



**Pediapharm Inc.**

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

**For the three months and twelve months ended  
December 31, 2013 and 2012**

## Notice to Reader

The accompanying unaudited condensed interim consolidated financial statements of PEDIAPHARM INC. (the "Corporation") for the periods of three months and twelve months ended on December 31, 2013 and 2012 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 Corporation's audit committee. These unaudited condensed interim consolidated financial statements have not been reviewed by the Corporation's auditors.

# Pediapharm Inc.

## Condensed Interim Consolidated Statements of Financial Position

(unaudited)

(expressed in Canadian dollars)

		As at December 31, 2013 \$	As at December 31, 2012 \$
<b>Assets</b>	<b>Note</b>		
<b>Current assets</b>			
Cash		6,104,636	599,551
Accounts receivable		1,039,191	264,606
Prepaid expenses		11,855	32,520
Inventories		407,240	106,833
Investment		-	50,506
		<b>7,562,922</b>	<b>1,054,016</b>
<b>Deposits</b>		2,143	2,143
<b>Property and equipment</b>		22,610	18,605
<b>Intangible assets</b>		674,924	631,227
		<b>8,262,599</b>	<b>1,705,991</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		1,268,645	513,286
Deferred revenue		112,607	268,956
Current portion of long-term debt		5,250	9,000
		<b>1,386,502</b>	<b>791,242</b>
<b>Long-term debt</b>		573,896	1,869,798
<b>Puttable Class "A" common shares</b>		-	8,414,701
		<b>1,960,398</b>	<b>11,075,741</b>
<b>Shareholders' Equity</b>			
<b>Share capital</b>	<b>3,6</b>	18,802,321	1,000
<b>Contributed surplus</b>		717,729	815,430
<b>Deficit</b>		(13,217,848)	(10,186,180)
		<b>6,302,202</b>	<b>(9,369,750)</b>
		<b>8,262,599</b>	<b>1,705,991</b>
<b>Subsequent events</b>	<b>10</b>		

Approved on behalf of the Board, on February 28, 2014

(s) Normand Chartrand, Director

(s) Sylvain Chretien, Director

# Pediapharm Inc.

## Condensed Interim Consolidated Statements of Comprehensive Loss (unaudited)

(expressed in Canadian dollars)

	<b>For the three-month periods ended December 31,</b>		<b>For the twelve-month periods ended December 31,</b>	
<b>Note</b>	<b>2013 \$</b>	<b>2012 \$</b>	<b>2013 \$</b>	<b>2012 \$</b>
<b>Revenue</b>	<b>1,237,538</b>	<b>570,945</b>	<b>4,003,807</b>	<b>2,490,503</b>
<b>Operating expenses</b>				
Selling	1,121,024	944,752	3,822,311	3,862,300
Administrative	168,892	185,007	621,660	708,172
	<b>1,289,916</b>	<b>1,129,759</b>	<b>4,443,971</b>	<b>4,570,472</b>
<b>Operating loss</b>	<b>(52,378)</b>	<b>(558,814)</b>	<b>(440,164)</b>	<b>(2,079,969)</b>
<b>Other expenses</b>				
Stock exchange listing expense	3 1,568,008	-	1,613,170	-
Finance costs	4 81,055	106,267	460,686	173,956
Foreign exchange losses (gains)	8,185	(3,797)	7,175	(4,265)
Interest income	(6,502)	(1,326)	(8,004)	(3,592)
	<b>1,650,746</b>	<b>101,144</b>	<b>2,073,027</b>	<b>166,099</b>
<b>Loss and comprehensive loss for the period</b>	<b>(1,703,124)</b>	<b>(659,958)</b>	<b>(2,513,191)</b>	<b>(2,246,068)</b>
<b>Earnings per share from continuing operations attributable to equity holders of the Corporation</b>				
Basic and diluted	(0.08)	(0.08)	(0.22)	(0.28)
Weighted average number of common shares outstanding	20,716,289	8,160,000	11,256,071	8,160,000

# Pediapharm Inc.

## Condensed Interim Consolidated Statements of Changes in Equity

(unaudited)

(expressed in Canadian dollars)

		<b>Common Shares</b>	<b>Share capital</b>	<b>Contributed surplus</b>	<b>Deficit</b>	<b>Total shareholders' deficiency</b>
<b>Note</b>	Number of shares	\$	\$	\$	\$	\$
	8,160,000	1,000	487,061	(7,940,112)	(7,452,051)	
<b>Balance – January 1, 2012</b>						
Loss and comprehensive loss for the period				(2,246,068)	(2,246,068)	
Share-based compensation – Stock option plan			148,182		148,182	
Issuance of warrants			109,384		109,384	
Issuance of deferred share units			89,703		89,703	
Buyback of deferred share units			(18,900)		(18,900)	
<b>Balance – December 31, 2012</b>	8,160,000	1,000	815,430	(10,186,180)	(9,369,750)	
<b>Balance – January 1, 2013</b>	8,160,000	1,000	815,430	(10,186,180)	(9,369,750)	
Loss and comprehensive loss for the period				(2,513,191)	(2,513,191)	
Qualifying transaction	<b>3</b>	32,173,332	12,296,600	109,915		12,406,515
Issuance of shares for Private Placements	<b>3</b>	23,254,968	6,976,490			6,976,490
Issuance of shares for Finders fees	<b>3</b>	825,000	247,500			247,500
Issuance of shares for conversion of debt	<b>3</b>	1,666,667	236,833	263,167		500,000
Share-based compensation – Stock option plan	<b>3</b>			(323,100)		(323,100)
Issuance of warrants	<b>3</b>			115,634		115,634
Adjustment of previously issued warrants	<b>3</b>			(174,214)		(174,214)
Issuance of agents options & warrants	<b>3</b>		(293,842)	293,842		-
Cost related to the issuance of shares	<b>3</b>		(662,260)			(662,260)
Adjustment for conversion of term loans	<b>3</b>				(518,477)	(518,477)
Deferred share units issuance, conversion and adjustments	<b>3</b>			(382,945)		(382,945)
<b>Balance – December 31, 2013</b>	66,079,967	18,802,321	717,729	(13,217,848)	6,302,202	

# Pediapharm Inc.

## Condensed Interim Consolidated Statements of Cash Flows

(unaudited)

(expressed in Canadian dollars)

Note	For the three-month periods ended December 31,		For the twelve-month periods ended December 31,	
	2013	2012	2013	2012
	\$	\$	\$	\$
<b>Cash flows from</b>				
<b>Operating activities</b>				
Loss for the period	(1,703,124)	(659,957)	(2,513,191)	(2,246,068)
Adjustments for				
Depreciation of property and equipment	2,899	4,642	6,438	17,976
Amortization of intangible assets	21,465	9,956	77,595	60,555
Amortization of financing fees related to term loans	4,685	-	18,738	-
Share-based compensation compensation	3 (245,554)	37,045	(245,554)	148,182
Interest on long-term debt (adjustment)	-	89,171	96,502	156,860
Chelsea amalgamation	3 1,031,643	-	1,031,643	-
Interest income	-	(1,326)	-	(3,592)
Gain on warrant conversion	3 292,052	-	292,052	-
Unrealized foreign exchange loss (gain)	8,185	2,368	7,175	1,900
Amortization of debt discount	19,855	-	82,555	-
Deferred share units expense	-	89,703	21,000	89,703
	(567,894)	(428,398)	(1,125,047)	(1,774,484)
Changes in non-cash operating working capital items	5 (452,505)	205,910	(458,453)	(146,258)
Interest paid	-	(12,461)	-	(15,472)
Interest received	-	1,326	-	3,592
	(1,020,399)	(233,623)	(1,583,500)	(1,932,622)
<b>Investing activities</b>				
Cash acquired through amalgamation	3 178,272	-	-	-
Investments and deposit	71,171	-	71,171	-
Purchases of property and equipment	-	705	(10,173)	50
Purchases of intangible assets	-	(100)	(122,787)	(78,422)
	249,443	605	(61,789)	(78,372)
<b>Financing activities</b>				
Proceed from long-term debts and warrants	80,000	307,434	870,000	1,832,544
Repayment of long-term debt	(18,500)	(2,250)	(26,682)	(9,000)
Proceeds from issuance of shares	3 6,314,230	-	6,314,230	-
Buyback of deferred share units	-	(18,900)	-	(18,900)
	6,375,730	286,284	7,157,548	1,804,644
<b>Foreign exchange impact on cash</b>	(8,185)	(2,368)	(7,175)	(1,900)
<b>Net change in cash during the period</b>	5,596,589	50,898	5,505,084	(208,250)
<b>Cash – Beginning of period</b>	508,046	548,653	599,551	807,801
<b>Cash (bank indebtedness) – End of period</b>	6,104,635	599,551	6,104,635	599,551

## **1 Incorporation and nature of activities**

Pediapharm Inc. (the “Corporation”) was incorporated under the Canada Business Corporations Act and offers sales and marketing services to the pharmaceutical industry, particularly related to pediatric care. The Corporation is domiciled in Canada, and its registered office is located at 1 Place du Commerce, Suite 225, Verdun, Quebec H3E 1A2. The Board of Directors of the Corporation has decided, following the amalgamation with Chelsea Acquisition Corporation completed on December 10, 2013, to change the Corporation’s financial year-end from December 31 to March 31. Pursuant to section 4.8 of National Instrument 51-102 – *Continuous Disclosure Obligations*, the Corporation has filed on SEDAR a Notice of Change in Year End providing information about the length and filing dates of its annual audited financial statements and interim financial statements for both its transition year and subsequent financial years.

## **2 Basis of presentation and significant accounting policies**

### **Basis of presentation**

These condensed interim consolidated financial statements, approved by the Board of Directors on February 28, 2014, have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements, including IAS 34, “Interim Financial Reporting”. These condensed interim consolidated financial statements as well as the related notes should be read in conjunction with audited consolidated financial statements of Pediapharm Inc as at December 31, 2012. These audited financial statements are included as an attachment in the Management Information Circular of Chelsea Acquisition Corporation on SEDAR.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of February 28, 2014.

The accompanying consolidated financial statements were prepared on a going concern basis under the historical cost convention, except for puttable Class “A” common shares and warrants for puttable Class “A” common shares, which are measured at fair value through profit or loss (“FVTPL”).

### 3 Qualifying transaction

On December 10, 2013, the shareholders of Chelsea Acquisition Corporation (“**Chelsea**”) approved the previously announced proposed qualifying transaction of Chelsea involving the amalgamation (the “**Amalgamation**”) of Chelsea and Pediapharm Inc. (“**Pediapharm**”). Pursuant to the Amalgamation, a new entity was formed on December 10, 2013 under the *Canada Business Corporations Act* called “Pediapharm Inc.” (“**the Corporation**”). The Amalgamation constituted the qualifying transaction of Chelsea in accordance with the requirements of the TSX Venture Exchange Inc. Policy 2.4 - *Capital Pool Companies*. TSX Venture Exchange accepted for filing the qualifying transaction and the Corporation began trading on the TSX Venture under the symbol “PDP” on December 27, 2013.

This type of share exchange is referred to as a reverse acquisition. A reverse acquisition involving a non-public enterprise and a non-operating public enterprise is a capital transaction in substance, rather than a business combination. Since the Qualifying Transaction (“**transaction**”) does not meet the definition of a business combination in accordance with IFRS 3, Business Combinations, the Transaction will be accounted for as an asset acquisition as follows:

- The assets and liabilities of Pediapharm are recognized and measured in the consolidated statement of financial position at their pre-transaction carrying amounts.
- The identifiable assets and liabilities of Chelsea are recognized at fair value at the acquisition date. The fair value of Chelsea is determined based on the number of equity interests deemed to have been issued by Pediapharm.
- The excess of the fair value over the identifiable assets and liabilities of Chelsea is charged to comprehensive loss in accordance with IFRS 2, Share-based Payment.
- Deficit and other equity balances recognized in the consolidated statement of financial position are those of Pediapharm immediately prior to the transaction.
- The amount recognized as issued common shares and warrants (presented in contributed surplus) in the consolidated statement of financial position is determined by adding the fair value of Chelsea to Pediapharm’s issued equity immediately prior to the transaction. However, the equity structure shown in the consolidated statement of financial position reflects Chelsea’s equity structure, including the common shares issued by Chelsea to effect the acquisition. The equity structure of Pediapharm was restated using the established exchange ratio to reflect the number of shares issued by Chelsea in the Transaction.

The net assets acquired are as follows:

	\$
Cash	<u>178,272</u>
Net tangible assets acquired	<u>178,272</u>



The fair value of consideration paid to acquire Chelsea's net assets is as follows:

	<b>Number</b>	<b>Amount \$</b>
Outstanding shares of Chelsea	3,666,666 <sup>(1)</sup>	1,100,000
Outstanding share options of Chelsea	466,666 <sup>(1)</sup>	<u>109,915</u>
		<u>1,209,915</u>

(1) Each group of three outstanding Chelsea common shares and three Corporation outstanding share options were exchanged for one common share and one share option, respectively.

The excess of the fair value over the carrying value of the identifiable assets and liabilities of Chelsea is recorded as a stock exchange listing expense and has been charged to comprehensive loss in the amount of \$1,031,643. The fair value of the share options of Chelsea were estimated using the Black-Scholes valuation model with the following assumptions: expected term of 1.7 years for 100,000 options and 8.7 years for the remaining 366,667 options; volatility of 100%; dividend yield of 0% and risk-free interest rate of 1.25%.

The details of the transaction include:

- a. The issued and outstanding Pediapharm Common Shares were exchanged for an aggregate of 36,666,666 common shares of the Corporation with a deemed value of \$0.30 per share as follows:
  - i. 8,014,001 puttable Class "A" common shares at a value of \$8,414,701 were converted into 19,233,650 Corporation Common Shares and no longer have the put at the option of the holders. 3,400,000 Class "A" common shares of Pediapharm at an aggregate value of \$1,000 were converted into 8,160,019 Corporation Common Shares.
- b. On September 20, 2013, a shareholders' resolution approved the conversion of term loans of \$1,781,925 into 3,195,003 Class "A" common shares that were subsequently converted into 7,668,026 Corporation Common Shares for an aggregate share price of \$2,300,402. This includes the principal, accumulated interest up to August 31, 2013 and a 20% share conversion discount. (as per the term loan agreements). The resulting discount of \$518,477 on conversion was charged to deficit.
  - i. On September 20, 2013, a shareholders' resolution approved the issuance of 251,000 Class "A" common shares which were subsequently converted into 602,401 Corporation Common Shares for an aggregate value of \$180,720. These shares were issued to minority shareholders due to their anti-dilution rights. The \$180,720 was recognised as stock based compensation expense in the consolidated Statement of Comprehensive Loss.
  - ii. On September 20, 2013, a shareholders' resolution approved the conversion of 417,737 vested deferred share units at an aggregate value of \$403,948 into 417,737 Class "A"

common shares which were subsequently converted into 1,002,571 Corporation Common Shares using a conversion ratio resulting in an aggregate value of \$300,771. The \$103,177 was recognised as stock based compensation recovery in the consolidated Statement of Comprehensive Loss.

- iii. Outstanding stock options and agents' options of Chelsea were exchanged for stock options or agents' options of Corporation exercisable at \$0.30 per share.
- c. Pediapharm completed a private placement of subscription receipts of Pediapharm (the "Subscription Receipts") at a price of \$0.30 per receipt for gross proceeds of \$6,376,490. Each Subscription Receipt was converted into one Corporation Common Share concurrent with the completion of the Transaction at no additional cost to the holder. The net proceeds were \$5,790,480 (\$6,376,490 less share issue costs of \$586,010, which were charged against Share Capital). The fair value of the 1,700,396 agents options warrants issued as part of the private placement is estimated at \$268,571 using the Black-Scholes valuation model with the following assumptions: expected term of two years; volatility of 100%; dividend yield of 0% and risk-free interest rate of 1.25%.
- d. Pediapharm, through Corporation, has closed a brokered private placement (the "**QSSP Offering**") of Common Shares to a qualified mutual fund through the Quebec Stock Savings Plan II. Pursuant to the QSSP Offering, Corporation issued 2,000,000 Common Shares at a price of \$0.30 per Common Share for gross proceeds of \$600,000. The net proceeds were \$533,750 (\$600,000 less share issue costs of \$66,250, which were charged against Share Capital). The fair value of the 160,000 agents options warrants issued as part of the private placement is estimated at \$25,271 using the Black-Scholes valuation model with the following assumptions: expected term of two years; volatility of 100%; dividend yield of 0% and risk-free interest rate of 1.25%.
- e. In connection with the Amalgamation, the Corporation paid a finder's fee to Richardson GMP Limited of \$200,000 with \$50,000 being paid in cash and the balance paid by the issuance of 500,000 Common Shares. In addition, the Corporation paid a finder's fee to 9132-8757 Québec Inc. of \$130,000 with \$32,500 paid in cash and the balance paid by the issuance of the 325,000 Common Shares.
- f. 342,857 outstanding Pediapharm share purchase warrants with a value of \$225,019 were exchanged for 342,857 share purchase warrants of the Corporation. with an exercise price of \$0.44 per share. This is a modification of the previously issued warrants and the revised fair value of those warrants is estimated at \$50,805 using the Black-Scholes valuation model with the following assumptions: expected term of 2.5 years, volatility of 100%, dividend yield of 0% and risk-free interest rate of 1.25%.
- g. 602,038 outstanding Pediapharm share options were forfeited by their holders, resulting in a reduction of contributed surplus and a recovery of stock based compensation expense of \$323,100.

#### Convertible debentures:

On September 20, 2013, financing of \$490,000 was obtained (\$500,000 less share issue costs of \$10,000, which were charged against Share Capital) and warrants that entitle the holder to acquire 1,666,667 Corporation common shares at an exercise price of \$0.30 per share for a period of 24 months ending September 20, 2015. The financing of \$490,000 was converted into 1,666,667 Corporation Common Shares as a result of the completion of the Qualifying Transaction and the beginning of the Corporation trading on the TSX Venture. Corporation The fair value of the warrants was estimated at \$263,167 using the Black-Scholes valuation model with the following assumptions: expected term of two years; volatility of 100%; dividend yield of 0% and risk-free interest rate of 1.25%. Including the issued warrants, the net proceeds were \$226,833.

#### **4 Finance costs**

	<b>For the three-month periods ended December 31,</b>		<b>For the twelve-month periods ended December 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Interest on long-term debt	42,778	106,267	348,791	173,956
Financing fees	38,277	-	111,895	-
	<b>81,055</b>	<b>106,267</b>	<b>460,686</b>	<b>173,956</b>

#### **5 Cash flows**

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

Decrease (increase) in				
Accounts receivable	(258,231)	185,102	(774,585)	(152,744)
Prepaid expenses	(541)	12,758	20,665	26,730
Inventories	(30,789)	22,440	(300,407)	(63,029)
Increase (decrease) in				
Accounts payable and accrued liabilities	(45,773)	(95,578)	752,223	(176,824)
Deferred revenue	(117,171)	81,188	(156,349)	219,609
	<b>(452,505)</b>	<b>205,910</b>	<b>(458,453)</b>	<b>(146,258)</b>

## 6 Share Capital

		<b>Common Shares</b>	<b>Share capital</b>
	<b>Note</b>	Number of shares	\$
<b>Balance – January 1, 2012</b>		8,160,000	1,000
<b>Balance – December 31, 2012</b>		8,160,000	1,000
<b>Balance – January 1, 2013</b>		8,160,000	1,000
Qualifying transaction	<b>3</b>	32,173,332	12,296,600
Issuance of shares for Private Placements	<b>3</b>	23,254,968	6,976,490
Issuance of shares for Finders fees	<b>3</b>	825,000	247,500
Issuance of shares for conversion of debt	<b>3</b>	1,666,667	236,833
Issuance of agents options & warrants	<b>3</b>		(293,842)
Cost related to the issuance of shares	<b>3</b>		(662,260)
<b>Balance – December 31, 2013</b>		66,079,967	18,802,321

## 7 Warrants and Agents options issued and outstanding

At December 31, 2013, the following warrants were outstanding, which were all part of the Qualifying Transaction (Note 3) and the concurrent private placements.

	<u>outstanding</u>	<u>price</u>	<u>expiry</u>
Warrants	1,666,667	0.30	September 20, 2015
Warrants	342,857	0.44	December 12, 2015
Agents options	1,860,396	0.30	December 27, 2015
<b>TOTAL</b>	<b>3,869,920</b>	<b>0.31</b>	(average)

## 8 Related party transactions

In the three months ended December 31, 2013, the Corporation paid management fees in the amount of \$46,290 (2012 - \$0) to 9198-4419 Quebec Inc., a company owned by the current Chief Financial Officer of the Corporation. In the twelve months ended December 31, 2013, the Corporation paid management fees in the

amount of \$68,790 (2012 - \$0) to 9198-4419 Quebec Inc., a company owned by the current Chief Financial Officer of the Corporation.

In the three months ended December 31, 2013, the Corporation paid management fees in the amount of \$10,000 (2012 - \$0) to a Director of the Corporation for a project outside of the regular duties of a Director. In the twelve months ended December 31, 2013, the Corporation paid management fees in the amount of \$10,000 (2012 - \$0) to a Director of the Corporation for a project outside of the regular duties of a Director.

In the three months ended December 31, 2013, the Corporation paid consulting fees in the amount of \$0 (2012 - \$17,022) to a firm of which a Director of the Corporation is a partner. In the twelve months ended December 31, 2013, the Corporation paid consulting fees in the amount of \$28,427 (2012 - \$45,522) to a firm of which a Director of the Corporation is a partner.

## **9 Director fees**

In the three months ended December 31, 2013, the Corporation paid director fees in the amount of \$60,000 (2012 - \$0) to Directors of the Corporation. In the twelve months ended December 31, 2013, the Corporation paid director fees in the amount of \$60,000 (2012 - \$0) to Directors of the Corporation.

## **10 Subsequent events**

On January 22, 2014, the Corporation's Board of Directors approved the grant of 3,585,000 stock options to certain directors, officers and employees of the Corporation, subject to regulatory and TSX Venture Exchange approval. The options were issued with an exercise price of \$0.46 per share and have a term of ten (10) years. In addition, the options have varied vesting provisions such that they vest either over three (3) or four (4) years.

On February 17, 2014, the Corporation's Board of Directors approved the grant of 225,000 stock options to an officer of the Corporation under its employee stock option plan, subject to regulatory and TSX Venture Exchange approval. The options were issued with an exercise price of \$0.46 per share, have a term of ten (10) years and have vesting provisions such that they vest over four (4) years.

On February 21, 2014, the Corporation completed a "bought deal" private placement of 5,555,556 common shares of the Corporation (the "Common Shares") at a price of \$0.36 per common shares for gross proceeds of \$2,000,000.16. The common shares are subject to a hold period expiring on June 22, 2014. The Offering is subject to certain conditions including, but not limited to, the receipt of all necessary approvals including the approval of the TSX Venture Exchange. All shares are admissible under the Quebec Stock Saving Plan II.