12
Diluted	**0.17**	0.11

	December 31, 2005		September 30, 2005	
	U.S. GAAP	Canadian GAAP	U.S. GAAP	Canadian GAAP
	$	$	$	$
Balance sheet adjustments				
Current assets	**205,504**	**205,504**	190,357	190,357
Property, plant and equipment	**30,618**	**30,618**	31,673	31,673
Intangible assets	**382,985**	**395,280**	388,921	401,229
Goodwill	**27,467**	**28,862**	27,467	28,862
Deferred debt issue expenses	**2,302**	**2,302**	2,577	2,577
Deferred income tax asset	**781**	**612**	412	412
Current liabilities	**58,869**	**58,869**	58,336	58,336
Long-term debt	**126,047**	**114,194**	126,332	113,250
Deferred income tax liability	**38,929**	**40,023**	39,135	40,234
Shareholders' equity				
Equity component of convertible debt	**–**	**24,239**	–	24,239
Capital stock	**261,780**	**273,088**	261,714	273,022
Additional paid-in capital	**2,401**	**14,367**	1,329	13,293
Retained earnings	**148,032**	**120,643**	138,787	112,806
Accumulated foreign currency translation adjustments	**13,599**	**17,755**	15,774	19,930

CORPORATE INFORMATION

Axcan is a leading specialty pharmaceutical company focused in the field of gastroenterology. The Company markets a broad line of prescription products sold for the treatment of symptoms in a number of gastrointestinal diseases and disorders such as Inflammatory Bowel Disease, Irritable Bowel Syndrome, cholestatic liver diseases, and complications related to Cystic Fibrosis. Axcan's products are marketed by its own sales force in North America and Europe. Today, the Company counts more than 450 employees worldwide.

Headquartered in Mont-St-Hilaire, Quebec, Canada, Axcan's common shares are traded on the Toronto Stock Exchange under the symbol "AXP" and on the NASDAQ National Market under the symbol "AXCA".

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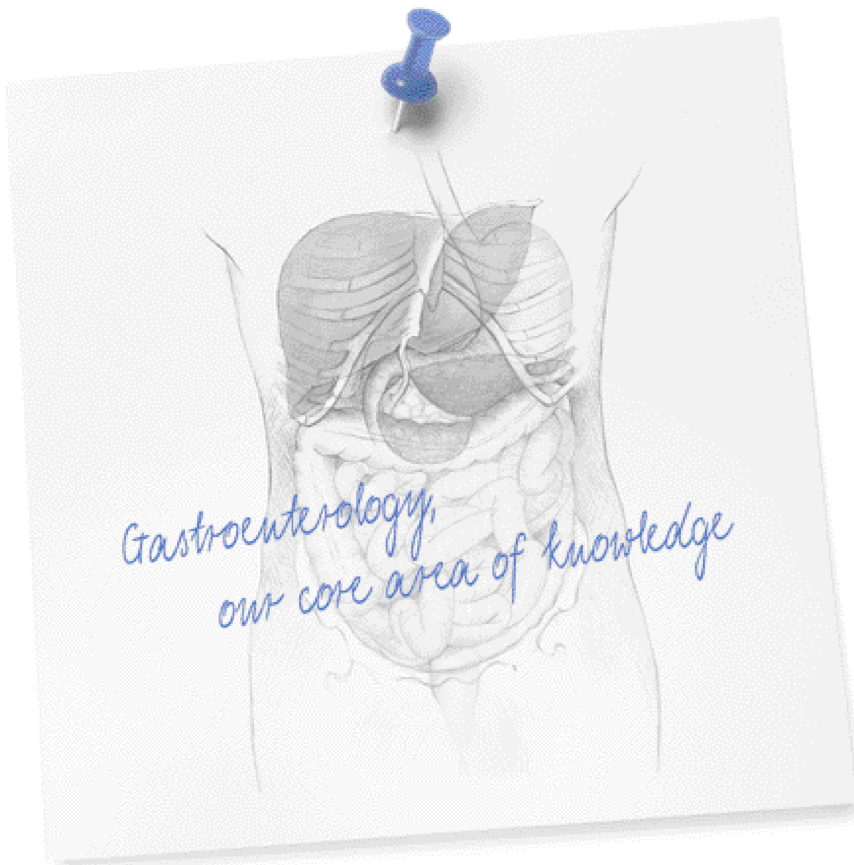

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