

Pediapharm Inc.

Condensed Consolidated Interim Financial
Statements (unaudited)
(expressed in Canadian dollars)

For the three and six month periods ended
September 30, 2016 and 2015

Notice to Reader

The accompanying unaudited condensed interim consolidated financial statements of PEDIAPHARM INC. (the "Company") for the periods of three and six months ended on September 30, 2016 and 2015 have been prepared by the management and are its responsibility. These unaudited condensed interim consolidated financial statements, together with the accompanying notes, have been reviewed and approved by the members of the Company's audit committee. These unaudited condensed interim consolidated financial statements have not been reviewed by the Company's auditors.

Pediapharm Inc.

Condensed Interim Consolidated Statements of Financial Position (unaudited)

(expressed in Canadian dollars)

	Note	As at September 30, 2016 \$	As at March 31, 2016 \$
Assets			
Current assets			
Cash and cash equivalents		5,110,318	4,941,494
Accounts receivable		769,294	300,108
Prepaid expenses		119,312	52,808
Inventories		1,118,810	609,458
		<u>7,117,734</u>	<u>5,903,868</u>
Property and equipment		33,129	39,625
Intangible assets		<u>1,740,347</u>	<u>1,709,701</u>
		<u>8,891,210</u>	<u>7,653,194</u>
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		896,671	768,435
Interest payable	3, 4	170,500	166,833
Current portion of long-term debt			380
		<u>1,067,171</u>	<u>935,648</u>
Convertible debentures	3	<u>4,105,344</u>	<u>3,910,695</u>
		<u>5,172,515</u>	<u>4,846,343</u>
Shareholders' Equity			
Share capital		21,025,018	20,966,018
Contributed surplus		3,849,075	3,600,707
Deficit		<u>(21,155,398)</u>	<u>(21,759,874)</u>
		<u>3,718,695</u>	<u>2,806,851</u>
		<u>8,891,210</u>	<u>7,653,194</u>

Approved by the Board of Directors on November 28, 2016

(Sylvain Chretien) Director (Normand Chartrand) Director
Sylvain Chretien *Normand Chartrand*

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Pediapharm Inc.

Condensed Interim Consolidated Statements of Comprehensive Income (Loss) - (unaudited)

(expressed in Canadian dollars)

	Note	For the 3-month period ended September 30, 2016 \$	For the 3-month period ended September 30, 2015 \$	For the 6-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2015 \$
Revenue					
Products		1,803,397	1,455,459	2,614,643	1,997,628
Commissions		78,750	16,275	160,665	79,748
		<u>1,882,147</u>	<u>1,471,734</u>	<u>2,775,308</u>	<u>2,077,376</u>
Cost of sales		<u>661,228</u>	<u>517,254</u>	<u>950,839</u>	<u>729,168</u>
Gross Profit		<u>1,220,919</u>	<u>954,480</u>	<u>1,824,468</u>	<u>1,348,208</u>
Selling & administrative expenses	5,8	1,788,085	1,688,949	3,275,609	3,452,043
Depreciation & Amortization		21,481	26,286	42,243	51,169
Foreign exchange loss (gain)		(8,531)	(8,068)	(34,852)	(5,356)
Other Income	9	-	-	(2,570,200)	-
		<u>(580,116)</u>	<u>(752,688)</u>	<u>1,111,668</u>	<u>(2,149,651)</u>
Operating Income (Loss)		<u>(580,116)</u>	<u>(752,688)</u>	<u>1,111,668</u>	<u>(2,149,651)</u>
Finance costs	4	270,634	211,931	531,986	423,888
Interest income		(12,429)	(10,607)	(24,793)	(24,879)
		<u>(838,320)</u>	<u>(954,011)</u>	<u>604,475</u>	<u>(2,548,657)</u>
Net Income (Loss) and Comprehensive Income (Loss)		<u>(838,320)</u>	<u>(954,011)</u>	<u>604,475</u>	<u>(2,548,657)</u>
Income (Loss) per share from continuing operations attributable to equity holders of the Company					
Basic and diluted		<u>(0.01)</u>	<u>(0.01)</u>	<u>0.01</u>	<u>(0.04)</u>
Weighted average number of common shares outstanding		<u>72,605,368</u>	<u>72,342,469</u>	<u>72,558,903</u>	<u>72,281,030</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Pediapharm Inc.

Condensed Interim Consolidated Statements of Changes in Equity (unaudited)

(expressed in Canadian dollars)

Note	Share capital \$	Contributed surplus \$	Deficit \$	Total shareholders' equity (deficiency) \$
Balance – April 1, 2015	20,779,567	3,171,121	(19,460,580)	4,490,108
Loss and comprehensive loss for the year	-	-	(2,548,657)	(2,548,657)
Share-based compensation – Stock option plan	-	250,514	-	250,514
Issuance of shares for officer compensation	57,250	-	-	57,250
Options forfeited	-	(12,526)	-	(12,526)
Exercise of warrants and options	97,970	(25,970)	-	72,000
Balance – September 30, 2015	20,934,786	3,383,140	(22,009,237)	2,308,689
Balance – April 1, 2016	20,966,018	3,600,707	(21,759,874)	2,806,851
Net income and comprehensive income for the period (loss)	-	-	604,476	604,476
Share-based compensation – Stock option plan	-	248,369	-	248,369
Issuance of shares for officer compensation	59,000	-	-	59,000
Balance – September 30, 2016	21,025,018	3,849,075	(21,155,398)	3,718,695

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Pediapharm Inc.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(expressed in Canadian dollars)

Note	For the 3- month period ended September 30, 2016 \$	For the 3- month period ended September 30, 2015 \$	For the 6- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2015 \$
Cash flows from				
Operating activities				
Income (Loss) for the period	(838,320)	(954,011)	604,475	(2,548,657)
Adjustments for				
Depreciation of property and equipment	5,066	5,815	9,941	11,337
Amortization of intangible assets	26,002	30,867	51,479	60,624
Amortization of financing fees	34,475	43,179	66,923	86,358
Share-based compensation expense	220,767	205,477	307,369	295,236
Interest on convertible debentures	170,500	2,311	337,336	170,977
Convertible debentures interest accretion	65,658	-	127,727	-
Interest income	(12,429)	-	(24,793)	-
	(328,280)	(666,362)	1,480,457	(1,924,125)
Changes in non-cash operating working capital items	7 (821,098)	(459,264)	(916,809)	(540,871)
Interest paid	(166,833)	-	(333,669)	-
Interest received	12,429	-	24,793	-
	(1,303,782)	(1,125,626)	254,771	(2,464,996)
Investing activities				
Purchases of property and equipment	(3,445)	-	(3,445)	(3,839)
Purchases of intangible assets	(82,125)	(284,129)	(82,125)	(284,129)
	(85,570)	(284,129)	(85,570)	(287,968)
Financing activities				
Proceeds from issuance of shares, net of issuance costs	-	-	-	72,000
Repayment of long-term debt	-	(1,064)	(377)	(2,098)
	-	(1,064)	(377)	69,902
Net change in cash and cash equivalents during the period	(1,389,352)	(1,410,818)	168,824	(2,683,062)
Cash and cash equivalents – Beginning of period	6,499,670	5,526,526	4,941,494	6,798,770
Cash and cash equivalents – End of period	5,110,318	4,115,708	5,110,318	4,115,708

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

1 Incorporation and nature of activities

Pediapharm Inc. (the “Company”) was incorporated under the Canada Business Corporations Act and offers sales and marketing services to the pharmaceutical industry, particularly related to pediatric care. The Company is domiciled in Canada, and its registered office is located at 1 Place du Commerce, Suite 225, Verdun, Quebec H3E 1A2. Pediapharm Inc.’s shares are traded on the TSX Venture Stock Exchange.

2 Basis of presentation and summary of significant accounting policies

Basis of presentation

The key accounting policies applied in the preparation of these condensed interim consolidated financial statements are consistent with those disclosed in Note 2 of the Company’s consolidated financial statements for the year ended March 31, 2016. These policies have been consistently applied to all periods presented. These condensed consolidated interim financial statements should be read in conjunction with the Company’s most recent annual consolidated financial statements for the year ended March 31, 2016.

These consolidated interim financial statements have been prepared in accordance with Part I of the CPA Canada Handbook (referred to as IFRS) as issued by the International Accounting Standards Board (IASB) applicable to the preparation of interim financial statements, IAS 34, *Interim Financial Reporting*.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of November 28, 2016.

The accompanying condensed interim consolidated financial statements were prepared on a going concern basis under the historical cost convention.

Basis of consolidation

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies to obtain benefits from its activities. Subsidiaries are fully consolidated from the date control is obtained and they are deconsolidated on the date control ceases. These consolidated financial statements include the Company’s one inactive subsidiary, Pediapharm Licensing Inc.

3 Convertible debentures

On March 31, 2015, the Company closed a private placement of secured, convertible debentures of the Company and share purchase warrants of the Company for aggregate gross proceeds of \$5,500,000.

The fair value of the liability component was estimated at \$3,882,394 using a discount rate of 25% and the estimated fair value of the warrants was \$367,606. The residual amount attributed to the equity conversion feature was \$1,250,000.

The proceeds received from the convertible debentures were allocated between the convertible debentures and the determined fair value of the warrants and the equity conversion feature. The resulting debentures discount of \$1,617,605 is accreted to the face value of the convertible debentures until maturity.

Issuance costs of \$299,629 were also capitalized and are being amortized using the effective interest method.

4 Finance costs

	For the 3-month period ended September 30, 2016 \$	For the 3-month period ended September 30, 2015 \$	For the 6-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2015 \$
Interest on convertible debentures	170,500	168,752	337,336	337,530
Amortization of deferred financing fees	34,476	18,727	66,923	37,454
Convertible debentures interest accretion	65,658	24,452	127,727	48,904
	<u>270,634</u>	<u>211,931</u>	<u>531,986</u>	<u>423,888</u>

5 Employee benefit expense

- a) Employees other than the Company's president, chief financial officer and vice-presidents

	For the 3-month period ended September 30, 2016 \$	For the 3-month period ended September 30, 2015 \$	For the 6-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2015 \$
Salaries and benefits	426,657	522,755	843,008	1,050,335
Share-based compensation	45,379	61,267	86,681	113,292
	<u>472,036</u>	<u>584,022</u>	<u>929,690</u>	<u>1,163,627</u>

- b) Key management personnel include the Company's president, chief financial officer, vice-presidents and Board of Directors.

	For the 3-month period ended September 30, 2016 \$	For the 3-month period ended September 30, 2015 \$	For the 6-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2015 \$
Key management compensation				
Short-term employee benefits and consulting fees	358,027	243,152	603,972	473,850
Share-based compensation	116,389	144,210	161,688	181,947
	<u>474,416</u>	<u>387,362</u>	<u>765,660</u>	<u>655,797</u>

Key management compensation is included in selling and administrative expenses.

6 Related party transactions

All related party transactions, unless otherwise disclosed, occurred in the normal course of operations.

For the three-month period ended September 30, 2016, the Company paid management fees in the amount of Nil (for the three-month period ended September 30, 2015 – \$37,500) to a company owned by the current Chief Financial Officer of the Company. For the six-month period ended September 30, 2016, the Company paid management fees in the amount of \$69,310 (for the six-month period ended September 30, 2015 – \$75,000) to a company owned by the current Chief Financial Officer of the Company.

For the three-month period ended September 30, 2016, the Company paid legal fees in the amount of \$4,702 (for the three-month period ended September 30, 2015 – \$13,191) to a firm of which a Director of the Company is a partner. For the six-month period ended September 30, 2016, the Company paid legal fees in the amount of \$4,702 (for the six-month period ended September 30, 2015 – \$20,316) to a firm of which a Director of the Company is a partner.

7 Cash flows

Changes in non-cash operating working capital items are as follows:

	For the 3-month period ended September 30, 2016 \$	For the 3-month period ended September 30, 2015 \$	For the 6-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2015 \$
Decrease (increase) in				
Accounts receivable	(378,653)	(316,177)	(469,186)	(341,887)
Prepaid expenses	(30,659)	1,072	(66,503)	76,812
Inventories	(274,586)	(105,013)	(509,353)	(110,420)
Increase (decrease) in				
Accounts payable and accrued liabilities	(137,200)	(39,146)	128,232	(165,376)
	<u>(821,098)</u>	<u>(459,264)</u>	<u>(916,809)</u>	<u>(540,871)</u>

8 Selling and administrative expenses

	For the 3- month period ended September 30, 2016 \$	For the 3- month period ended September 30, 2015 \$	For the 6- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2015 \$
Sales and marketing expenses	928,486	866,527	1,741,186	1,747,143
Business development and regulatory affairs	309,026	355,325	587,770	857,049
General administrative	550,573	467,097	946,653	847,851
Total	1,788,085	1,688,949	3,275,609	3,452,043

9 Sale of US rights to Naproxen Suspension

On February 2, 2016, the Company signed a formal asset purchase agreement with an industry third party (the Acquirer) for the sale of the Company's US rights to the drug Naproxen Suspension in a transaction valued at approximately US\$4.25 million (the Transaction). Financial terms of the Transaction included an unconditional payment by the Acquirer of US\$2.25 million in cash (\$3,134,249) which was received at closing, and which was recognized as other income in the consolidated statement of comprehensive loss for the year ended March 31, 2016, as there were no further conditions to meet. In addition, there was a payment of US\$2.0 million in cash that is conditional on the Company being granted approval from the US Food and Drug Administration (FDA) of the manufacturing site transfer on or before September 30, 2016.

On May 11, 2016, the Company announced that it had received FDA approval regarding the manufacturing site transfer of Naproxen Suspension for the US market. This approval triggered the second and final payment of US\$2.0 million, which was recognized as other income in the consolidated statement of comprehensive loss for the year ended March 31, 2016.

10 Global Exclusive Licensing Agreement for Relaxa®

On September 19, 2016, the Company signed an exclusive licensing agreement (the "Licensing Agreement") with a company owned by Mr. Gerard Leduc (the "Licensor"), a globally known pharmaceutical executive for drug product Relaxa® (the "Product"). Under the terms of the Licensing Agreement, Pediapharm has the exclusive right to manufacture, promote, market, sell and distribute the Product globally. In return, Pediapharm will pay the Licensor royalties based on annual net sales of the Product. Pursuant to the terms of the Licensing Agreement, Pediapharm has the right to acquire the Product at any time until the seventh anniversary of the effective date of the Licensing Agreement. The aggregate price payable for the Product during such term shall be five million dollars (\$5,000,000) plus a two percent (2%) royalty on the annual net sales of the Product up to a maximum of one million five hundred thousand dollars (\$1,500,000) (the "Option Exercise Price"). Moreover, for the term commencing on the fifth anniversary of the effective date of the Licensing Agreement and ending on seventh anniversary of the effective date of the licensing agreement, the Licensor will have the option to sell the Product to Pediapharm for the same Option Exercise Price.