

Pediapharm Inc.

Consolidated Financial Statements
March 31, 2017 and 2016
(expressed in Canadian dollars)



June 27, 2017

Independent Auditor's Report

To the Shareholders of Pediapharm Inc.

We have audited the accompanying consolidated financial statements of Pediapharm Inc. which comprise the consolidated statements of financial position as at March 31, 2017 and 2016 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years ended March 31, 2017 and 2016, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Pediapharm Inc. as at March 31, 2017 and 2016 and its financial performance and its cash flows for the years ended March 31, 2017 and 2016, in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP¹

¹ CPA auditor, CA, public accountancy permit No. A125677

Pediapharm Inc.

Consolidated Statements of Financial Position

As at March 31, 2017 and 2016

(expressed in Canadian dollars)

	Note	2017 \$	2016 \$
Assets			
Current assets			
Cash and cash equivalents		3,241,097	4,941,494
Accounts receivable	4	638,441	300,108
Prepaid expenses		17,681	52,808
Inventories	2	1,704,540	609,458
		<u>5,601,759</u>	<u>5,903,868</u>
Property and equipment	5	22,805	39,625
Intangible assets	6	<u>2,103,077</u>	<u>1,709,701</u>
		<u>7,727,641</u>	<u>7,653,194</u>
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	7	1,943,184	768,435
Interest payable		165,000	167,213
		<u>2,108,184</u>	<u>935,648</u>
Convertible debentures	8	<u>4,323,821</u>	<u>3,910,695</u>
		<u>6,432,005</u>	<u>4,846,343</u>
Shareholders' Equity			
Share capital		21,025,018	20,966,018
Contributed surplus		3,862,379	3,600,707
Deficit		<u>(23,591,761)</u>	<u>(21,759,874)</u>
		<u>1,295,636</u>	<u>2,806,851</u>
		<u>7,727,641</u>	<u>7,653,194</u>

Approved by the Board of Directors on June 27, 2017

(Sylvain Chretien)

Director

(Normand Chartrand)

Director

Sylvain Chretien

Normand Chartrand

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

Pediapharm Inc.

Consolidated Statements of Loss and Comprehensive Loss For the years ended March 31, 2017 and 2016

(expressed in Canadian dollars)

	Note	2017 \$	2016 \$
Revenue			
Products		5,951,474	3,504,696
Commissions		255,665	245,540
		<u>6,207,139</u>	<u>3,750,236</u>
Cost of sales	2	<u>2,778,393</u>	<u>1,295,999</u>
Gross profit		3,428,746	2,454,237
Selling and administrative expenses	9, 12, 15	6,803,665	6,750,581
Depreciation and amortization	5, 6	23,994	105,721
Foreign exchange loss (gain)		(39,168)	71,901
Other income	3	<u>(2,570,200)</u>	<u>(3,134,249)</u>
Operating loss		(789,545)	(1,339,717)
Financing costs	11	1,082,294	1,001,046
Interest income		<u>(39,952)</u>	<u>(41,469)</u>
Net loss and comprehensive loss for the year		<u>(1,831,887)</u>	<u>(2,299,294)</u>
Net loss per share attributable to shareholders of the Company			
Basic and diluted		<u>(0.025)</u>	<u>(0.032)</u>
Weighted average number of common shares outstanding		<u>72,634,209</u>	<u>72,381,586</u>

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

Pediapharm Inc.

Consolidated Statements of Changes in Shareholders' Equity For the years ended March 31, 2017 and 2016

(expressed in Canadian dollars)

	Note	Share capital			Total shareholders' equity \$	
		Common shares	Amount \$	Contributed surplus \$		
Balance – March 31, 2015		72,055,856	20,779,567	3,171,121	(19,460,580)	4,490,108
Loss and comprehensive loss for the year		-	-	-	(2,299,294)	(2,299,294)
Share-based compensation – Stock option plan	9	-	-	466,327	-	466,327
Exercise of warrants and options	10	288,200	129,201	(36,741)	-	92,460
Issuance of shares for officer compensation	9	168,382	57,250	-	-	57,250
Balance – March 31, 2016		72,512,438	20,966,018	3,600,707	(21,759,874)	2,806,851
Loss and comprehensive loss for the year		-	-	-	(1,831,887)	(1,831,887)
Share-based compensation – Stock option plan	9	-	-	261,672	-	261,672
Issuance of shares for officer compensation	9	196,665	59,000	-	-	59,000
Balance – March 31, 2017		72,709,103	21,025,018	3,862,379	(23,591,761)	1,295,636

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.

Consolidated Statements of Cash Flows For the years ended March 31, 2017 and 2016

(expressed in Canadian dollars)

	Note	2017 \$	2016 \$
Cash flows from			
Operating activities			
Net loss for the year		(1,831,887)	(2,299,294)
Adjustments for			
Depreciation of property and equipment	5	20,265	23,260
Amortization of intangible assets	6	31,602	124,045
Amortization of financing fees	11	142,472	50,202
Share-based compensation expense	9	320,672	523,576
Interest on convertible debentures	11	669,168	673,117
Convertible debenture interest accretion	11	270,654	277,727
Impairment loss on intangible assets	6	13,701	230,299
Interest income		(39,952)	(41,469)
		(403,305)	(438,537)
Changes in non-cash operating working capital items	14	(223,539)	(382,945)
Interest paid		(671,381)	(506,287)
Interest received		39,952	41,469
		(1,258,273)	(1,286,300)
Investing activities			
Purchases of property and equipment		(3,445)	(3,840)
Purchases of intangible assets		(438,679)	(655,287)
		(442,124)	(659,127)
Financing activities			
Proceeds from issuance of shares, net of issuance costs		-	92,460
Repayment of long-term debt		-	(4,309)
		-	88,151
Net change in cash and cash equivalents during the year		(1,700,397)	(1,857,276)
Cash and cash equivalents – Beginning of year		4,941,494	6,798,770
Cash and cash equivalents – End of year		3,241,097	4,941,494

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

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Notes to Consolidated Financial Statements

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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 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 consolidated financial statements are based on IFRS issued and outstanding as of June 27, 2017.

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

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New standards not yet adopted by the Company

IAS 7, Statement of Cash Flows

In January 2016, IASB amended IAS 7. The amendments require that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. One way to fulfill the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Finally, the amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities. This amendment was mandatory for annual periods beginning on or after January 1, 2017. The extent or the impact of the adoption of IAS 7 has not yet been determined.

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 is currently evaluating the impact of the standard on its consolidated financial statements.

IFRS 15, Revenue from Contracts with Customers

In May 2014, the IASB released IFRS 15, which supersedes IAS 11, Construction Contracts, and IAS 18, Revenue, and the related interpretations on revenue recognition: IFRS Interpretations Committee (IFRIC) 13, Customer Loyalty Programmes, IFRIC 15, Agreements for the Construction of Real Estate, IFRIC 18, Transfers of Assets from Customers, and Standard Interpretations Committee (SIC) 31, Revenue – Barter Transactions Involving Advertising Services. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Company is currently evaluating the impact of the standard on its consolidated financial statements.

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.

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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.

Use of judgments, estimates and assumptions

The preparation of consolidated financial statements in conformity with IFRS requires the Company's management to make estimates and judgments that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Management bases its estimates and judgments on historical experience and on various other assumptions that it considers reasonable. The areas involving a high degree of judgment or complexity, or other areas where assumptions and estimates are significant to the consolidated financial statements are disclosed below. Actual results could differ from those estimates. Changes will be reported in the period in which they are identified.

a) Fair value of stock options and warrants

When the Company issues stock options and warrants, an estimate of fair value is derived for the instrument using the Black-Scholes option-pricing model. The application of this option-pricing model requires management to make assumptions regarding several variables, including the period for which the instrument will be outstanding, the price volatility of the Company's shares over a relevant time frame, the determination of a relevant risk-free interest rate and an assumption regarding the Company's dividend policy in the future. If different assumptions are used, the value derived for the instruments could be significantly impacted. See notes 9 and 10 for assumptions used to value these instruments.

b) Impairment of intangible assets

Licences are recognized as intangible assets and are amortized over their useful lives when they meet the criteria for capitalization. Forecasted revenue and profitability for the relevant products are used to assess compliance with the capitalization criteria and to assess the recoverable amount of the assets. The useful life is determined by identifying the period in which substantially all of the cash flows are expected to be generated and generally amortization starts either from the date of the distribution approval granted by Health Canada or from the date of the licence contract signature, depending on the contract terms. Whenever licences are tested for impairment, the determination of the assets' recoverable amount involves the use of estimates by management and can have a material impact on the respective values and ultimately the amount of any impairment.

On December 31, 2015, the Company announced that Health Canada upheld the May 2015 Notice of Deficiency – Withdrawal Letter regarding Easyhaler Budesonide, without prejudice to refiling. The Company is assessing its potential alternatives. For the year ended March 31, 2016, management recorded an impairment expense of \$216,975 for the Easyhaler Budesonide capitalized licence costs (included in intangible assets).

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c) Fair value of convertible debentures

The convertible debentures are a compound financial instrument under IAS 32, Financial Instruments: Presentation, and have both a liability and an 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 components. The most significant assumption used is the discount rate to fair value for the liability component. If other assumptions are used, the values derived could be significantly impacted. See note 8 for the assumptions used to determine the fair value of the convertible debentures.

d) Returns provision

The returns provision is calculated using management's best estimate of products that will ultimately be returned by customers. The estimation of the returns provision is based on historical experience with returned products and is deducted from revenues. The estimated returns provision for the year ended March 31, 2017 was \$95,831 (2016 – \$37,657).

Foreign currency translation

The Company's presentation and functional currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end exchange rates. Exchange gains and losses resulting from the translation of these amounts are included in the consolidated statement of loss and comprehensive loss for the year. Non-monetary assets and liabilities denominated in foreign currencies that are measured at historical cost are translated at the exchange rate in effect at the transaction date.

Revenue recognition

Sale of products

The Company sells pediatric pharmaceutical products. Revenue from the sale of products in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns. Products are delivered by truck directly from the Company to customers located in Canada and are recognized as revenue when the ownership of the products are transferred to the customer. Revenues are recognized net of applicable rebates and after the following criteria have been met: (i) there is evidence of an arrangement; (ii) delivery was made; (iii) there is no continuing management involvement with the products; (iv) the price is fixed; and (v) the recovery of the consideration is probable.

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Commission revenue

The Company receives commission revenue in the course of ordinary activities, which is measured at the fair value of the consideration received or receivable. Revenue is recognized when the recovery of the consideration is probable, the associated costs can be estimated reliably, there is no continuing management involvement and the amount of revenue can be measured reliably.

Cash and cash equivalents

Cash and cash equivalents consist of cash and highly liquid investments with original terms to maturity of 90 days or less at the date of purchase.

Inventories

Finished goods are valued at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. For the year ended March 31, 2017, the cost of inventories sold included in cost of sales is \$1,938,224 (2016 – \$842,607).

Property and equipment

Property and equipment is recorded at cost less accumulated depreciation and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. The Company depreciates its property and equipment as follows:

	Method	Rate/Period
Computer equipment	Straight-line	3 years
Office furniture and equipment	Declining balance	20%

Intangible assets

Separately acquired trademarks and licences are recorded at cost less accumulated amortization and any accumulated impairment charges. These assets have finite useful lives.

Intangible assets are amortized using the straight-line basis over their estimated lives as follows:

	Period
Licences	Between 7 and 15 years
Trademarks	15 years
Software	3 years

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Amortization method and useful lives are reviewed and adjusted, if appropriate, on a prospective basis at each reporting date.

Impairment of long-lived assets

Property and equipment and intangible assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels at which they have separately identifiable cash flows (cash-generating units). Non-financial assets that previously had impairment are reviewed for possible reversal of the impairment at each reporting date. With the exception of the impairment expense of \$216,975 for the Easyhaler Budesonide capitalized licence costs for the year ended March 31, 2016, there was no other material impairment of the Company's long-lived assets for any of the periods presented.

Financial instruments

The Company classifies its financial instruments into the following categories: "Loans and receivables"; "Held-to-maturity"; "Financial liabilities at FVTPL", and "Other financial liabilities". The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial instruments at their initial recognition. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

The Company's financial instruments are classified as follows:

Loans and receivables – Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company classifies cash and cash equivalents and accounts receivable in the consolidated statement of financial position as loans and receivables.

Loans and receivables are initially recognized at fair value plus transaction costs and are subsequently measured at amortized cost using the effective interest method. Financial assets are derecognized when the rights to receive cash flows have expired or have been transferred and the Company has substantially transferred all risks and rewards of ownership.

Held-to-maturity – Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

Held-to-maturity investments are initially recognized at fair value including transaction costs and measured subsequently at amortized cost using the effective interest method.

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The Company has no financial instruments classified as held-to-maturity.

Financial liabilities at FVTPL – Financial liabilities at FVTPL are financial liabilities held for trading, which include derivatives and financial liabilities designated by the Company at fair value through profit or loss. The financial liabilities were designated at FVTPL, as they are managed on a fair value basis.

Financial liabilities at FVTPL are initially recognized at fair value, and transaction costs are expensed immediately in the consolidated statement of comprehensive loss. Gains and losses arising from changes in the fair value of financial liabilities at FVTPL are presented in the consolidated statement of comprehensive loss in other losses, net in the period in which they arise.

The Company will derecognize a financial liability, or part of a financial liability, when it is extinguished, that is, when the obligation specified in the contract is discharged, cancelled or expired.

The Company has no financial instruments classified as financial liabilities at FVTPL.

Other financial liabilities – These financial instruments are measured initially at fair value and subsequently at amortized cost using the effective interest method. The Company classifies accounts payable and accrued liabilities, interest payable and convertible debentures as other financial liabilities.

Impairment of financial assets

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (loss event) and that the loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Impairment losses on financial assets carried at cost are reversed in subsequent periods if the amount of loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Income taxes

Current income tax expense is calculated on the basis of the applicable Canadian tax laws enacted or substantively enacted at the end of the reporting period. The tax expense for the fiscal year comprises current and deferred income tax. Tax expense is recognized in the consolidated statement of comprehensive loss, except to the extent that it is recognized in equity.

Deferred income tax is recognized using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects either accounting or taxable profit or loss. Deferred income tax is determined using tax rates that have been enacted or substantively enacted at the consolidated statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Share-based compensation

The Company has outstanding common stock options which are considered equity awards. Accordingly, the Company recognizes a share-based compensation expense based on the fair value of the options at the grant date with a corresponding credit to contributed surplus. The options vest in tranches (graded vesting); accordingly, the expense is recognized using the accelerated expense attribution method over the vesting period. The vesting of an award is not contingent on the attainment of performance conditions. When the stock options are exercised, the Company issues new shares and the proceeds net of any directly attributable transaction costs are credited to share capital.

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in shareholders' equity as a deduction, net of tax, from the proceeds.

Loss per share

Loss per share is calculated by dividing the net loss for the year attributable to the common shareholders of the Company by the weighted average number of common shares outstanding during the year. The diluted weighted average number of common shares outstanding is calculated by taking into account the dilution that would occur if the securities or other agreements for the issuance of common shares were exercised or converted into common shares at the later of the beginning of the year or the issuance date, unless it is anti-dilutive. The treasury stock method is used to determine the dilutive effect of the stock options. The treasury stock method is a method of recognizing the use of proceeds that could be obtained upon the exercise of options in computing diluted earnings per share. It assumes that any proceeds would be used to purchase common shares at the average market price during the year. The Company has two categories of dilutive potential common shares: share-based compensation options and warrants. For the year ended March 31, 2017, share-based compensation options, warrants and convertible debenture conversion options to acquire 10,429,029 common shares (2016 – 6,238,631) have been excluded from the diluted earnings per share calculation, since their inclusion would have had an anti-dilutive effect.

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Segment reporting

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses. The Company has one reportable operating segment: the products sold and the marketing services offered to the pharmaceutical industry. The operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. All of the Company's assets are located in Canada.

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.

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 consolidated statement of loss and comprehensive loss for the year ended March 31, 2017.

4 Accounts receivable

	2017 \$	2016 \$
Trade accounts receivable, net of allowance for doubtful accounts of nil (2016 – nil)	631,396	269,610
Sales taxes receivable	7,045	30,498
	<hr/> 638,441	<hr/> 300,108

No trade accounts receivable were past due or impaired as at March 31, 2017 and 2016.

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5 Property and equipment

	Computer equipment \$	Office furniture and equipment \$	Total \$
For the year ended March 31, 2016			
Opening net book value	37,057	21,988	59,045
Additions	3,840	-	3,840
Depreciation charge	(18,862)	(4,398)	(23,260)
Closing net book value	22,035	17,590	39,625
As at March 31, 2016			
Cost	109,358	51,865	161,223
Accumulated depreciation	(87,323)	(34,275)	(121,598)
Net book value	22,035	17,590	39,625
For the year ended March 31, 2017			
Opening net book value	22,035	17,590	39,625
Additions	3,445	-	3,445
Depreciation charge	(16,747)	(3,518)	(20,265)
Closing net book value	8,733	14,072	22,805
As at March 31, 2017			
Cost	112,803	51,865	164,668
Accumulated depreciation	(104,070)	(37,793)	(141,863)
Net book value	8,733	14,072	22,805

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6 Intangible assets

	Licences \$	Trademarks \$	Software \$	Total \$
For the year ended March 31, 2016				
Opening net book value	1,396,145	2,100	10,513	1,408,758
Additions	655,287	-	-	655,287
Amortization charge	(118,785)	(300)	(4,960)	(124,045)
Impairment loss	(230,299)	-	-	(230,299)
Closing net book value	1,702,348	1,800	5,553	1,709,701
As at March 31, 2016				
Cost	1,964,104	4,500	33,830	2,002,434
Accumulated amortization	(261,756)	(2,700)	(28,277)	(292,733)
Net book value	1,702,348	1,800	5,553	1,709,701
For the year ended March 31, 2017				
Opening net book value	1,702,348	1,800	5,553	1,709,701
Additions	438,679	-	-	438,679
Amortization charge	(27,873)	(300)	(3,429)	(31,602)
Impairment loss	(13,701)	-	-	(13,701)
Closing net book value	2,099,453	1,500	2,124	2,103,077
As at March 31, 2017				
Cost	2,387,954	4,500	33,830	2,426,284
Accumulated amortization	(288,501)	(3,000)	(31,706)	(323,207)
Net book value	2,099,453	1,500	2,124	2,103,077

As at March 31, 2017, the average remaining life of the licences was approximately eight years (2016 – seven years).

7 Accounts payable and accrued liabilities

	2017 \$	2016 \$
Accounts payable – Trade	1,298,114	350,568
Accrued liabilities	645,070	417,867
	1,943,184	768,435

Pediapharm Inc.

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(expressed in Canadian dollars)

8 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 \$63,979 was recognized in the consolidated statement of loss and comprehensive loss for the year ended March 31, 2017 (2016 – \$50,202)

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.

9 Share-based compensation

Stock option plan

	2017		2016	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Options outstanding – Beginning of year	4,781,414	0.42	4,245,902	0.43
Granted	2,475,000	0.30	1,655,000	0.34
Exercised	-	-	(100,000)	0.30
Expired	(61,442)	0.40	-	-
Forfeited	(98,943)	0.40	(1,019,488)	0.46
Options outstanding – End of year	7,096,029	0.37	4,781,414	0.40
Options exercisable – End of year	3,573,689	0.41	2,213,207	0.42

As at March 31, 2017, the options outstanding under the plan have a weighted average remaining life of approximately eight years (2016 – eight years).

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Exercise price	Number of options outstanding
\$0.30	2,728,334
\$0.34	1,595,000
\$0.46	<u>2,772,695</u>
	<u>7,096,029</u>

a) 2014 Stock option plan

The Company's stock option is a "rolling plan" under which the Company may grant options for a maximum of 10% of the issued and outstanding common shares of the Company at the time of the grant. The number of common shares that may be reserved under the stock option plan automatically increases or decreases as the number of issued and outstanding common shares of the Company increases or decreases.

On January 22, 2014, the Company adopted a stock option plan for common shares. The plan provided that the terms and pricing of the options would be established by the directors.

On July 2, 2015, the Company granted 150,000 stock options to a service provider. The options were issued with an exercise price of \$0.34 per share, have a term of two years and vest over a 12-month period at a rate of 25% per quarter.

On July 23, 2015, the Company granted 1,505,000 common shares to directors, officers, employees and consultants of the Company. The options were issued with an exercise price of \$0.34 per share and have a term of 10 years. In addition, the options have varied vesting provisions such that for some, one third of the options may be exercised on the grant date and the remaining options may be exercised in the proportion of one third in each subsequent year, and for others, one fourth of the options may be exercised on the first anniversary of the grant date and the remaining options may be exercised in the proportion of one fourth in each subsequent year.

On July 25, 2016, the Company granted 2,475,000 common shares to directors, officers, employees and consultants of the Company. The options were issued with an exercise price of \$0.30 per share and have a term of 10 years. In addition, the options have varied vesting provisions such that for some, one third of the options may be exercised on the grant date and the remaining options may be exercised in the proportion of one third in each subsequent year, and for others, one fourth of the options may be exercised on the first anniversary of the grant date and the remaining options may be exercised in the proportion of one fourth in each subsequent year.

As at March 31, 2017, a total of 174,881 common shares remained authorized for issuance under the stock option plan.

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All options granted become immediately exercisable in the event of any change of control of the Company.

In estimating the share-based compensation expense for options granted to directors, officers, employees and consultants, the Company uses the Black-Scholes option-pricing model. The assumptions used for options granted were as follows:

	2017	2016
Risk-free interest rate	0.56% to 0.74%	0.45% to 1.22%
Volatility*	72%	72%
Expected life	2 to 6 years	2 to 6 years
Expected dividend yield	Nil	Nil
Expected forfeiture rate	5%	5%
Fair value per option granted	\$0.12 to \$0.19	\$0.13 to \$0.22

* Expected share price volatility was calculated using the Company's historical volatility.

For the year ended March 31, 2017, the share-based compensation expense with respect to these options, as well as the vesting of previously granted options, amounted to \$261,672 (2016 – \$466,327) and is included in selling and administrative expenses in the consolidated statement of loss and comprehensive loss.

b) Payment of bonuses through issuance of shares

On July 23, 2015, the Company's Board of Directors approved the payment of bonuses to certain officers of the Company for their contribution during the year ended March 31, 2015. A portion of the bonuses, which was recorded in accrued liabilities as at March 31, 2015, was paid through the issuance of an aggregate of 168,382 common shares of the Company at a deemed price of \$0.34 per share for a total of \$57,250.

On July 25, 2016, the Company's Board of Directors approved the payment of bonuses to certain officers of the Company for their contribution during the year ended March 31, 2016. A portion of the bonuses was paid through the issuance of an aggregate of 196,665 common shares of the Company at a deemed price of \$0.30 per share for a total of \$59,000.

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Notes to Consolidated Financial Statements

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10 Warrants

	2017			2016		
	Number of warrants	Weighted average exercise price \$	Fair value \$	Number of warrants	Weighted average exercise price \$	Fair value \$
Warrants outstanding – Beginning of year	3,692,091	0.33	367,606	7,408,345	0.32	969,085
Exercised	-	-	-	(188,200)	0.30	(10,771)
Expired	(359,091)	0.33	(23,627)	(3,528,054)	0.30	(590,708)
Warrants outstanding – End of year	3,333,000	0.33	343,979	3,692,091	0.33	367,606

Warrants outstanding as at March 31, 2017:

	Number of warrants outstanding	Price \$	Expiry
Warrants	3,333,000	0.33	March 30, 2019

11 Financing costs

	2017 \$	2016 \$
Interest on convertible debentures	669,168	673,117
Amortization of deferred financing fees	142,472	50,202
Convertible debenture interest accretion	270,654	277,727
	1,082,294	1,001,046

12 Employee benefit expense

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

	Note	2017 \$	2016 \$
Salaries and benefits		1,778,857	2,039,555
Share-based compensation	9	(35,392)	224,178
		1,743,465	2,263,733

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Notes to Consolidated Financial Statements

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

	Note	2017 \$	2016 \$
Key management compensation			
Short-term employee benefits and consulting fees		1,120,039	976,756
Share-based compensation	9	297,064	242,149
		<u>1,417,103</u>	<u>1,218,905</u>

Key management compensation is included in selling and administrative expenses.

13 Related party transactions

Transactions with related parties during the year and amounts due to or from these parties as at March 31, 2017 and 2016 are disclosed in these consolidated financial statements.

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

For the year ended March 31, 2017, the Company incurred management fees in the amount of \$43,810 (2016 – \$171,590) to a company owned by the current Chief Financial Officer of the Company, and no amount was included in accounts payable and accruals as at March 31, 2017 (2016 – \$25,500).

For the year ended March 31, 2017, the Company incurred and paid legal fees in the amount of \$16,282 (2016 – \$36,955) to a firm of which a director of the Company is a partner.

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Notes to Consolidated Financial Statements

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14 Consolidated statement of cash flows

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

	2017 \$	2016 \$
Decrease (increase) in		
Accounts receivable	(338,333)	778
Prepaid expenses	35,127	82,271
Inventories	(1,095,082)	(239,706)
Increase (decrease) in		
Accounts payable and accrued liabilities	1,174,749	(226,288)
	<u>(223,539)</u>	<u>(382,945)</u>

15 Selling and administrative expenses

	2017 \$	2016 \$
Sales and marketing expenses	3,938,706	3,214,917
Business development and regulatory affairs	1,092,494	1,519,251
General administrative	1,772,465	2,016,413
	<u>6,803,665</u>	<u>6,750,581</u>

16 Commitments

The future minimum payments required under a long-term operating lease for office space are as follows:

	\$
2018	121,088
2019	79,525

The Company also has commitments related to milestone payments it is required to pay to existing partners if some key milestones are achieved, such as Health Canada approvals.

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Notes to Consolidated Financial Statements

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17 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 March 31, 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.

18 Income taxes

A reconciliation of income taxes at the Canadian statutory rate with reported income taxes are as follows:

	2017 \$	2016 \$
Statutory federal and provincial tax	(492,778)	(618,510)
Increase (decrease) in taxes recoverable resulting from:		
Effect of change in valuation allowance	354,598	816,281
Non-deductible share-based compensation	86,261	140,842
Non-deductible expenses for tax purposes	7,512	8,235
Other differences	44,407	(346,848)
	<u>-</u>	<u>-</u>

The Canadian combined statutory rate as at March 31, 2017 was 26.9% (2016 – 26.9%).

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Notes to Consolidated Financial Statements

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The Company has accumulated non-capital losses which can be carried forward to reduce future taxable income and which expire as follows:

	\$
2028	612,683
2029	700,862
2030	1,998,228
2031	1,739,847
2032	2,120,629
2033	847,524
2034	1,197,126
2035	4,864,409
2036	3,260,192
2037	2,891,421
	<hr/>
	20,232,921
	<hr/>

The future benefit of these losses has not been recognized in the accounts.

Significant components of the Company's unrecognized deferred tax assets and deferred tax liabilities are as follows:

	2017 \$	2016 \$
Deferred tax assets		
Non-capital loss carryforwards	5,361,724	4,699,574
Financing and share-issue costs	-	313,872
Property and equipment and intangible assets	148,684	102,184
Deferred tax liabilities		
Financing and share-issue costs	(40,180)	-
	<hr/>	<hr/>
Unrecognized deferred tax assets	5,470,228	5,115,630
	<hr/>	<hr/>

Pediapharm Inc.

Notes to Consolidated Financial Statements

March 31, 2017 and 2016

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19 Financial instruments

Financial instruments by category

	2017		
	Loans and receivables \$	Held-to- maturity \$	Total \$
Assets as per consolidated statement of financial position			
Cash and cash equivalents	3,241,097	-	3,241,097
Accounts receivable	631,396	-	631,396
	<u>3,872,493</u>	<u>-</u>	<u>3,872,493</u>
	Liabilities at FVTPL \$	Other financial liabilities \$	Total \$
Liabilities as per consolidated statement of financial position			
Accounts payable and accrued liabilities	-	1,943,184	1,943,184
Interest payable	-	165,000	165,000
Convertible debentures	-	4,323,821	4,323,821
	<u>-</u>	<u>6,432,005</u>	<u>6,432,005</u>
	2016		
	Loans and receivables \$	Held-to- maturity \$	Total \$
Assets as per consolidated statement of financial position			
Cash and cash equivalents	4,941,494	-	4,941,494
Accounts receivable	269,610	-	269,610
	<u>5,211,104</u>	<u>-</u>	<u>5,211,104</u>

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	Liabilities at FVTPL \$	Other financial liabilities \$	Total \$
Liabilities as per consolidated statement of financial position			
Accounts payable and accrued liabilities	-	768,435	768,435
Interest payable	-	167,213	167,213
Convertible debentures	-	3,910,695	3,910,695
	-	4,846,343	4,846,343

The carrying values of the short-term financial assets and financial liabilities approximate their fair values due to the short-term nature of the instruments. The fair values of the convertible debentures are the same as their carrying values as at March 31, 2017 and 2016.

Fair value estimation

The different levels of the fair value hierarchy are defined as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity-specific estimates. If all significant inputs required to determine fair value of an instrument are observable, the instrument is included in Level 2.

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are liquidity risk, credit risk and market risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse effects on the Company's financial performance.

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Liquidity risk

Liquidity risk arises when a company encounters difficulties in meeting commitments associated with liabilities and other payment obligations. Liquidity risk is managed by maintaining adequate reserves and banking facilities and by closely monitoring forecast and actual cash flows. The Company is exposed to this risk mainly in respect of its accounts payable and accrued liabilities and convertible debentures.

The tables below categorize the Company's financial liabilities into relevant maturity groupings based on the remaining period at the consolidated statement of financial position date to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

	2017			
	Less than 3 months \$	Between 3 months and 1 year \$	Between 1 and 5 years \$	Total \$
Accounts payable and accrued liabilities	1,923,039	20,145	-	1,943,184
Interest payable	165,000	-	-	165,000
Convertible debentures	-	-	5,500,000	5,500,000
	2,088,039	20,145	5,500,000	7,608,184

	2016			
	Less than 3 months \$	Between 3 months and 1 year \$	Between 1 and 5 years \$	Total \$
Accounts payable and accrued liabilities	768,435	-	-	768,435
Interest payable	167,213	-	-	167,213
Convertible debentures	-	-	5,500,000	5,500,000
	935,648	-	5,500,000	6,435,648

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company is exposed mainly to credit risk on its cash and cash equivalents and accounts receivable. The Company offers credit to its customers in the normal course of its operations. It continually assesses the credit risk of its customers and accounts for an allowance for doubtful accounts, if any. The credit risk on cash and cash equivalents is mitigated by the fact that they are in place with major Canadian financial institutions.

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Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk. The Company is exposed mainly to currency risk and interest rate risk. The exposures of the Company are monitored regularly by the Company's management.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company has performed a sensitivity analysis on currency risk as at March 31, 2017 and 2016. A change in foreign exchange rates of 10% higher or lower will not have a significant impact on loss and comprehensive loss for the year.

The consolidated statements of financial position have amounts denominated in other currencies as follows:

	2017 \$	2016 \$
Cash		
US dollar	84,784	582,732
Euro	579,509	7,107

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is exposed to interest rate risk on its fixed and floating interest rate financial instruments. Fixed rate instruments subject the Company to fair value risk, while floating rate instruments subject it to cash flow risk. The Company has performed a sensitivity analysis on interest rate risk as at March 31, 2017 and 2016. A change in interest rates on borrowings of 1% higher or lower will not have a significant impact on loss and comprehensive loss for the year.

The Company is exposed to interest rate risk as follows:

Cash and cash equivalents	Floating rate
Accounts receivable	Non-interest bearing
Accounts payable and accrued liabilities	Non-interest bearing
Convertible debentures	As described in note 8

Capital risk management

The common shares are managed as the capital of the Company for all periods concerned. The Company's objective when managing capital is to safeguard its ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to minimize the cost of capital. In order to maintain or adjust the capital structure, the Company may issue new common shares from time to time.

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20 Subsequent event

On May 25, 2017, the Company announced it has closed a non-brokered private placement (the offering) of units of the Company (the units) in trust, pending receipt of the final approval from the TSX Venture Exchange (the exchange).

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. No commissions or fees were paid in connection with the offering.

Completion of the offering is subject to the final approval of the exchange. As a result of the offering, the subscriber will become a new insider of the company as a holder of more than 10% of the issued and outstanding common shares. The offering has therefore been closed in trust pending the receipt of applicable clearance searches to be conducted by the exchange which are anticipated to take up to six weeks to obtain.

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