



INTERIM REPORT

**Management's Discussion and
Analysis**
of Financial Condition and Results of Operations

Fourth Quarter
September 30, 2007

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INTRODUCTION

Axcan Pharma Inc. ("Axcan" or "the Company") is a leading specialty 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's main products include pancreatic enzymes (ULTRASE, PANZYTRAT and VIOKASE) for the treatment of exocrine pancreatic insufficiency; bile acid (URSO/URSO 250, URSO FORTE/URSO DS and DELURSAN) for the treatment of certain cholestatic liver diseases; mesalamine (SALOFALK and CANASA) for the treatment of certain inflammatory bowel diseases; and sucralfate (CARAFATE and SULCRATE) for the treatment of gastric and duodenal ulcers. Axcan also has a number of projects in all phases of clinical development.

VISION

Axcan's vision is to become the reference gastroenterology specialty pharmaceutical company. The Company's vision is supported by goals to provide value-added therapeutics for a broad spectrum of unmet needs in gastroenterology, achieve a leadership position in its targeted gastroenterology segments, offer stimulating and rewarding opportunities for its employees and create shareholder value and a competitive shareholder return.

STRATEGY

Axcan seeks to develop its gastrointestinal franchise by 1) growing its base business; 2) launching new products; 3) making strategic acquisitions; 4) advancing its research and development portfolio; and 5) expanding internationally.

Base Business and New Products: Axcan's intention is to grow sales by building on its solid base business and introducing new products onto the market. The Company's strategy brings together its focus on product differentiation and a competitive time-to-market for its products, combined with astute portfolio management and a heightened sales focus. Axcan believes that its revenues should be enhanced through increased sales of the Company's existing products.

Strategic Acquisitions: Axcan's goal is to build on its proven acquisition strategy and continue to aggressively seek products and/or companies to fuel future growth. By capitalizing on its current business model, the Company seeks to leverage its strengths and capabilities in order to develop and acquire products that have significant market potential and complement its area of focus.

Research and Development: Axcan's products continue to provide great benefit to patients. The Company will sustain investment into research and development, in order to develop the next generation of products to address unmet needs in gastroenterology.

International Expansion: Axcan's current infrastructure, both in North America and Europe, will form the basis of the Company's international expansion, as management believes that it will serve as a springboard to increase Axcan's sales and marketing footprint worldwide.

BUSINESS ENVIRONMENT

Axcan's revenue in North America has historically been and continues to be principally derived from sales of pharmaceutical products to large pharmaceutical wholesalers and large pharmacy chains. Axcan utilizes a "pull-through" marketing approach that is typical of pharmaceutical companies. According to 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 pharmacy chains, their distribution centres, to which Axcan sells its products. Axcan's revenue in Europe and other markets has historically been and continues to be principally derived from sales of pharmaceutical products to institutional buyers and pharmacies through a network of distributors. 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.

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 which Axcan licenses some of its commercialized products), research and development expenses, as well as depreciation and amortization.

Axcan's 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's products for approved indications; and wholesaler buying patterns.

Historically, wholesalers' business models in the United States were dependent on drug price inflation. Their profitability and gross margins were directly tied to the speculative purchasing of pharmaceutical products at pre-increase prices, and the selling of their product inventory to their customers at the increased price. This inventory price arbitrage accounted for a predominant portion of wholesalers' compensation for their distribution services and had a dramatic effect on wholesaler buying patterns, as they invested in inventories in anticipation of generating higher gross margins from manufacturer price increases. Since fiscal 2005, pharmaceutical manufacturers have not been increasing drug prices as frequently, and the percentage increases have been lower. For these and other reasons, some wholesalers have changed their business model to a fee-for-service arrangement, whereby manufacturers pay wholesalers a fee for inventory management and other services. These fees typically are a percentage of the wholesaler's purchases from the manufacturer or a fixed charge per item or per unit. The fee-for-service approach results in wholesalers' compensation being more stable, and volume-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 inventories from their historical levels. Under the new model, the consequence of manufacturers using wholesalers is that they now realize the benefit of price increases more rapidly in return for paying wholesalers for the services they provide, on a fee-for-service basis. This change in wholesalers' business models has affected Axcan's revenue since fiscal 2005, and the resulting distribution services agreement ("DSA") fees are deducted from gross sales. Currently, only one such DSA is in place and Axcan expects to enter into further DSAs with its other wholesalers.

FINANCIAL OVERVIEW

This discussion and analysis is based on the Company's unaudited interim consolidated financial statements reported under generally accepted accounting principles in the United States ("U.S. GAAP"). This discussion should be read in conjunction with the information contained in Axcan's annual consolidated financial statements and the related notes thereto. All amounts are expressed in U.S. dollars.

For the three-month period ended September 30, 2007, revenue was \$92.5 million (\$72.3 million in 2006), operating income was \$19.1 million (\$11.2 million in 2006) and net income was \$16.8 million (\$8.3 million in 2006). For the year ended September 30, 2007, revenue was \$348.9 million (\$292.3 million in 2006), operating income was \$102.8 million (\$57.8 million in 2006) and net income was \$71.5 million (\$39.1 million in 2006). Revenue from sales of Axcan's products in the United States was \$254.7 million (73.0% of total revenue) for the year ended September 30, 2007, compared to \$201.8 million (69.0% of total revenue) for fiscal 2006. In Canada, revenue was \$38.0 million (10.9% of total revenue) for the year ended September 30, 2007, compared to \$38.0 million (13.0% of total revenue) for fiscal 2006. In Europe, revenue was \$55.9 million (16.0% of total revenue) for the year ended September 30, 2007, compared to \$52.1 million (17.8% of total revenue) for fiscal 2006.

In September 2007, Axcan entered into an exclusive license and development agreement with Cellerix SL ("Cellerix") of Spain, for the North American (United States, Canada and Mexico) rights to Cx401, an innovative biological product in development for the treatment of perianal fistulas. Cx401 uses non-embryonic stem-cells to treat perianal fistulas in Crohn's and non-Crohn's Disease patients. A Phase II clinical trial has demonstrated the efficacy and confirmed the safety of Cx401 in the treatment of perianal fistulas. The primary endpoint for this study was photographically assessed complete closure and healing, and showed a 71% response rate in the acute phase, both in Crohn's and non-Crohn's Disease patients. Based on its current understanding of the market, Axcan believes that peak sales for this product could exceed \$250 million in the United States alone. Patent applications have been submitted, which, if granted, could provide protection until 2025. Under the terms of the agreement, as at September 30, 2007, Axcan recorded a \$10.0 million upfront payment payable to Cellerix, and will make regulatory milestone payments that could total up to \$30.0 million. Furthermore, Axcan will pay scaled royalties based on the net sales of Cx401. Axcan has also agreed to make an equity investment of up to \$5.0 million in Cellerix, should Cellerix complete its initial public offering by September 30, 2010.

During the third quarter of fiscal 2007, the Company called for redemption all of its \$125.0 million 4.25% Convertible Subordinated Notes, (the "Notes") and the holders of all of the Notes exercised their right to convert their Notes, in lieu of redemption, which resulted in the Company issuing an aggregate of 8,924,080 common shares. Long-term debt was consequently reduced by \$125.0 million, and capital stock increased by the same amount. The difference between the basic and diluted average number of common shares decreased for the quarters following the conversion. During the period when the Notes were outstanding, financial analysts estimated the Company's earnings per share on a fully diluted basis and, as a result, the conversion had no effect on future estimates of earnings per share other than the elimination of financing expenses. As a result of the conversion, financial expenses for the year ended September 30, 2007, were reduced by \$2.5 million in interest on long-term debt and increased by \$0.4 million in amortization of deferred debt issue expenses, compared to fiscal 2006. For the three-month period ended September 30, 2007, financial expenses were reduced by \$1.3 million in interest on long-term debt, and amortization of deferred debt issue expenses were reduced by \$0.2 million, compared to the same period of fiscal 2006.

Guidance

Total revenues for the year ended September 30, 2007, were \$348.9 million, exceeding the top end of the Company's previously issued guidance of \$335 to \$343 million. This compares with \$292.3 million for fiscal 2006, and represents an increase of 19.4%. The Company's research and development and selling and administrative expenses were within the range given in previously issued guidance.

Overview of Results

Results of Operations

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

	For the three-month periods ended September 30,			
	2007	2006	Change	
	\$	\$	\$	%
Revenue	92.5	72.3	20.2	27.9
Cost of goods sold ^(a)	22.6	18.3	4.3	23.5
Selling and administrative expenses ^(a)	27.7	21.6	6.1	28.2
Research and development expenses ^(a)	7.2	15.3	(8.1)	(52.9)
Acquired in-process research	10.0	-	10.0	-
Depreciation and amortization	5.9	5.9	-	-
	73.4	61.1	12.3	20.1
Operating income	19.1	11.2	7.9	70.5
Financial expenses	0.1	1.7	(1.6)	(94.1)
Interest income	(3.8)	(2.1)	(1.7)	(81.0)
Loss (gain) on foreign currency	1.3	(0.4)	1.7	425.0
	(2.4)	(0.8)	(1.6)	200.0
Income before income taxes	21.5	12.0	9.5	79.2
Income taxes	4.7	3.7	1.0	27.0
Net income	16.8	8.3	8.5	102.4
(a) Exclusive of depreciation and amortization				
Income per common share				
Basic	0.30	0.18	0.12	66.7
Diluted	0.30	0.17	0.13	76.5

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

For the years ended September 30,

	2007	2006	Change	
	\$	\$	\$	%
Revenue	348.9	292.3	56.6	27.9
Cost of goods sold ^(a)	83.7	72.8	10.9	23.5
Selling and administrative expenses ^(a)	101.3	93.3	8.0	28.2
Research and development expenses ^(a)	28.6	39.8	(11.2)	(52.9)
Acquired in-process research	10.0	-	10.0	-
Depreciation and amortization	22.5	22.8	(0.3)	(1.3)
Partial write-down of intangible assets	-	5.8	(5.8)	(100.0)
	246.1	234.5	12.3	20.1
Operating income	102.8	57.8	7.9	70.5
Financial expenses	4.8	7.0	(1.6)	(94.1)
Interest income	(11.4)	(5.5)	(1.7)	(81.0)
Loss (gain) on foreign currency	2.4	(1.1)	1.7	425.0
	(4.2)	0.4	(1.6)	200.0
Income before income taxes	107.0	57.4	9.5	79.2
Income taxes	35.5	18.3	1.0	27.0
Net income	71.5	39.1	8.5	102.4
Income per common share				
Basic	1.47	0.86	0.12	66.7
Diluted	1.33	0.79	0.13	76.5

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 September 30,		For the years ended September 30,	
	2007	2006	2007	2006
	%	%	%	%
Revenue	100.0	100.0	100.0	100.0
Cost of goods sold	24.4	25.3	24.0	24.9
Selling and administrative expenses	30.0	29.8	29.0	31.9
Research and development expenses	7.8	21.2	8.2	13.6
Acquired in-process research	10.8	-	2.9	-
Depreciation and amortization	6.3	8.2	6.4	7.8
Partial write-down of intangible assets	-	-	-	2.0
	79.3	84.5	70.5	80.2
Operating income	20.7	15.5	29.5	19.8
Financial expenses	0.1	2.4	1.4	2.4
Interest income	(4.1)	(2.9)	(3.3)	(1.9)
Loss (gain) on foreign currency	1.4	(0.6)	0.7	(0.4)
	(2.6)	(1.1)	(1.2)	0.1
Income before income taxes	23.3	16.6	30.7	19.7
Income taxes	5.1	5.2	10.2	6.3
Net income	18.2	11.4	20.5	13.4

Revenue

For the three-month period ended September 30, 2007, revenue was \$92.5 million compared to \$72.3 million for the corresponding period of the preceding fiscal year, an increase of 27.9%. For the year ended September 30, 2007, revenue was \$348.9 million compared to \$292.3 million for the preceding fiscal year, an increase of 19.4%.

These increases 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. Although sales have increased by 19.4%, major wholesalers in the United States slightly decreased their average inventory levels, in fiscal 2007. Based on its best estimate derived from information obtained from a number of its wholesalers in the United States, the Company believes that changes in wholesaler inventory levels favourably impacted revenue by approximately \$7.0 million for the fourth quarter of fiscal 2007. The Company estimates that at the end of its fourth quarter overall wholesaler inventory levels of key products sold in the United States were at the higher end of the four- to six-week range.

Sales in Europe also increased in the year ended September 30, 2007, mainly due to a strong sales performance of PANZYTRAT in Germany. This overall increase in sales in Europe was achieved despite the delisting in March 2006 by the French government of a number of pharmaceutical products from government formularies, including LACTEOL, and the re-pricing of other pharmaceuticals, including TAGAMET. For fiscal 2006, sales of LACTEOL in Europe amounted to \$18.1 million, compared to \$16.3 million for fiscal 2007. The reduction in LACTEOL sales in France has been partially offset by the addition of Over The Counter ("OTC") sales of the product since the end of fiscal 2006 and higher export sales, thus reducing the anticipated decline. As previously disclosed, the Company believes that the sales impact caused by the delisting from French government formularies on March 1, 2006, has stabilized.

Revenue is stated net of deductions for product returns, chargebacks, contract rebates, DSA fees, discounts and other allowances. The following table summarizes the Company's gross-to-net revenue adjustments for each significant category:

(in millions of U.S. dollars)	For the three-month periods ended September 30,			
	2007	2006	Change	
	\$	\$	\$	%
Gross revenue	107.0	88.6	18.4	20.8
Gross-to-net revenue adjustments				
Product returns	3.6	4.7	(1.1)	(23.4)
Chargebacks	2.1	3.0	(0.9)	(30.0)
Contract rebates	6.0	5.7	0.3	5.3
DSA fees	0.8	2.7	(1.9)	(70.4)
Discounts and other allowances	2.0	0.2	1.8	900.0
Total gross-to-net revenue adjustments	14.5	16.3	(1.8)	(11.0)
Net revenue	92.5	72.3	20.2	27.9

(in millions of U.S. dollars)

	For the years ended September 30,			
	2007	2006	Change	
	\$	\$	\$	%
Gross revenue	409.7	350.9	58.8	16.8
Gross-to-net revenue adjustments				
Product returns	13.1	16.8	(3.7)	(22.0)
Chargebacks	14.2	14.5	(0.3)	(2.1)
Contract rebates	22.7	20.9	1.8	8.6
DSA fees	3.6	2.6	1.0	38.5
Discounts and other allowances	7.2	3.8	3.4	89.5
Total gross-to-net revenue adjustments	60.8	58.6	2.2	3.8
Net revenue	348.9	292.3	56.6	19.4

Product returns, chargebacks, contract rebates, DSA fees, discounts and other allowances totalled \$14.5 million (13.6% of gross revenue) for the three-month period ended September 30, 2007, and \$16.3 million (18.4% of gross revenue) for the three-month period ended September 30, 2006. Product returns, chargebacks, contract rebates, DSA fees, discounts and other allowances totalled \$60.8 million (14.8% of gross revenue) for the year ended September 30, 2007, and \$58.6 million (16.7% of gross revenue) for the year ended September 30, 2006.

The decrease in total deductions as a percentage of gross revenue for the year and quarter ended September 30, 2007, was primarily due to decrease in product returns, which is in line with the decline in wholesaler inventory levels which occurred during the first half of fiscal 2007. As stated earlier, DSA fees are included in "Gross-to-net revenue adjustments" since the quarter ended September 30, 2006; prior to July 1, 2006, such fees were included in selling and administrative expenses.

Cost of goods sold

Cost of goods sold consists principally of the costs of raw materials, royalties and manufacturing costs. Axcan outsources most of its manufacturing requirements. For the three-month period ended September 30, 2007, cost of goods sold increased \$4.3 million (23.5%) to \$22.6 million from \$18.3 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 September 30, 2007, decreased as compared to the corresponding period of the preceding fiscal year from 25.3% to 24.4%. For the year ended September 30, 2007, cost of goods sold increased \$10.9 million (15.0 %) to \$83.7 million from \$72.8 million for the preceding fiscal year. As a percentage of revenue, cost of goods sold for the year ended September 30, 2007, decreased as compared to the corresponding period of the preceding fiscal year from 24.9% to 24.0%. These decreases in the cost of goods sold as a percentage of revenue occurred as the Company continues to benefit from improvements to its information systems, allowing for better monitoring of its inventories as well as lower manufacturing and purchasing costs. A reduction in certain project related expenses incurred for technical services and commercial product process improvements also contributed to the decreases.

Selling and administrative expenses

Selling and administrative expenses consist principally of salaries and other costs associated with Axcan's sales force and its marketing activities. For the three-month period ended September 30, 2007, selling and administrative expenses increased \$6.1 million (28.2%) to \$27.7 million from \$21.6 million for the corresponding period of the preceding fiscal year. For the year ended September 30, 2007, selling and administrative expenses increased \$8.0 million (8.6%) to \$101.3 million from \$93.3 million for the preceding fiscal year. The increases in selling and administrative expenses are largely attributable to higher expenses linked to increased sales performance in our base business as well as costs associated with the launch of PYLERA in May 2007, in the United States. Launch costs include certain marketing materials as well as the hiring of an additional seven sales representatives in the second quarter of fiscal 2007, to support launch activities.

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 decreased \$8.1 million (52.9%) to \$7.2 million for the three-month period ended September 30, 2007, from \$15.3 million for the corresponding period of the preceding fiscal year. For the year ended September 30, 2007, research and development expenses decreased \$11.2 million (28.1%) to \$28.6 million, from \$39.8 million for the preceding fiscal year. Most of the decrease is due to the termination during the last fiscal year of the development of ITAX for the treatment of Functional Dyspepsia. This decrease was partially offset by the costs specifically related to the New Drug Applications ("NDAs") for ULTRASE and VIOKASE. In April 2004, the U.S. Food and Drug Administration ("FDA") had formally notified manufacturers of pancreatic insufficiency products that these drugs, which include ULTRASE and VIOKASE, must receive approval before April 2008, in order to remain on the market. This deadline was recently extended to April 2010. Axcan completed the submission of its NDA for ULTRASE during fiscal 2007, and is currently advancing the completion of its NDA for VIOKASE.

Acquired in-process research

The acquired in-process research of \$10.0 million for the three-month period and the year ended September 30, 2007, relates to an up-front license fee payable upon signing of the exclusive license agreement for North America with Cellerix to develop, manufacture and market Cx401, an innovative biological product in development for the treatment of perianal fistulas. As this product had not reached technological feasibility, the license fee was considered to be acquired in-process research and was expensed in the fourth quarter of the year ended September 30, 2007, the period of acquisition.

Depreciation and amortization

Depreciation and amortization consists principally of the amortization of intangible assets with a finite life. Intangible assets include trademarks, trademark licenses and manufacturing rights. Depreciation and amortization decreased \$0.1 million (1.7%) to \$5.8 million for the three-month period ended September 30, 2007, from \$5.9 million for the corresponding period of the preceding fiscal year. For the year ended September 30, 2007, depreciation and amortization decreased \$0.3 million (1.3%) to \$22.5 million from \$22.8 million for the preceding fiscal year, as some assets reached the end of their depreciation period.

Partial write-down of intangible assets

In the second quarter of fiscal 2006 and as a result of budgetary initiatives implemented by the French government, which resulted in the delisting of a number of pharmaceutical products from government formularies and the re-pricing of other pharmaceutical products, the Company reviewed the appropriate carrying value and useful life of its French subsidiary's intangible assets. During the three-month period ended March 31, 2006, a partial write-down of \$5.8 million was recognized on a French line of products including TAGAMET and TRANSULOSE, as the carrying value of the intangible assets associated with these products, totalling \$18.7 million prior to the write-down, exceeded their estimated fair value since management expected a negative effect on TAGAMET and TRANSULOSE future sales.

Financial expenses

Financial expenses consist principally of interest and fees paid in connection with funds borrowed for acquisitions. Financial expenses decreased \$1.6 million to \$0.1 million for the three-month period ended September 30, 2007, from \$1.7 million for the corresponding period of the preceding fiscal year. For the year ended September 30, 2007, financial expenses decreased \$2.2 million to \$4.8 million from \$7.0 million for the preceding fiscal year. This decrease is mainly due to the reduction in interest on long-term debt and the increase in amortization of deferred debt issue expenses, which were written-off in the third quarter, following the conversion of the Notes.

Interest income

For the three-month period ended September 30, 2007, interest income increased \$1.7 million (81.0%) to \$3.8 million, compared to \$2.1 million for the corresponding period of the preceding fiscal year. For the year ended September 30, 2007, interest income increased \$5.9 million (107.3%) to \$11.4 million from \$5.5 million for the preceding fiscal year. These increases are related to the increase in cash, cash equivalents and short-term investments and an increase in the interest rates applicable to such investments.

Income taxes

For the three-month period ended September 30, 2007, income taxes amounted to \$4.7 million compared to \$3.7 million for the corresponding period of the preceding fiscal year. The effective tax rate was 22.0% for the three-month period ended September 30, 2007, compared to 31.2% for the three-month period ended September 30, 2006. For the year ended September 30, 2007, income taxes amounted to \$35.5 million compared to \$18.3 million for the preceding fiscal year. The effective tax rates were 33.2% for the year ended September 30, 2007, and 31.8% for the year ended September 30, 2006. The increase in the effective tax rate for the year ended September 30, 2007, was mainly due to a charge of \$5.5 million to account for capital gains taxes on currency exchange gains made upon conversion of the Notes during the third quarter of fiscal 2007. This charge was partly offset by capital losses tax savings of \$3.6 million on currency exchange losses made during the third and fourth quarter on cash held in foreign currency which was the primary reason for the reduction in the effective tax rate for the fourth quarter.

The Company has been audited by Canada Revenue Agency, mainly on transfer pricing issues, for fiscal years 2002 to 2004. As a result of this audit, which was completed in the second quarter of fiscal 2007, the Company received new assessments from Canada Revenue Agency, which allowed management to confirm that the current estimate of the Company's tax provision is reasonable.

Net income

Net income was \$16.8 million or \$0.30 of basic and diluted income per share, for the three-month period ended September 30, 2007, compared to \$8.3 million or \$0.18 of basic income per share and \$0.17 of diluted income per share for the corresponding period of the preceding year. The change in net income for the three-month period ended September 30, 2007, resulted mainly from an increase in revenue of \$20.2 million, an increase in interest income of \$1.7 million and a decrease in financial expenses of \$1.6 million, which were partly offset by an increase in income taxes of \$1.0 million and an increase in operating expenses of \$12.3 million. The weighted average number of common shares outstanding used to establish the basic per share amounts increased from 45.8 million for the three-month period ended September 30, 2006, to 55.3 million for the three-month period ended September 30, 2007, following the exercise of options previously granted pursuant to Axcan's stock incentive plans, as well as the conversion of the Company's Notes to equity, which occurred on June 28, 2007. The weighted average number of common shares used to establish the diluted per share amounts increased from 55.0 million for the three-month period ended September 30, 2006, to 56.1 million for the three-month period ended September 30, 2007. As at November 27, 2007, there were 55.4 million common shares issued and outstanding, including the 8,924,080 common shares issued on June 28, 2007, upon conversion of all outstanding Notes.

Net income was \$71.5 million or \$1.47 of basic income per share and \$1.33 of diluted income per share, for the year ended September 30, 2007, compared to \$39.1 million or \$0.86 of basic income per share and \$0.79 of diluted income per share for the preceding year. The change in net income for the year ended September 30, 2007, resulted mainly from an increase in revenue of \$56.6 million, an increase in interest income of \$5.9 million and a decrease in financial expenses of \$2.2 million which were partly offset by an increase in operating expenses of \$11.6 million, an increase in income taxes of \$17.2 million. The operating expenses for the year ended September 30, 2006, included a \$5.8 million expense of partial write-down of intangible assets.

Balance sheet

The following table summarizes balance sheet information as at September 30, 2007, compared to September 30, 2006:

(in millions of U.S. dollars)

	September 30, 2007	September 30, 2006	Change	
	\$	\$	\$	%
Cash, cash equivalents and short-term investments	309.6	173.0	136.6	79.0
Current assets	402.1	262.4	139.7	53.2
Total assets	832.6	695.8	136.8	19.7
Current liabilities	104.7	64.6	40.1	62.1
Long-term debt	0.1	125.6	(125.5)	(99.9)
Total liabilities	142.4	228.4	(86.0)	(37.7)
Shareholders' equity	690.2	467.4	222.8	47.7
Working capital	297.4	197.8	99.6	50.4

Axcan's cash, cash equivalents and short-term investments increased by \$136.6 million (79.0%) to \$309.6 million as at September 30, 2007, from \$173.0 million at September 30, 2006. As at September 30, 2007, Axcan does not hold any asset backed commercial paper. As at September 30, 2007, working capital was \$297.4 million, compared to \$197.8 million at September 30, 2006, an increase of \$99.6 million (50.4%). Total assets

increased \$136.8 million (19.7%) to \$832.6 million as at September 30, 2007, from \$695.8 million as at September 30, 2006. These increases were mainly due to the cash flows from operating activities of \$136.1 million for the year ended September 30, 2007.

Shareholders' equity increased \$222.8 million (47.7%) to \$690.2 million as at September 30, 2007, from \$467.4 million as at September 30, 2006. The increase in shareholders' equity is mainly due to the conversion of the Notes, amounting to \$125.0 million, into capital stock and the net income of the year ended September 30, 2007, of \$71.5 million. Long-term debt decreased \$125.5 million (99.9%) to \$0.1 million as at September 30, 2007, from \$125.6 million as at September 30, 2006. This decrease is mainly due to the conversion of the Notes, amounting to \$125.0 million, into capital stock.

LIQUIDITY AND CAPITAL RESOURCES

Cash Requirements

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, which have since been converted into equity. 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 \$39.8 million for fiscal 2006 and \$28.6 million for fiscal 2007. Axcan believes that its 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 its growth strategy, regulatory approvals of future products and the extension of product indications, stemming from its research and development efforts, will 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.

Contractual Obligations and Other Commitments

The following table summarizes Axcan's significant contractual obligations as at September 30, 2007, and the effect such obligations are expected to have on its liquidity and cash flows in future years. This table excludes amounts already recorded on the balance sheet as current liabilities at September 30, 2007, and certain other purchase obligations as discussed below:

(in millions of U.S. dollars)

For the years ending September 30,

	2008	2009	2010	2011	2012 and thereafter
	\$	\$	\$	\$	\$
Long-term debt	0.5	0.1	-	-	-
Operating leases	2.4	1.0	0.2	0.1	0.1
Other commitments	1.6	1.0	0.6	0.3	-
	<u>4.5</u>	<u>2.1</u>	<u>0.8</u>	<u>0.4</u>	<u>0.1</u>

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 its vendors within 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. As milestone payments are primarily contingent on receiving regulatory approval for products under development, they do not have defined maturities and therefore are not included in the above table.

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

Long-term debt

Long-term debt, including instalments due within one year, totalled \$0.6 million as at September 30, 2007, compared to \$126.2 million as at September 30, 2006. As at September 30, 2006, the long-term debt included \$1.2 million of obligations under capital leases and the \$125.0 million Notes.

During the third quarter of fiscal 2007, the Company called for redemption all of its Notes and the holders of all of the Notes exercised their right to convert their Notes, in lieu of redemption, by June 28, 2007. The Company completed the conversion of the Notes by issuing the holders an aggregate of 8,924,080 shares of its common stock.

Operating leases

The Company has various long-term operating lease agreements for office space, automotive equipment and other equipment. The latest expiry date for these agreements is in 2013.

Other commitments

Other operating commitments consist primarily of amounts relating to administrative services, clinical studies and other research and development services.

Line of Credit

Since September 28, 2007, the Company has had an amended credit agreement with a banking syndicate relative to a \$125.0 million 5-year financing maturing on April 30, 2012 (September 20, 2009 in 2006). Under certain conditions, the amount of the credit can now be increased up to an additional \$100.0 million and the maturity date extended.

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 50% (10% in 2006) of the Company's net income for the preceding fiscal year.

The interest rate varies, depending on the Company's leverage, between 5 and 75 (25 and 100 in 2006) basis points over the Canadian prime rate or U.S. base rate and between 90 and 175 (125 and 200 in 2006) basis points over the LIBOR rate or bankers' acceptances. The line of credit also provides for a stand-by fee of between 20 and 32.5 (25 and 37.5 in 2006) basis points. The credit facility may be drawn in U.S. dollars, in Canadian dollars or in euro equivalent. As at September 30, 2007, there was no amount outstanding under the line of credit.

Sources and Uses of Cash

The Company's cash flows from operating, investing and financing activities, as reflected in the consolidated statements of cash flows, are summarized in the following table:

(in millions of U.S. dollars)

	For the three-month periods ended September 30,		
	2007	2006	Change
	\$	\$	\$
Cash provided by operating activities	41.3	22.5	18.8
Cash used by investing activities	(125.2)	(59.7)	(65.5)
Cash provided (used) by financing activities	0.6	(0.4)	1.0

(in millions of U.S. dollars)

	For the years ended September 30,		
	2007	2006	Change
	\$	\$	\$
Cash provided by operating activities	136.1	84.3	51.8
Cash used by investing activities	(19.4)	(108.1)	88.7
Cash provided (used) by financing activities	6.6	(0.6)	7.2

Cash flows provided by operating activities increased \$18.8 million from \$22.5 million for the three-month period ended September 30, 2006, to \$41.3 million for the three-month period ended September 30, 2007, mainly due to the increase in net income and a decrease in accounts receivable. Cash flows used by investing activities for the three-

month period ended September 30, 2007, were \$125.2 million, mainly due to the acquisition of short-term investments of \$123.8 million, plus the cash used for the acquisition of property, plant and equipment for \$1.4 million. Cash flows used by investing activities for the three-month period ended September 30, 2006, were \$59.7 million, mainly due to the net acquisition of short-term investments of \$57.4 million, and the cash used for the acquisition of property, plant and equipment for \$2.3 million. Cash flows provided by financing activities were \$0.6 million for the three-month period ended September 30, 2007, mainly due to the issue of common shares for cash consideration of \$0.8 million, as a result of the exercise of stock options during the quarter. Cash flows provided by operating activities increased \$51.8 million from \$84.3 million for the year ended September 30, 2006, to \$136.1 million for the year ended September 30, 2007, mainly due to the increase in net income, a decrease in inventories and increases in current liabilities. Cash flows used by investing activities for the year ended September 30, 2007, were \$19.4 million, mainly due to the net acquisition of short-term investments of \$12.8 million, plus the net cash used for the acquisition of property, plant and equipment for \$6.6 million. Cash flows used by investing activities for the year ended September 30, 2006, were \$108.1 million, mainly due to the net acquisition of short-term investments of \$99.5 million, and the cash used for the acquisition of property, plant and equipment for \$4.0 million and intangible assets for \$4.6 million. Cash flows provided by financing activities were \$6.6 million for the year ended September 30, 2007, mainly due to the issue of common shares for cash consideration of \$7.3 million as a result of the exercise of stock options during the period.

Including cash, cash equivalents and short term investments, as well as the line of credit described above, as at September 30, 2007, Axcan had up to \$534.6 million of cash resources available.

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, and does not 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.

QUARTERLY FINANCIAL HIGHLIGHTS

(in millions of U.S. dollars
except share related data)

	For the three-month periods ended			
	September 30, 2007	June 30, 2007	March 30, 2007	December 30, 2006
	\$	\$	\$	\$
Revenue	92.5	92.3	85.3	78.8
Net income	16.8	19.4	17.8	17.5
Income per common share:				
Basic	0.30	0.42	0.39	0.38
Diluted	0.30	0.36	0.34	0.34

	September 30, 2006	June 30, 2006	March 30, 2006	December 30, 2005
	\$	\$	\$	\$
Revenue	72.3	76.7	72.8	70.6
Net income	8.3	13.3	8.3	9.2
Income per common share:				
Basic	0.18	0.29	0.18	0.20
Diluted	0.17	0.26	0.17	0.19

Net income per share for each quarter has been computed based on the weighted average number of shares issued and outstanding during the respective quarter; therefore, quarterly amounts may not add up to the annual total.

CRITICAL ACCOUNTING POLICIES

Axcan's consolidated financial statements are prepared in accordance with U.S. GAAP, applied on a consistent basis. Some of Axcan's critical accounting policies require the use of judgment in their application or require estimates of inherently uncertain matters. Therefore, a change in the facts and circumstances of an underlying transaction could significantly change the application of Axcan's accounting policies to that transaction, which could have an effect on the Company's financial statements. The policies that management believes are critical and require the use of complex judgment in their application are described below.

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements and also affect the recognized amounts of revenues and expenses during the year. Significant estimates and assumptions made by management include allowances for accounts receivable and inventories, reserves for product returns, rebates, chargebacks and DSA fees, the classification of intangible assets between finite life and indefinite life, the useful lives of long-lived assets, the expected cash flows used in evaluating long-lived assets, goodwill and investments for impairment, stock-based compensation costs, pending legal settlements, the establishment of provisions for income taxes including the realizability of deferred tax assets and the allocation of the purchase price of acquired assets and businesses. The estimates are made using the historical information and various other relevant factors 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 the Company sells its products, changes in the health care environment, foreign exchange and managed care consumption patterns.

Revenue Recognition

Revenue is recognized when the product is shipped to the Company's customers, 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, products returns and distribution

service agreement fees are established as a reduction of product sales revenues at the time such revenues are recognized. These revenue reductions are established by the Company at the time of sale, based on historical experience adjusted to reflect known changes in the factors that impact such reserves. In certain circumstances, returns of products are allowed under the Company's policy and provisions are maintained accordingly. These revenue reductions are generally reflected as an addition to accrued expenses. Amounts received from customers as prepayments for products to be shipped in the future are reported as deferred revenue.

The following table summarizes the activity in the accounts related to revenue reductions:

(in millions of U.S. dollars)

	Product returns	Contract rebates	Charge-backs	DSA fees	Discounts and other	Total
	\$	\$	\$	\$	\$	\$
Balance as at						
September 30, 2006	7.8	7.2	4.8	0.9	0.3	21.0
Provisions	13.1	22.7	14.2	3.6	7.2	60.8
Settlements	(8.4)	(20.5)	(13.1)	(2.9)	(7.1)	(52.0)
Balance as at						
September 30, 2007	12.5	9.4	5.9	1.6	0.4	29.8

Axcan does not provide any form of price protection to its wholesale customers and permits product returns only if the product is returned in the 12 months following its expiration date. Credit for returns is issued to the original purchaser at current wholesale acquisition cost less 10%. Accrued liabilities include reserves of \$12.5 million and \$7.8 million as at September 30, 2007, and September 30, 2006, respectively, for estimated product returns.

In the United States, the Company establishes and maintains reserves for amounts payable to managed care organizations and state Medicaid programs for the reimbursement of portions of the retail price of prescriptions filled that are covered by these programs. Axcan establishes and maintains reserves for amounts payable to wholesale distributors for the difference between their regular sale price and the contract price for the products sold to its contract customers. The amounts are recognized as revenue reductions at the time of sale based on the Company's best estimate of the product's utilization by these managed care and state Medicaid patients and sales to its contract customers, using historical experience adjusted to reflect known changes in the factors that impact such reserves. Accrued liabilities include reserves of \$9.4 million and \$5.9 million as at September 30, 2007, and \$7.2 million and \$4.8 million as at September 30, 2006, respectively, for estimated contract rebates and chargebacks.

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

Intangible Assets and Goodwill

In the past, the Company has acquired products and businesses that included 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, goodwill and intangible assets with indefinite life are not amortized. The value of goodwill and intangible assets with indefinite life are subject to an annual impairment test

and the intangible assets with definite life are subject to an impairment test whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable. The Company compares the carrying value of the unamortized portion of intangible assets with definite life to the future benefits of the Company's activities or expected sales of pharmaceutical products. For goodwill and intangible assets with indefinite life, the test is based on the comparison of the fair value of the asset with its carrying amount. Should there be a permanent impairment in value, a write-down will be recognized for the current year to reflect the assets at fair value. To date, Axcan has not recognized any significant impairment in value on goodwill and intangible assets with an indefinite life.

Intangible assets with a finite life are amortized over their estimated useful lives according to the straight-line method over periods varying from 7 to 25 years. The straight-line method of amortization is used because it reflects, in the opinion of management, the pattern in which the intangible assets with a 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 to support the asset, the use of the asset, the existence and expiration date of a patent, the existence of a generic version of, or competitor to, the product and any legal or regulatory provisions that could limit the use of the asset. Axcan had not recognized any significant impairment in value of intangible assets with a finite life prior to the three-month period ended March 31, 2006, during which Axcan recognized a write-down of \$5.8 million on a French product line including TAGAMET and TRANSULOSE, following budgetary initiatives implemented by the French government that adversely affected the estimated future sales of these products.

As a result of acquisitions of product rights and other identifiable intangible assets, the Company carries \$367.2 million and \$375.7 million as net intangible assets on its consolidated balance sheets as at September 30, 2007, and September 30, 2006, respectively. The estimated annual amortization expense for intangible assets with a finite life, which have a remaining weighted average amortization period of approximately 17 years, for the next five fiscal years, is approximately \$17.4 million.

Also as a result of these acquisitions, the Company carries \$27.5 million of goodwill on its consolidated balance sheets as at September 30, 2007, and September 30, 2006.

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 expensed at the time of acquisition. The cost of intangibles that are purchased from others for a particular research and development project that have no alternative future use are expensed at the time of acquisition.

Stock-based compensation

The Company maintains stock-based compensation plans under which stock options, deferred share units and restricted shares units may be granted to employees and non-employee directors. Awards granted from the plans are granted at the stock price on the last trading date prior to the date of grant and vest over periods ranging from 1 to 5 years.

Effective October 1, 2005, the Company adopted Statement of Financial Accounting Standard ("SFAS") No. 123(R), "*Share-Based Payment*" SFAS No. 123(R) requires all stock-based payments to employees to be expensed over the requisite service based on the grant-date fair value of the awards and requires that the unvested portion of all outstanding awards upon adoption be recognized using the same fair value and attribution

methodologies previously determined under SFAS No. 123, *“Accounting for Stock-Based Compensation”*. The Company measures stock-based compensation cost at grant date, based on the estimated fair value of the award, and recognizes the cost as an expense on a straight-line basis (net of estimated forfeitures) over the employee requisite service period. The Company continues to use the Black-Scholes valuation method and applied the requirements of SFAS No. 123(R) using the modified prospective transition approach. Prior to adoption of SFAS No. 123(R), the Company accounted for stock-based employee compensation including stock options, using the method prescribed in APB No. 25 *“Accounting for Stock Issued to Employees”* and SFAS No. 123 *“Accounting for Stock-Based Compensation”*. Under the provision of Accounting Principles Board Opinion (“APB”) No. 25 and SFAS No. 123 the compensation cost was recognized using the intrinsic value and pro-forma disclosure of net income and income per share had to be presented in the financial statements as if the fair value method had been applied. The intrinsic value method measures stock-based compensation expense as the amount by which the stock price at the date of grant exceeds the exercise price.

Income taxes

Income taxes are calculated using the liability method. Under this method, deferred income tax assets and liabilities are recognized to account for the estimated taxes that will result from the recovery or settlement of assets and liabilities recorded at their financial statement carrying amounts. Deferred income tax assets and liabilities are measured based on enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse. A valuation allowance is provided for the portion of deferred tax assets that is more likely than not to remain unrealized. Adjustments to the deferred income tax asset and liability balances are recognized in net income as they occur.

The Company conducts business in various countries throughout the world and is subject to tax in numerous jurisdictions. As a result of its business activities, the Company files a significant number of tax returns that are subject to examination by various federal, state, and local tax authorities. Tax examinations are often complex as tax authorities may disagree with the treatment of items reported by the Company and this may require several years to resolve.

Changes in accounting policies

In June 2007, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue No. 07-3, *“Accounting for Non-refundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities.”* As a result of this consensus, non-refundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the services are performed, or when the goods or services are no longer expected to be provided. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2007, and earlier application is not permitted. This consensus is to be applied prospectively for new contracts entered into on or after the effective date. The Company is currently evaluating the impact of adoption of this consensus on its consolidated financial statements.

In February 2007, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 159, *“The Fair Value Option for Financial Assets and Financial Liabilities”*, which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using

different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. This statement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of the provisions of SFAS No. 159 on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 108, *"Considering the Effects of Prior Year Misstatements when Quantifying the Misstatements in Current Year Financial Statements"* that expresses the Staff's views regarding the process of quantifying financial statement misstatements. This bulletin is effective for any interim period of the first fiscal year ending after November 15, 2006. SAB No. 108 requires that companies utilize a "dual approach" to assess the quantitative effects of financial statement misstatements. The dual approach includes both an income statement focus and balance sheet focus assessment. SAB No. 108 permits companies to record the cumulative effect of initially applying the dual approach in the first year ending after November 15, 2006 by recording any necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings. The adoption of this bulletin did not have a material effect on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements"*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of the provisions of SFAS No. 157 on the consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *"Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109"*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statements recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 and is effective for the Company in the first quarter of the year beginning October 1, 2007. The Interpretation also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Differences between tax positions taken in a tax return and amounts recognized in the financial statements are recorded as adjustments to income taxes payable or receivable, or adjustments to deferred taxes, or both. FIN No. 48 also requires expanded disclosure at the end of each annual reporting period including a tabular reconciliation of unrecognized tax benefits. In accordance with FIN No. 48, the Company will report the difference between the net amount of assets and liabilities recognized in the balance sheet prior to and after the application of FIN No. 48 as a cumulative effect adjustment to the opening balance of retained earnings. The Company is currently evaluating the impact of the adoption of FIN No. 48 on the consolidated financial statements. In May 2007, the FASB issued FASB Staff

Position (“FSP”) FIN 48-1, *“Definition of Settlement in FASB Interpretation No. 48”*, which is effective upon the initial adoption of Interpretation 48. FSP FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The Company will apply the principles set forth in this FSP upon its adoption of FIN No. 48.

During the June 2006 meeting of the EITF, a consensus was reached on EITF Issue No. 06-3, *“How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation).”* The EITF reached a consensus that this Issue applies to any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue producing transaction between a seller and customer. Accordingly, taxes such as sales, use, value added, and some excise taxes may be within the scope of this Issue. The EITF reached a consensus that the income statement presentation (gross or net) of such taxes is an accounting policy decision that should be disclosed. In addition, a company should disclose in interim and annual financial statements the amount of such taxes reported on a gross basis, if significant. This Issue became effective for interim and annual reporting periods beginning after December 15, 2006. The Company elected to present on a net basis taxes collected from customers and remitted to governmental authorities; that is, they are excluded from revenues. The adoption of this consensus did not have an effect on the Company’s consolidated financial statements presentation.

During the June 2006 meeting of the EITF, a consensus was reached on EITF Issue No. 05-1, *“Accounting for the Conversion of an Instrument that Became Convertible upon the Issuer’s Exercise of a Call Option”*, that the issuance of equity securities to settle a debt instrument (pursuant to the instrument’s original conversion terms) that became convertible upon the issuer’s exercise of a call option should be accounted for as a conversion if the debt instrument contained a substantive conversion feature as of its issuance date. That is, no gain or loss should be recognized related to the equity securities issued to settle the instrument. The issuance of equity securities to settle a debt instrument that became convertible upon the issuer’s exercise of a call option should be accounted for as a debt extinguishment if the debt instrument did not contain a substantive conversion feature as of its issuance date. That is, the fair value of the equity securities issued should be considered a component of the reacquisition price of the debt. This Issue applies to all conversions within the scope of this Issue that result from the exercise of call options and became effective for interim or annual reporting periods beginning after June 28, 2006, irrespective of whether the instrument was entered into prior or subsequent to Board ratification of this Issue. The adoption of this accounting pronouncement did not have an impact on the Company’s consolidated financial statements.

In November 2005, the FASB issued FSP No. 115-1 and No. 124-1, *“The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments”* (“FSP No. 115-1”), which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP No. 115-1 also includes accounting considerations subsequent to the recognition of other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP No. 115-1 is required to be applied to reporting periods beginning after December 15, 2005 and was required to be adopted by the Company in the second quarter of 2006. The Company adopted FSP No. 115-1 beginning on January 1, 2006, and the adoption of FSP No. 115-1 did not have a material impact on the Company’s consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, “*Accounting Changes and Error Corrections*” which provides guidance on the accounting for and reporting of accounting changes and correction of errors. This statement changes the requirements for the accounting for and reporting of a change in accounting principle and applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this statement did not have an effect on the Company’s consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, “*Inventory Costs, an Amendment of ARB No. 43, Chapter 4*”. SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material and requires that such items be recognized as current-period charges regardless of whether they meet the criterion of “so abnormal”. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of this statement did not have an effect on the Company’s consolidated financial statements.

During the September 2004 meeting of the EITF, a consensus was reached on EITF Issue 04-8, “*The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*”. The EITF 04-8 requires companies to include certain convertible instruments, that were previously excluded, in their calculations of diluted earnings per share. The EITF concluded that Issue 04-8 is effective for periods ending after December 15, 2004, and must be applied by restating all periods during which time the applicable convertible instruments were outstanding. The common shares issuable under the 4.25% convertible subordinated notes issued in 2003, are therefore included in the Company’s diluted income per share calculation.

CONTROLS AND PROCEDURES

There were no changes in Axcan’s internal controls over financial reporting during the fourth quarter of fiscal year 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

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 “Part III - Business of Axcan” of the Company’s Annual Information Form.

Foreign Currency Risk

Axcan operates internationally; however, a substantial portion of revenue and expense activities as well as capital expenditures are transacted in U.S. dollars. Axcan’s results of operations are also affected by fluctuations of currencies other than U.S. dollar, in particular euros and Canadian dollars. Axcan’s exposure to exchange rate fluctuations in these currencies is reduced because, in general, Axcan’s revenues denominated in currencies other than the U.S. dollar are partially offset by a corresponding amount of costs

denominated in the same currency. However, significant long-term fluctuations in relative currency values could have an adverse effect on future profitability.

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.

Other

The Company does not believe that unfavourable decisions in possible proceedings related to any future tax assessment or any amount it might be required to pay will have a material adverse effect on the Company's financial position, cash flows or overall trends in results of operations. There is the possibility of a material adverse impact on the results of operations of the period in which the matter is ultimately resolved, if it is resolved unfavourably, or in the period in which an unfavourable outcome becomes probable and reasonably estimable.

FORWARD LOOKING STATEMENTS

This document contains forward-looking statements, which reflect the Company's current expectations regarding future events. To the extent any statements made in this release contain information that is not historical, these statements are essentially forward-looking, and are generally identified by words such as "anticipate," "expect," "estimate," "intend," "project," "plan" and "believe." Forward-looking statements are subject to risks and uncertainties and undue reliance should not be placed on these statements. Certain material assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied in such statements. Important factors that could cause actual results to differ materially from these expectations are outlined in the body of this document, and also include the difficulty of predicting FDA and other regulatory approvals, acceptance and demand for new pharmaceutical products, the impact

of competitive products and pricing, new product development and launch, reliance on key strategic alliances, availability of raw materials, the regulatory environment, fluctuations in operating results, the protection of our intellectual property and other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission and the Canadian securities regulators. The Company cautions that the foregoing list of factors that may affect future results is not exhaustive. Axcan undertakes no obligation to update or revise any forward-looking statement, unless obligated to do so pursuant to applicable securities laws and regulations.

This MD&A has been prepared as at November 28, 2007. 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 and the 40-F on the EDGAR website.

On behalf of Management,
(signed)



Steve Gannon
Senior Vice President and Chief Financial Officer

The names AXCAN, AXCAN PHARMA, CANASA, CARAFATE, DELURSAN, ITAX, LACTEOL, PANZYTRAT, PYLERA, SALOFALK, SULCRATE, TAGAMET, TRANSULOSE, ULTRASE, URSO/URSO 250, URSO FORTE, URSO DS and VIOKASE appearing in this document are trademarks or registered trademarks of Axcan Pharma Inc. and its subsidiaries.