Pediapharm Inc.

Condensed Interim Consolidated Financial Statements (unaudited)

For the three- and six-month periods ended September 30, 2018 and 2017
(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, 2018 and 2017 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, 2018 $	As at March 31, 2018 $
Assets			
Current assets			
Cash and cash equivalents		2,802,174	3,608,506
Accounts receivable		1,190,243	738,454
Prepaid expenses and deferred costs		409,382	98,795
Inventories		1,924,748	2,189,278
		6,326,547	6,635,033
Property and equipment		16,940	20,099
Intangible assets		2,791,583	2,602,330
		9,135,070	9,257,462
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	10	5,467,286	1,688,454
Interest payable	3, 4	168,667	165,613
Convertible debentures		20,000	20,000
		5,655,953	1,874,067
Convertible debentures	3	4,599,755	4,345,627
		10,255,708	6,219,694
Shareholders' Equity			
Share capital		25,444,225	25,347,384
Contributed surplus		4,955,849	4,902,565
Deficit		(31,520,711)	(27,212,181)
		(1,120,637)	3,037,768
		9,135,070	9,257,462

Approved by the Board of Directors on November 27, 2018

_______________*(Sylvain Chretien)*______ Director — Sylvain Chretien

________*(Michael P. Mueller)*_________ Director — Michael P. Mueller

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, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Revenue					
Products		3,449,203	3,083,397	6,698,342	5,546,240
Commissions		-	-	-	2,705
		3,449,203	3,083,397	6,698,342	5,548,945
Cost of sales		1,593,882	1,368,169	3,105,021	2,546,667
Gross profit		1,855,321	1,715,228	3,593,321	3,002,278
Selling and administrative expenses	5, 8	1,502,818	1,783,377	3,652,037	3,917,893
Transaction-related fees & expenses	10	3,670,905	-	3,670,905	-
Depreciation and amortization		1,929	3,476	3,859	6,564
Foreign exchange loss (gain)		(6,210)	(19,448)	2,787	(32,240)
Operating income profit (loss)		(3,314,121)	(52,177)	(3,736,267)	(889,939)
Financing costs	4	310,482	294,817	589,628	580,722
Interest income		(8,164)	(10,363)	(17,365)	(16,101)
Net income (loss) and comprehensive income (loss)		(3,616,440)	(336,631)	(4,308,530)	(1,454,560)
Net income (loss) per share attributable to shareholders of the Company					
Basic and diluted		(0.04)	(0.004)	(0.05)	(0.017)
Weighted average number of common shares outstanding		87,434,289	87,414,986	87,453,383	83,132,504

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				
		Common shares	**Amount $**	**Contributed surplus $**	**Deficit $**	**Total shareholders’ equity $**
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	9	14,705,883	4,956,965	-	-	4,956,965
Issuance of warrants for private placement	9		(776,772)	776,772		-
Balance – September 30, 2017		87,414,986	25,205,213	4,821,466	(25,046,321)	4,980,358
Balance – March 31, 2018		87,414,986	25,347,384	4,902,565	(27,212,181)	3,037,768
Loss and comprehensive loss		-	-	-	(4,308,530)	(4,308,530)
Share-based compensation – Stock option plan		-	-	90,800	-	90,800
Issuance of shares for exercise of options		196,250	96,841	(37,516)		59,325
Balance – September 30, 2018		87,611,236	25,444,225	4,955,849	(31,520,711)	(1,120,637)

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, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Cash flows from					
Operating activities					
Net loss for the year		(3,616,440)	(336,631)	(4,308,530)	(1,454,560)
Adjustments for					
Depreciation of property and equipment		1,579	2,869	3,159	5,351
Amortization of intangible assets		74,518	50,322	150,989	92,752
Share-based compensation expense		40,222	86,564	90,800	182,316
Interest on convertible debentures	4	168,667	168,667	335,500	335,500
Convertible debenture interest accretion net of deferred financing cost amortization	4	141,816	126,150	254,128	245,222
Interest income		(8,164)	(10,363)	(17,365)	(16,101)
		(3,197,802)	87,578	(3,491,319)	(609,519)
Changes in non-cash operating working capital items	7	3,164,584	(783,902)	3,280,986	(2,002,237)
Interest paid		(166,833)	(166,833)	(332,447)	(331,833)
Interest received		8,164	10,363	17,365	16,101
		(191,888)	(852,795)	(525,414)	(2,927,489)
Investing activities					
Purchases of property and equipment		-	(864)	(7,380)	(3,232)
Purchases of intangible assets		(332,863)	-	(332,863)	(295,900)
		(332,863)	(864)	(340,243)	(299,132)
Financing activities					
Proceeds from issuance of shares, net of issuance costs		59,325	(26,275)	59,325	4,956,967
		59,325	(26,275)	59,325	4,956,967
Net change in cash and cash equivalents during the year		(465,427)	(879,934)	(806,332)	1,730,347
Cash and cash equivalents – Beginning of year		3,267,601	5,851,377	3,608,506	3,241,097
Cash and cash equivalents – End of year		2,802,174	4,971,443	2,802,174	4,971,443

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

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, 2018.

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.

New standards adopted by the Company

IFRS 9, Financial Instruments

The IASB previously published versions of IFRS 9 that introduced new classification and measurement requirements in 2009 and 2010 and a new hedge accounting model in 2013. In July 2014, the IASB released the final version of IFRS 9, which replaces earlier versions of IFRS 9 issued and completes the IASB's project to replace IAS 39, Financial Instruments: Recognition and Measurement. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Company assessed the impact of the adoption of IFRS 9 on its consolidated financial statements and determined that there were no significant changes from the adoption of the new standard.

IFRS 15, Revenue from Contracts with Customers

The Company adopted IFRS 15 using the modified retrospective method of adoption in its consolidated financial statements for the annual period beginning on April 1, 2018. The standard outlines the principles that must be applied to measure and recognize revenue and the related cash flows.

The principles in IFRS 15 are applied using the following five steps: 1. Identify the contract(s) with a customer 2. Identify the performance obligations in the contract 3. Determine the transaction price 4. Allocate the transaction price to the performance obligations in the contract 5. Recognize revenue when (or as) the entity satisfies a performance obligation

Product revenue Performance obligations for product sales are primarily satisfied upon delivery of product to the Company's customers. Revenue is recorded on a net basis, representing the amounts receivable from customers after the deduction for discounts, returns and early payment discounts. The methodology and assumptions used to estimate discounts, returns and early payments discounts are monitored and adjusted in light of contractual and historical information. Invoices are generated at the time of product shipment and are payable in 30 days. The provision for returns is a complex estimate used in the recognition of revenue. The Company has a returns policy that allows wholesalers to return product within a specified period prior to and subsequent to the expiration date. Provisions for returns are recognized in the period in which the underlying sales are recognized, as a reduction of product sales revenue. The Company estimates provisions for returns based upon historical experience if applicable, representing management's best estimate. While such experience has allowed for reasonable estimations in the past, history may not always be an accurate indicator of future returns. The Company continually monitors provisions for returns and adjusts when it believes that actual product returns may differ from established reserves.

New standards not yet adopted by the Company

IFRS 16, Leases

In January 2016, the IASB released IFRS 16. The new standard eliminates the classification of leases as either operating or finance leases and introduces a single accounting model for the lessee under which a lease liability and a right-of-use asset is recognized for all leases with a term of more than 12 months. IFRS 16 also substantially carries forward the lessor accounting requirements; accordingly, a lessor continues to classify its leases as operating leases or finance leases. IFRS 16 supersedes IAS 17, Leases, and related interpretations. IFRS 16 is effective for annual periods beginning on January 1, 2019 for the Company, with earlier application permitted for companies that also apply IFRS 15. The Company is currently evaluating the impact of the new standard on its consolidated financial statements.

There are no other IFRSs or IFRIC Interpretations that are not yet effective that would be expected to have a material impact on the Company.

3 Convertible debentures

On January 31, 2018, the Company announced it had entered into agreements to extend $5,480,000 of the total debentures issued to holders (Holders) in connection with the original private placement. The extension is to be one year in length, making the new maturity date March 30, 2020 (the New Maturity Date). Any such extensions that are not approved by the individual Holders will remain subject to the original terms of the debentures and shall mature on March 30, 2019 (the Original Maturity Date). A total of $20,000 was not extended and will therefore mature on the Original Maturity Date.

(expressed in Canadian dollars)

The extension of the debentures was not considered as a substantial modification of the terms of the existing financial liabilities and do not result in a derecognition of the original financial liabilities under IAS 39. The impact of the extension of the maturity date results in a gain of $475,702 in the consolidated statement of loss and comprehensive loss (note 13) due to the revaluation of the fair value with the New Maturity Date.

The convertible debentures bear interest at a rate of 12% per annum paid quarterly in cash, and they 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, which was March 30, 2015, 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.

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..

4 Financing costs

	For the 3-month period ended September 30, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Interest on convertible debentures	168,667	168,667	335,500	335,500
Convertible debenture interest accretion net of deferred financing cost amortization	141,815	126,150	254,128	245,222
	310,482	294,817	589,628	580,722

(expressed in Canadian dollars)

5 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, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Salaries and benefits		523,906	494,305	1,106,361	991,406
Share-based compensation		16,432	10,177	28,185	43,014
		540,338	504,482	1,134,546	1,034,420

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, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Key management compensation					
Short-term employee benefits and consulting fees		322,414	294,729	684,558	679,003
Share-based compensation		23,790	76,387	62,615	139,303
		346,204	371,116	747,173	818,306

Key management compensation is included in selling and administrative expenses.

6 Related party transactions

Transactions with related parties during the period and amounts due to or from these parties as at September 30, 2018 and 2017 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 three-month period ended September 30, 2018, the Company incurred a total of $12,133 in interest expense on the convertible debentures with 9346-4646 Québec Inc. and two Board members.

(expressed in Canadian dollars)

For the six-month period ended September 30, 2018, the Company incurred a total of $24,267 in interest expense on the convertible debentures with 9346-4646 Québec Inc. and two Board members.

7 Consolidated statement of cash flows

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

	For the 3-month period ended September 30, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Decrease (increase) in				
Accounts receivable	50,363	130,026	(451,789)	(575,847)
Prepaid expenses and deferred costs	(226,685)	(26,688)	(310,587)	(48,829)
Inventories	(106,782)	(374,058)	264,530	(789,661)
Increase (decrease) in				
Accounts payable and accrued liabilities	3,447,689	(513,182)	3,778,832	(587,901)
	3,164,584	(783,902)	3,280,986	(2,002,237)

8 Selling and administrative expenses

	For the 3-month period ended September 30, 2018 $	For the 3-month period ended September 30, 2017 $	For the 6-month period ended September 30, 2018 $	For the 6-month period ended September 30, 2017 $
Sales and marketing expenses	989,159	1,111,944	2,415,036	2,525,099
Business development and regulatory affairs	203,501	247,775	418,426	448,568
General administrative	310,158	423,658	818,575	944,226
	1,502,818	1,783,377	3,652,037	3,917,893

9 Non-brokered private placement

On May 24, 2017, the Company closed a non-brokered private placement of 14,705,883 units at a price of $0.34 per unit for gross proceeds of $5,000,000 with 9346-4626 Québec Inc., a private company operating as

Transican (the subscriber). The total gross proceeds were allocated between common shares and warrants for amounts of $4,359,892 and $640,108, respectively.

Each unit comprises one common share in the capital of the Company and ½ of one common share purchase warrant of the Company. Each whole warrant entitles the subscriber to purchase one common share at a price of $0.51 per share until May 24, 2020. The fair value of the warrants, using the Black-Scholes model, was value at $0.0435 per ½ warrant. The assumptions used were expected volatility of 66.5%, a risk-free rate of 0.78%, an expected life of three years, and an exercise price of $0.51 per common share. No commissions or fees were paid in connection with the offering, other than $43,035 in legal fees.

As a result of the closing of the transaction, the subscriber has become a new shareholder of the Company as a holder of more than 10% of the issued and outstanding common shares.

10 Subsequent Events

In the period ended September 30, 2018, the Company incurred $3,670,905 in expenses pertaining to the transactions mentioned below, which closed on October 16, 2018. An additional amount of approximately $4,400,000 in agents' commissions and other professional fees attributable to the private placement (gross proceeds of $62,000,000) mentioned below, which closed after the date of these financial statements, will be included in the period ending December 31, 2018.

On October 11, 2018, the Company announced the closing of a private placement offering (the "Offering") of Subscription Receipts (as defined below). The Offering consisted of both a brokered private placement (the "Brokered Offering"), co-led by Cormark Securities Inc. and Mackie Research Capital Corporation, as co-lead agents and joint bookrunners (the "Agents"), and a concurrent non-brokered private placement (the "Non-Brokered Offering"). The Non-Brokered Offering was assisted by Goodwood Inc. ("Goodwood").The Company closed the Offering for aggregate gross proceeds of approximately $62 million.

The Offering consisted of the issuance of a combination of (i) subscription receipts exchangeable for units ("Units"), with such Units being comprised of one (1) common share of Pediapharm ("Common Share") and one half (1/2) of one Common Share purchase warrant ("Unit Subscription Receipts"), and (ii) subscription receipts exchangeable for convertible debentures ("Convertible Debentures"), with such Convertible Debentures being convertible into units, each comprised of one (1) Common Share and one half (1/2) of one Common Share purchase warrant ("Debenture Subscription Receipts", and, together with the Unit Subscription Receipts, the "Subscription Receipts"). Pursuant to the Offering, Pediapharm issued 58,676,397 Unit Subscription Receipts, representing aggregate subscription proceeds of approximately $20 million, and 42,000 Debenture Subscription Receipts, representing aggregate subscription proceeds of $42 million. In connection with the Offering, the Agents (a) earned cash commissions in the aggregate amount of approximately $2,236,500 (the "Cash Commission"), equal to a cash fee of 7.0% for the aggregate gross proceeds raised in the Offering in excess of $30,000,000, which Cash Commission will be held in escrow pending satisfaction of the escrow release conditions set out in the Subscription Receipt Agreement (as defined below); and (b) received 2,867,306 Common Share purchase warrants ("Compensation Warrants"), each one (1) Compensation Warrant being exercisable for one Common Share at an exercise price of $0.63 per Common Share. The Compensation Warrants are exercisable for a period of 36 months following closing. Pediapharm will also pay cash commissions in the total amount of approximately $1,090,090 to registered dealers involved in the Non-

Brokered Offering (the “Dealers’ Commission“) on satisfaction of the escrow release conditions set out in the Subscription Receipt Agreement.

On October 16, 2018, the Company closed its acquisitions of two specialty pharmaceutical companies.

Pediapharm completed the acquisition of all of the issued and outstanding shares of Medexus Inc. (“Medexus“), a Canadian pharmaceutical innovator with strategic partnerships in key international markets (the “Medexus Acquisition“). The total consideration paid by Pediapharm for the Medexus Acquisition is approximately CDN$23 million, which was satisfied through the issuance of 67,646,009 common shares of Pediapharm (the “Common Shares“) to former holders of Medexus shares, at a deemed issue price of CDN$0.34 per Common Share.

Pediapharm also completed the acquisition of all of the issued and outstanding shares of Medac Pharma, Inc. (“Medac Pharma“), a privately held specialty pharmaceutical company focusing primarily in the area of rheumatology in the United States, from medac Gesellschaft für klinische Spezialpräparate m.b.H. (“medac GmbH“) (the “Medac Pharma Acquisition” and, together with the Medexus Acquisition, the “Acquisitions“). The total consideration payable by Pediapharm for the Medac Pharma Acquisition is up to U.S. $50 million, of which a cash payment of U.S. $13.1 million was paid on closing, together with the issuance of 7,260,235 units of Pediapharm (the “Consideration Units“) with a value of approximately U.S. $1.9 million with an issue price of CDN$0.34 per Consideration Unit. Each Consideration Unit consists of one Common Share and one half of one Common Share purchase warrant (each such full warrant being exercisable into one Common Share for a period of five years at an exercise price of CDN$0.63 per share). A contingent cash payment of U.S. $5 million and annual payments in an amount equal to 7.5% of the aggregate consolidated EBITDA of Pediapharm, subject to certain agreed-upon adjustments and until such time as an aggregate of U.S. $30 million in annual payments have been made, are also payable in connection with the Medac Pharma Acquisition.

Concurrent with closing of the Medac Pharma Acquisition, medac GmbH, Pediapharm and Medac Pharma entered into a manufacturing and supply agreement (the “Medac Supply Agreement“) for an initial term of 12 years from the completion of the Medac Pharma Acquisition, which Medac Supply Agreement will provide for the continued supply of products by medac GmbH to Pediapharm for sale in the United States by Pediapharm. In addition, the existing supply agreement between medac GmbH and Medexus was extended, on its existing financial terms, such that it expires 12 years from the date of the completion of the Medac Pharma Acquisition.

In connection with the completion of the Acquisitions, Pediapharm satisfied all of the conditions necessary for the subscription receipts of Pediapharm (the “Subscription Receipts”) issued pursuant to Pediapharm’s brokered offering co-led by Cormark Securities Inc. and Mackie Research Capital Corporation, and non-brokered private placement offering, to automatically convert into an aggregate of: (i) 58,676,397 units (“Units“), consisting of one Common Share (“Common Share“) and one half of one Common Share purchase warrant (each such full warrant being exercisable into one Common Share for a period of five years at an exercise price of CDN$0.63 per share); and (ii) $42 million principal amount of convertible debentures (“Convertible Debentures being convertible into units (“Conversion Units”) consisting of one (1) Common Share and one half of one Common Share purchase warrant (each such full warrant being exercisable into one Common Share for a period of five years at an exercise price of CDN$0.63 per share) at a conversion price of CDN$0.42 per Conversion Unit.

Aggregate net proceeds of approximately CDN$58.46 million which had been held in escrow in accordance with the terms of the Subscription Receipts, were released to Pediapharm. Following completion of the Acquisitions and the conversion of the Subscription Receipts, Pediapharm had an aggregate of 221,193,877 Common Shares outstanding.