

Pediapharm Inc.

Condensed Interim Consolidated Financial
Statements (unaudited)

**For the three and six month periods ended
September 30, 2017 and 2016**
(expressed in Canadian dollars)

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, 2017 and 2016 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, 2017 \$	As at March 31, 2017 \$
Assets			
Current assets			
Cash and cash equivalents		4,971,443	3,241,097
Accounts receivable		1,214,288	638,441
Prepaid expenses		66,511	17,681
Inventories		2,494,201	1,704,540
		<u>8,746,443</u>	<u>5,601,759</u>
Property and equipment		20,686	22,805
Intangible assets		<u>2,306,225</u>	<u>2,103,077</u>
		<u>11,073,354</u>	<u>7,727,641</u>
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		1,355,286	1,943,184
Interest payable	4, 5	<u>166,667</u>	<u>165,000</u>
		1,523,953	2,108,184
Convertible debentures	4	<u>4,569,043</u>	<u>4,323,821</u>
		<u>6,092,996</u>	<u>6,432,005</u>
Shareholders' Equity			
Share capital		25,205,213	21,025,018
Contributed surplus		4,821,466	3,862,379
Deficit		<u>(25,046,321)</u>	<u>(23,591,761)</u>
		<u>4,980,358</u>	<u>1,295,636</u>
		<u>11,073,354</u>	<u>7,727,641</u>

Approved by the Board of Directors on November 27, 2017

(Sylvain Chretien) Director
Sylvain Chretien

(Normand Chartrand) Director
Normand Chartrand

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

Pediapharm Inc.

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

(expressed in Canadian dollars)

	Note	For the 3-month period ended September 30, 2017 \$	For the 3-month period ended September 30, 2016 \$	For the 6-month period ended September 30, 2017 \$	For the 6-month period ended September 30, 2016 \$
Revenue					
Products		3,083,397	1,803,397	5,546,240	2,614,643
Commissions		-	78,750	2,705	160,665
		<u>3,083,397</u>	<u>1,882,147</u>	<u>5,548,945</u>	<u>2,775,308</u>
Cost of sales					
		<u>1,368,169</u>	<u>651,469</u>	<u>2,546,667</u>	<u>944,955</u>
Gross profit					
		<u>1,715,228</u>	<u>1,230,678</u>	<u>3,002,278</u>	<u>1,830,352</u>
Selling and administrative expenses	6, 9	1,783,377	1,797,845	3,917,893	3,281,494
Depreciation and amortization		3,476	21,481	6,564	42,243
Foreign exchange loss (gain)		(19,448)	(8,531)	(32,240)	(34,852)
Other income	3	-	-	-	(2,570,200)
		<u>(52,177)</u>	<u>(580,117)</u>	<u>(889,939)</u>	<u>1,111,667</u>
Operating income (loss)					
		<u>(52,177)</u>	<u>(580,117)</u>	<u>(889,939)</u>	<u>1,111,667</u>
Financing costs	5	294,817	270,634	580,722	531,986
Interest income		(10,363)	(12,429)	(16,101)	(24,793)
		<u>(336,631)</u>	<u>(838,321)</u>	<u>(1,454,560)</u>	<u>604,474</u>
Net income (loss) and comprehensive income (loss)					
		<u>(336,631)</u>	<u>(838,321)</u>	<u>(1,454,560)</u>	<u>604,474</u>
Net income (loss) per share attributable to shareholders of the Company					
Basic and diluted		<u>(0.004)</u>	<u>(0.012)</u>	<u>(0.017)</u>	<u>0.008</u>
Weighted average number of common shares outstanding					
		<u>87,414,986</u>	<u>72,605,368</u>	<u>83,132,504</u>	<u>72,558,903</u>

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

Pediapharm Inc.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity (unaudited)

(expressed in Canadian dollars)

	Note	Share capital			Total shareholders' equity \$	
		Common shares	Amount \$	Contributed surplus \$		Deficit \$
Balance – March 31, 2016		72,512,438	20,966,018	3,600,707	(21,759,874)	2,806,851
Income (loss) and comprehensive income (loss)		-	-	-	604,476	604,476
Share-based compensation – Stock option plan		-	-	248,369	-	248,369
Issuance of shares for officer compensation		196,665	59,000	-	-	59,000
Balance September 30, 2016		72,709,103	21,025,018	3,849,075	(21,155,398)	3,718,695
Balance – March 31, 2017		72,709,103	21,025,018	3,862,379	(23,591,761)	1,295,636
Loss and comprehensive loss		-	-	-	(1,454,560)	(1,454,560)
Share-based compensation – Stock option plan		-	-	182,316	-	182,316
Issuance of shares for private placement, net of fees	11	14,705,883	4,956,965	-	-	4,956,965
Issuance of warrants for private placement	11		(776,772)	776,772	-	-
Balance – September 30, 2017		87,414,986	25,205,213	4,821,466	(25,046,321)	4,980,358

Authorized shares

The Company is authorized to issue an unlimited number of common shares without par value.

The accompanying notes are an integral part of these 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, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Cash flows from					
Operating activities					
Net loss for the year		(336,631)	(838,320)	(1,454,560)	604,475
Adjustments for					
Depreciation of property and equipment		2,869	5,066	5,351	9,941
Amortization of intangible assets		50,322	26,002	92,752	51,479
Amortization of financing fees	5	43,936	34,475	85,288	66,923
Share-based compensation expense		86,564	220,767	182,316	307,369
Interest on convertible debentures	5	168,667	170,500	335,500	337,336
Convertible debenture interest accretion	5	82,214	65,658	159,934	127,727
Interest income		(10,363)	(12,429)	(16,101)	(24,793)
		87,578	(328,280)	(609,519)	1,480,457
Changes in non-cash operating working capital items	8	(783,902)	(821,098)	(2,002,237)	(916,809)
Interest paid		(166,833)	(166,833)	(331,833)	(333,669)
Interest received		10,363	12,429	16,101	24,793
		(852,795)	(1,303,782)	(2,927,489)	254,771
Investing activities					
Purchases of property and equipment		(864)	(3,445)	(3,232)	(3,445)
Purchases of intangible assets		-	(82,125)	(295,900)	(82,125)
		(864)	(85,570)	(299,132)	(85,570)
Financing activities					
Proceeds from issuance of shares, net of issuance costs	11	(26,275)	-	4,956,967	-
Repayment of long-term debt		-	-	-	(377)
		(26,275)	-	4,956,967	(377)
Net change in cash and cash equivalents during the year		(879,934)	(1,389,352)	1,730,347	168,824
Cash and cash equivalents – Beginning of year		5,851,377	6,499,670	3,241,097	4,941,494
Cash and cash equivalents – End of year		4,971,443	5,110,318	4,971,443	5,110,318

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

Pediapharm Inc.

Notes to Condensed Interim Consolidated Financial Statements (unaudited)

(expressed in Canadian dollars)

1 Incorporation and nature of activities

Pediapharm Inc. (the “Company”) was incorporated under the Canada Business Corporations Act and sells products and offers marketing services, particularly related to pediatric care, to the pharmaceutical industry. 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 Exchange.

2 Basis of presentation and summary of significant accounting policies

Basis of presentation

The Company prepares its condensed interim consolidated financial statements in accordance with Canadian generally accepted accounting principles (GAAP) as set out in Part I of the CPA Canada Handbook – Accounting, which incorporates International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of November 27, 2017.

The condensed interim consolidated financial statements have been prepared under the historical cost basis, except for certain financial instruments which are measured at fair value. In addition, the condensed interim consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

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 condensed interim consolidated financial statements include the Company’s one inactive subsidiary, Pediapharm Licensing Inc.

3 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 loss and 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 was 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.

Pediapharm Inc.

Notes to Condensed Interim Consolidated Financial Statements (unaudited)

(expressed in Canadian dollars)

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 in cash (\$2,570,200) which was recognized as other income in the condensed interim consolidated statement of income (loss) and comprehensive income (loss) for the three-month period ended June 30, 2016.

4 Convertible debentures

The convertible debentures mature on March 31, 2019, bear interest at a rate of 12% per annum paid quarterly in cash, and are fully secured by the assets of the Company. The principal amount is convertible at any time at the option of the holder into common shares of the Company at a price of \$0.45 per common share and upon giving effect to such conversion, all accrued and unpaid interest will be paid in full. The debentures will automatically convert into common shares at the conversion price if during any 20 consecutive trading days, the common shares trade at a volume weighted average price of at least \$0.60 on a total cumulative volume of not less than 2,000,000 shares. The Company may at any time after the second anniversary of the date of issue, and prior to maturity, repay the principal amount subject to an early repayment fee of 2% of the principal amount repaid. Issuance costs were deducted from the convertible debentures balance and are amortized using the effective interest method. An amount of \$43,936 was recognized in the condensed interim consolidated statement of income (loss) and comprehensive income (loss) for the three-month period ended September 30, 2017 (three-month period ended September 30, 2016 – \$34,476).

The convertible debentures are a compound financial instrument under IAS 32, and have both a liability and equity component. The fair value of the consideration for the compound instrument must be split into its liability and equity components. The fair value of the consideration in respect of the liability component is first measured at the fair value of a similar liability that does not have any associated equity conversion option. This becomes the liability component's carrying amount at initial recognition, and the residual amount is allocated to the equity component.

5 Financing costs

	For the 3- month period ended September 30, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Interest on convertible debentures	168,667	170,500	335,500	337,336
Amortization of deferred financing fees	43,936	34,476	85,288	66,922
Convertible debenture interest accretion	82,214	65,658	159,934	127,727
	<u>294,817</u>	<u>270,634</u>	<u>580,722</u>	<u>531,986</u>

Pediapharm Inc.

Notes to Condensed Interim Consolidated Financial Statements (unaudited)

(expressed in Canadian dollars)

6 Employee benefit expense

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

	Note	For the 3- month period ended September 30, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Salaries and benefits		494,305	426,657	991,406	839,698
Share-based compensation	9	10,176	45,379	43,014	86,681
		<u>504,482</u>	<u>472,036</u>	<u>1,034,420</u>	<u>926,379</u>

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

	Note	For the 3- month period ended September 30, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Key management compensation					
Short-term employee benefits and consulting fees		249,729	358,027	501,248	603,972
Share-based compensation	9	76,388	116,389	139,303	161,688
		<u>326,116</u>	<u>474,416</u>	<u>640,551</u>	<u>765,660</u>

Key management compensation is included in selling and administrative expenses.

7 Related party transactions

Transactions with related parties during the period and amounts due to or from these parties as at September 30, 2017 and 2016 are disclosed in these condensed interim consolidated financial statements.

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

For the six-month period ended September 30, 2017, the Company incurred management fees in the amount of Nil (six-month period ended September 30, 2016 – \$69,310) to a company owned by the current Chief Financial Officer of the Company.

Pediapharm Inc.

Notes to Condensed Interim Consolidated Financial Statements (unaudited)

(expressed in Canadian dollars)

For the three-month period ended September 30, 2017, the Company incurred and paid legal fees in the amount of Nil (three-month period ended September 30, 2016 – \$4,702) to a firm of which a director of the Company is a partner. For the six-month period ended September 30, 2017, the Company incurred and paid legal fees in the amount of \$18,037 (six-month period ended September 30, 2016 – \$4,702) to a firm of which a director of the Company is a partner.

8 Consolidated statement of cash flows

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

	For the 3- month period ended September 30, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Decrease (increase) in				
Accounts receivable	130,026	(378,653)	(575,847)	(469,186)
Prepaid expenses	(26,688)	(30,659)	(48,829)	(66,503)
Inventories	(374,058)	(274,586)	(789,661)	(509,353)
Increase (decrease) in				
Accounts payable and accrued liabilities	(513,182)	(137,200)	(587,901)	128,232
	<u>(783,902)</u>	<u>(821,098)</u>	<u>(2,002,237)</u>	<u>(916,809)</u>

9 Selling and administrative expenses

	For the 3- month period ended September 30, 2017 \$	For the 3- month period ended September 30, 2016 \$	For the 6- month period ended September 30, 2017 \$	For the 6- month period ended September 30, 2016 \$
Sales and marketing expenses	1,111,944	928,486	2,525,099	1,741,186
Business development and regulatory affairs	247,775	318,786	448,568	593,655
General administrative	423,659	550,574	944,225	946,653
	<u>1,783,377</u>	<u>1,797,845</u>	<u>3,917,893</u>	<u>3,281,494</u>

Pediapharm Inc.

Notes to Condensed Interim Consolidated Financial Statements (unaudited)

(expressed in Canadian dollars)

10 Global exclusive licensing agreement

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, the Company has the exclusive right to manufacture, promote, market, sell and distribute the product globally. In return, the Company will pay the licensor royalties based on annual net sales of the product. The Company accounts for the royalty payable at the same time as revenues of the Product are recognized. The Company has not recorded any asset or liability for the exercise purchase option in the licensing agreement, as the exercise purchase option is contingent on the other party exercising its sale option and actually delivering the Product intellectual property to the Company, which has not occurred as at September 30, 2017. Pursuant to the terms of the licensing agreement, the Company 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 \$5,000,000 plus a 2% royalty on the annual net sales of the product up to a maximum of \$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 the Company for the same option exercise price.

11 Non-brokered private placement

On July 4, 2017, the Company announced it has closed a non-brokered private placement (the offering) of units of the Company (the units). Pursuant to the offering, 9346-4626 Québec Inc., a private company operating as Transican (the subscriber) subscribed for 14,705,883 units, at a price of \$0.34 per unit, for aggregate proceeds to the Company of \$5,000,000. The subscriber is owned by Mr. Gerard Leduc, a globally known pharmaceutical executive.

Each unit comprises one common share in the capital of the Company (a common share) and 1/2 of one common share purchase warrant of the Company (a warrant). Each whole warrant entitles the subscriber to purchase one common share at a price of \$0.51 per share until May 24, 2020. Fair value of the warrants, using the Black-Scholes model, was deemed to be \$776,772. No commissions or fees were paid in connection with the offering, other than \$16,758 in legal fees.

As a result of the offering, the subscriber has become a new insider of the company as a holder of more than 10% of the issued and outstanding common shares.

Pursuant to applicable securities laws, all securities issued pursuant to the offering were subject to a hold period of four months plus one day following the closing of the offering.