



MANAGEMENT DISCUSSION AND ANALYSIS  
FOR THE THREE AND TWELVE MONTH PERIODS ENDED MARCH  
31, 2017

DATED JUNE 27, 2017

# Pediapharm Inc.

Management discussion for the 12-month period ended March 31, 2017

## **SCOPE OF THIS MANAGEMENT DISCUSSION & ANALYSIS AND NOTICE TO INVESTORS**

This management discussion and analysis of financial position and results of operations ("MD&A"), is prepared as of June 27, 2017, and complements the audited consolidated financial statements of Pediapharm Inc. ("Pediapharm" or the "Company"), which include Pediapharm Licensing Inc., its wholly owned subsidiary, for the twelve month period ended March 31, 2017.

All financial information has been prepared in accordance with International Financial Reporting Standards ("IFRS") and all amounts are in Canadian dollars unless otherwise indicated. This MD&A should be read in conjunction with the information contained in the audited consolidated financial statements of the Company and the notes thereto for the twelve-month period ended March 31, 2017.

The audited consolidated financial statements and the MD&A have been reviewed by the audit committee and approved by the Company's Board of Directors on June 27, 2017. These documents and more information about the Company are available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **FORWARD LOOKING STATEMENTS**

Certain statements made in this MD&A are forward-looking statements or information. The Company is hereby providing cautionary statements identifying important factors that could cause the Company's actual results to differ materially from those projected in the forward-looking statements. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "may", "is expected to", "anticipates", "estimates", "intends", "plans", "projection", "could", "vision", "goals", "objective" and "outlook") are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements. In making these forward-looking statements, the Company has assumed that the current market will continue and grow and that the risks listed below will not adversely impact the business of the Company. By their nature, forward looking statements involve numerous assumptions, inherent risks and uncertainties, both general and specific, which contribute to the possibility that the predicted outcomes may not occur or may be delayed. The risks, uncertainties and other factors, many of which are beyond the control of the Company that could influence actual results include, but are not limited to: future capital requirements and dilution; intellectual property protection and infringement risks; competition (including potential for generic competition); reliance on key management personnel; Pediapharm's ability to implement its business plan; regulatory approval by the Canadian Health authorities; product reimbursement by third party payers; patent litigation or patent expiry; litigation risk; stock price volatility; government regulation; potential third party claims. The Company's expected revenue in the Future Outlook section is based on historical revenue growth. Further, unless otherwise noted, any forward-looking statement speaks only as of the date of this MD&A, and, except as required by applicable law, the Company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all such factors and to assess in advance the impact of each such factor on the business of the Company, or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statement.

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## KEY HIGHLIGHTS-PERIOD ENDED MARCH 31, 2017

In the three-month period ended March 31, 2017, total revenue reached \$1,658,788 (three-month period ended March 31, 2016 - \$650,320), representing an increase of 155% including:

- 41% increase from NYDA®
- 22% increase from Naproxen Suspension
- Revenue from Relaxa™ which was in line with Management's estimate of approximately \$3 million on an annual basis
- Revenue from Rupall™, launched in late January 2017, was in line with Management's estimate.

In the twelve-month period ended March 31, 2017, total revenue reached \$6,207,139 (twelve months ended March 31, 2016 - \$3,750,236), representing an increase of 66% including:

- 29% increase from NYDA®
- 67% increase from Naproxen Suspension
- Revenue from Relaxa™, which was added to the Company's portfolio in late September 2016, was in line with Management's estimate of approximately \$3 million on an annual basis
- Revenue from Rupall™, launched in late January 2017, which was in line with Management's estimate.

The annual revenue growth of 66% was achieved with less than 1% increase in selling and administrative expenses. The Company's plan is to keep generating accelerated revenue growth with very minimal changes in selling and administrative expenses, bringing the Company into a positive operating cash flow situation for the year ended March 31, 2019.

The Company has net working capital of over \$3,490,000 as of March 31, 2017. Furthermore, the Company closed a \$5,000,000 equity financing in trust on May 25, 2017. On a proforma basis, the Company's working capital would exceed \$8,000,000 including the equity financing.

The Company now has over \$2.1 million in intangible assets as a result of exclusive in-licensing or distribution agreements it has signed since it started. Of that amount, approximately \$1.9 million is related to Rupall, Otixal and Cuvposa, which have yet to start generating meaningful revenue due to the fact they have either recently been launched, or in Cuvposa's case, its dossier is presently being reviewed by Health Canada.

During January 2017, Mackie Research Capital Corporation initiated coverage of Pediapharm.

### New Products:

#### ***Relaxa™***

On September 19, 2016, the Company signed an exclusive licensing agreement for drug product Relaxa®. Under the terms of the Licensing Agreement, Pediapharm has the exclusive right to manufacture, promote, market, sell and distribute Relaxa™ globally. Annual sales of Relaxa™, based on the trend of the last 12 months, is approximately \$3 million. However, the timing of the transaction, which occurred in late September, allowed for very few revenue-generating days in the three months ended September 30, 2016. The real impact of that transaction started in the three months ended December 31, 2016.

During February 2017, the Company introduced two new stock keeping units ("skus") of Relaxa™. Management believes that this addition to the existing line of Relaxa™ products will help increase revenues and improve gross margins beginning in the latter part of fiscal 2018.

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### ***Rupall™***

On January 25, 2017, the Company announced the Canadian commercial launch of Rupall™ (rupatadine) in Canada. This innovative allergy medication is available to patients suffering from allergy and urticaria through physician prescriptions. Rupall™ is currently being distributed within the various wholesalers and pharmacy channels. Rupall™ comes in two dosage forms; the tablet 10mg and Oral Solution 1mg/mL, and is indicated for the relief of the symptoms associated with Seasonal Allergic Rhinitis (SAR), Perennial Allergic Rhinitis (PAR) and Chronic Spontaneous Urticaria (CSU) in patients 2 years of age and older. It is the first prescription (Rx) antihistamine being launched over the past decade with all 3 indications (SAR, PAR and CSU), including a formulation for children over 2 years of age. The Canadian antihistamine market is estimated at \$130 million (IMS Data). Rupall™ will benefit from 8.5 years of market exclusivity granted by Health Canada's Office of Patented Medicines and Liaison under section C.08.004.1 of the Food and Drug Regulations.

### ***Otixal™***

On May 18, 2017, the Company announced the Canadian commercial launch of Otixal™ (ciprofloxacin 0.3 % and fluocinolone acetonide 0.025 %) otic solution for the treatment of acute otitis media with tympanostomy tubes ("AOMT") in pediatric patients (aged 6 months and older). Otixal™ is the first and only antibiotic and steroid combination ear drop available in single, sterile, preservative-free and unit-dose packaging. Otixal™ will be launched in a growing \$20 million market (IMS Data – June 2015).

### ***CUVPOSA™***

On August 3, 2016, the Company submitted to the Canadian Health Authorities its regulatory dossier of CUVPOSA™ (glycopyrrolate) oral solution intended for pediatric chronic severe drooling (sialorrhea) associated with neurologic conditions such as cerebral palsy. The Company expects a decision from Health Canada before the end of October 2017.

## **SUBSEQUENT EVENTS**

On May 15, 2017, the Company agreed to a non-brokered private placement of 14,705,883 units of the Company (the "Units") at a price of \$0.34 per Unit, for gross proceeds of \$5,000,000 (the "Offering"), all of which shall be subscribed for by 9346-4626 Québec Inc., a private company operating as Transican owned by Mr. Gerard Leduc, a globally known pharmaceutical executive. Each Unit is comprised of one (1) common share in the capital of the Company (a "Common Share") and one-half (1/2) of one common share purchase warrant of the Company (a "Warrant"). Each Warrant entitles the holder thereof to purchase one (1) Common Share at a price of \$0.51 per share expiring thirty-six (36) months from the date of issuance. No commissions or fees, other than legal and filing fees, are payable in connection with this financing. The net proceeds of this Offering will be used to secure new business opportunities as well as to accelerate the growth of the Company's recently launched products namely, Rupall™ and Otixal™. Completion of the Offering is subject to a number of conditions, including, without limitation, receipt of all regulatory approvals, including approval of the TSX Venture Exchange.

## **FUTURE OUTLOOK**

The Company's focus remains to execute its commercial plan with existing products, such as NYDA®, a revolutionary treatment indicated for eradication of head lice and its eggs. NYDA® reached approximately \$4,200,000 in revenue in fiscal 2017, is expected to reach over \$5,000,000 in fiscal 2018 and has the potential to achieve annual peak revenues of \$6,000,000 to \$8,000,000 within the next two years (IMS data and Management's estimate).

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With NYDA®, Naproxen Suspension and Relaxa™ alone, the Company is confident to generate approximately \$8.5 million of revenue in fiscal 2018 (year ended March 31, 2018). This does not include revenue from new products launches. Management’s objective in the next few quarters is to keep optimizing the Rupall™ and Otixal™ launch investments while keeping a solid balance sheet. While Rupall™ has only been launched in late January 2017, Management is closely monitoring Key Performance Indicators (“KPIs”) such as number of physicians prescribing Rupall™, and is very pleased with the results so far. These early results, combined with the on-going positive feedback from key opinion leaders in allergy, confirm Management’s estimate that Rupall™ has an annual peak sale potential of \$8-10 million within 5-6 years. Regarding Otixal™, which was launched in mid-May 2017, the Company estimates an annual peak sale potential of \$4 million within 5-6 years.

With its existing solid infrastructure in place, Management estimates that increases in selling and administrative expenses will be minimal even with its projected substantial revenue growth in years to come.

Pediapharm has a product pipeline of secured exclusive agreements which Management believes will enable the Company to obtain its corporate annual revenue goal of reaching between \$25,000,000 and \$30,000,000 within the next 5-6 years. This projected peak sales forecast is based in using IMS data and the Management’s estimate in the market share to be captured for each of the product. The following represents projected peak sales for the main products:

PRODUCT	INDICATION	EST. ANNUAL PEAK SALES (CDN\$) (2) (3)	LAUNCH DATE OR EST. LAUNCH DATE
NYDA®	Head lice treatment	\$6-8M	2012
Relaxa™	Occasional constipation	4-6M	Acquired by Pediapharm in September 2016
Naproxen suspension	Juvenile Arthritis – Medical Pain Conditions	1-2M	Re-launched by Pediapharm in March 2015
Rupatadine (Rupall™)	Symptoms of Allergy - Urticaria	8M-10M	January 2017
Cetraxal-Plus (Otixal™)	Ear Infection	4M	May 2017
Cuvposa™ (1)	Severe Drooling – Cerebral Palsy	5M	UNDER HC REVIEW – Est. Approval: Dec 2017 (4)
<b>TOTAL</b>		<b>28-35M</b>	

(1) Canadian License which requires Health Canada Approval

(2) Estimated Annual Peak sales is usually achieved within approximately 5 to 7 years of a product launch

(3) Based on Market Data (IMS) and Management’s estimates

(4) Based on Health Canada’s timelines regarding approval of submitted files

Now that Pediapharm has positioned itself with a strong portfolio of products as shown above, for which all of the regulatory investments are behind, the Company’s core strategy regarding business development has recently evolved to focus more on acquisitions of products with existing sales and on co-promotion for products already approved in Canada. The key objective is to generate profitability in a timely fashion while waiting for Health Canada’s decision on Cuvposa™, which is expected before October 2017. In parallel, Pediapharm will still assess additional exclusive licensing agreements (commonly known as “in-licensing”) as well as potential product acquisitions.

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*In summary, the Company has a solid cash position to execute its business plan, including the recent launches of Rupall™ in January 2017 and Otixal™ in May 2017. Furthermore, Pediapharm expects continuous revenue growth from Pediapharm's other branded products such as NYDA®, Naproxen Suspension and Relaxa™. Management estimates that the upcoming expected revenue growth and stable operational expenses will bring the Company into a positive operating cash flow situation for the year ended March 31, 2019. In parallel, the Company is in the process of assessing potential product acquisitions with the key objective to accelerate its strategy to generate positive cash flow over a short period of time. Pediapharm is a growth company in the high-margin specialty pharmaceutical industry, and when opportunities arise to feed that growth, it may raise incremental capital to provide for necessary funding and flexibility.*

## **CORPORATE STRUCTURE OF PEDIAPHARM**

Pediapharm was incorporated in 2003 under the federal laws of Canada and commenced its operations in late 2007. The head office and registered and records office of Pediapharm are both located at 225 - 1 Place du Commerce, Verdun, Québec, H3E 1A2. Pediapharm has one wholly-owned subsidiary, Pediapharm Licensing Inc., which was incorporated in 2011 under the laws of Ontario and was granted a drug establishment license by Health Canada. The registered office of Pediapharm Licensing Inc. is located at 4 Innovation Drive, Dundas, Ontario L9H 7P3.

## **BUSINESS OVERVIEW OF PEDIAPHARM**

Pediapharm is a specialty pharmaceutical corporation that distributes innovative prescription medicines used to treat pathological conditions that mainly affect children from infancy to eighteen (18) years of age. The products that Pediapharm distributes originate from transactions whereby Pediapharm either acquires intellectual property rights through licensing agreements (commonly known as "in-licensing") that enables Pediapharm to register the drug products with Health Canada in order to commercialize them, or through outright acquisitions. Pediapharm does not produce, manufacture or develop products. For most products, Pediapharm licenses finished products and sells them. In the case of products owned by Pediapharm or where it controls the supply chain, the Corporation uses third-party manufacturers to produce the finished goods. Pediapharm may continue to acquire products that are already commercialized in Canada. Pediapharm also commercializes non prescription products (non-prescription drugs and medical devices) that are innovative and fulfill unmet medical needs of children but the core strategy remains on commercialising prescription (Rx) products.

Pediapharm presently does not develop any of its own products or own any patents, but may eventually partner in low-risk novel formulation development of known drugs in order to make them more amenable for pediatric use. Finally, although the core of the commercial approach is geared toward the children population, the Company also has opportunities to generate revenues in the adult market when its products are being prescribed for this patient population.

## **SELECTED FINANCIAL INFORMATION**

### **FINANCIAL POSITION ANALYSIS**

#### **ASSETS**

At March 31, 2017, total assets were \$7,727,641 as opposed to \$7,653,194 at March 31, 2016. Operating and Net Loss, Health Canada filing fees as well as milestone payments for licensing/distribution agreements, had a negative impact on Cash. Accounts receivable have increased by \$338,333 mainly due to the significant increased sales generated during the twelve months ended March 31, 2017. Inventories have increased by \$1,095,082 mainly due to the Relaxa™ inventory resulting from the previously disclosed September 19, 2016 transaction, as well as inventory related to the recent launch of Rupall™. As revenue from Rupall™ and from the recently launches new Relaxa™ skus increase, Management estimates that inventory levels, while

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impacted by seasonality due to the Company's product portfolio, will generally stabilize at lower levels for the remaining of the current fiscal year.

### LIABILITIES

At March 31, 2017, total current liabilities were \$2,108,184 compared with \$935,648 at March 31, 2016. Accounts payable and accrued liabilities have increased by \$1,174,749 mainly due to the payables associated with increases in revenue as well as timing of payments regarding purchases of inventory. At March 31, 2017 as well as at March 31, 2016, there is approximately \$165,000 in interest payable related to the March 30, 2015 private placement of secured, convertible debenture for aggregate gross proceeds of \$5,500,000.

At March 31, 2017, total long-term liabilities were \$4,323,821 compared with \$3,910,695 at March 31, 2016, as a result of the March 30, 2015 private placement of secured, convertible debenture interest accretion.

### EQUITY

At March 31, 2017, Shareholders' equity was \$1,295,636 compared with \$2,806,851 as at March 31, 2016. The decrease is mainly due to the net loss during the twelve months ended March 31, 2017.

### STOCK OPTIONS

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 ten 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.

### OPERATING RESULTS ANALYSIS

	March 31, 2017 (3 months)	March 31, 2016 (3 months)	March 31, 2017 (12 months)	March 31, 2016 (12 months)
Revenue from Products	\$1,642,538	\$571,570	\$5,951,474	\$3,504,696
Revenue from Commissions	16,250	78,750	255,665	245,540
TOTAL Revenue	1,658,788	650,320	6,207,139	3,750,236
Gross Profit	712,385	416,672	3,428,746	2,454,237
Selling and administrative expenses	1,871,811	1,763,543	6,803,665	6,750,581
Other Income	-	3,134,249	2,570,200	3,134,249
Operating profit (loss)	(1,117,704)	1,910,221	(789,545)	(1,339,717)
Net profit (loss)	(1,388,613)	1,537,383	(1,831,887)	(2,299,294)
Cash flow from (used in) operating activities	(747,391)	1,731,941	(1,258,273)	(1,286,300)
Cash flow from (used in) investing activities	(127,284)	(124,787)	(442,124)	(659,127)
Cash flow from (used in) financing activities	378	(1,119)	-	88,151

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## FINANCIAL INFORMATION COMPARISON

### REVENUE

For the three months ended March 31, 2017, total revenue reached \$1,658,788 compared with revenue of \$650,320 in the three months ended March 31, 2016, representing a 155% increase. Revenue from NYDA® increased by 41%, while revenue from Pediapharm naproxen suspension increased by 22%. This quarter also included revenue generated from Relaxa™ as a result of the September 19, 2016 transaction, was in line Management's estimate. For the twelve months ended March 31, 2017, total revenue reached \$6,207,139 compared with revenue of \$3,750,236 in the twelve months ended March 31, 2016, representing a 66% increase. Revenue from NYDA® increased by 29% to reach approximately \$4,200,000, which was in line with Management's estimate and in line with the most recent IMS data NYDA®, which is showing a 35% increase on annual basis (MAT - December 2016). Revenue from Pediapharm naproxen suspension increased by 67%. Revenue generated from Relaxa™ as a result of the September 19, 2016 transaction, was in line with Management's estimate of approximately \$3,000,000 on an annual basis.

### GROSS PROFIT AND MARGIN

When comparing periods, in addition to focusing on gross profit dollars, it is also appropriate to focus on the gross margin as a percentage of revenue. Since there is no cost of sales related to revenue from commissions, the following gross margin percentages are calculated using cost of sales and revenue from products only. In addition to actual cost of goods and royalties paid to partners, gross margins are impacted by amortization of assets generating revenue, allowances for potential product returns as well as warehouse and logistics expenses.

For the three months ended March 31, 2017, gross profit reached \$712,385, representing an increase of 71% (three months ended March 31, 2016 - \$416,672). For the twelve months ended March 31, 2017, gross profit reached \$3,428,746, representing an increase of 40% (twelve months ended March 31, 2016 - \$2,454,237). Gross margin as a percentage of revenue was 58% (twelve months ended March 31, 2016 - 70%). The main reason for the lower gross margin percentage is related to Relaxa™. In addition to the fact that it has lower gross margins due to the nature of its product category, there were also non-recurrent expenses as part of the transition of Relaxa™ to Pediapharm, as well as the addition of 2 new Relaxa™ stock-keeping units ("skus") launched in the three months ended March 31, 2017. Over time, with the expected revenue growth from NYDA®, Rupall™ and Otixal™, Relaxa™ will represent a smaller percentage of revenue and hence, Management estimates that total gross margins as a percentage of revenue will improve and ultimately reach 60-70%.

### SELLING AND ADMINISTRATIVE EXPENSES

For the three months ended March 31, 2017, selling and administrative expenses reached \$1,871,811 (three months ended March 31, 2016 - \$1,763,543). For the twelve months ended March 31, 2017, selling and administrative expenses increased by \$53,084 to reach \$6,803,665, (twelve months ended March 31, 2016 - \$6,750,581). While regulatory expenses related to Health Canada dossiers for Rupall™ and Otixal™ have significantly decreased when comparing to last year, the Company made important investments in supporting the January 2017 commercial launch of Rupall™ and the May 2017 commercial launch of Otixal™. These pre-launch and launch investments include the set-up of an advisory board comprised of key opinion leaders across Canada, a medical symposium, in-depth training as well the purchase of external data (IMS) to better understand the market dynamics and ensure successful launches.

With its existing solid infrastructure in place, Management estimates that increases in selling and administrative expenses will remain minimal even with its projected substantial revenue growth in years to come.



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## **OTHER INCOME**

In the three months ended March 31, 2017, there was nothing to report as other income. In the three months ended March 31, 2016 the Company sold its 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 was recorded as other income. In the twelve months ended March 31, 2017 the Company received the second and final payment of US\$2 million in cash (\$2,570,200) from the sale of the US rights to the drug Naproxen Suspension in a transaction valued at approximately US\$4.25 million.

## **OPERATING PROFIT OR LOSS**

The operating loss for the three months ended March 31, 2017 was \$1,117,704 compared to an operating profit of \$1,910,221 in the three months ended March 31, 2016. In the three months ended March 31, 2016, the Company benefited from the aforementioned sale of its US rights to the drug Naproxen Suspension, which had a positive impact of \$3,134,249. The operating loss for the twelve months ended March 31, 2017 was \$789,545 compared to an operating loss of \$1,339,717 in the twelve months ended March 31, 2016. The increase in revenue combined with the flat selling and administrative expenses, helped generate an improvement of \$1,114,221 over the twelve-month period ended March 31, 2016. In both fiscal years, the Company benefited from the aforementioned sale of its US rights to the drug Naproxen Suspension. The transaction had a positive impact of \$2,570,200 in the twelve months ended March 31, 2017 vs a positive impact of \$3,134,249 in the twelve-month period ended March 31, 2016.

## **NET PROFIT OR LOSS**

The net loss for the three months ended March 31, 2017 was \$1,388,613 compared to a net profit of \$1,537,383 in the three months ended March 31, 2016. The net loss for the twelve months ended March 31, 2017 was \$1,831,887 compared to a net loss of \$2,299,294 in the twelve months ended March 31, 2016. In both periods, the difference between operating loss and net loss is mainly due to approximately \$1,000,000 in finance costs. The majority of the aforementioned finance costs are related to the March 31, 2015 private placement of secured, convertible debentures of the Company and share purchase warrants of the Company for aggregate gross proceeds of \$5,500,000.

## **CASH FLOW ANALYSIS**

### **Operating activities**

For the three months ended March 31, 2017, cash flows used in operating activities was \$747,391 compared with cash flows from operating activities of \$1,731,941 for the three months ended March 31, 2016. In the three months ended March 31, 2017, the change in non-cash operating working capital items had a positive impact of \$670,227. In the three months ended March 31, 2016, the Company benefited from a payment in cash of \$3,134,249. For the twelve months ended March 31, 2017, cash flows used operating activities was \$1,258,273 compared with \$1,286,300 for the twelve months ended March 31, 2016. While the Company experienced an increase in gross profit of \$974,509, the Company's benefit from the aforementioned sale of its US rights to the drug Naproxen Suspension, was lower in the twelve months ended March 31, 2017 (\$2,570,200) vs the twelve months ended March 31, 2016 (\$3,134,249).

### **Investing activities**

Most of the investing activities for Pediapharm involve the purchase of licenses, as well as the amortization charges as per Pediapharm's accounting policies.

For the three and twelve months ended March 31, 2017, cash flows used in investing activities was \$127,284 (three months ended March 31, 2016 – \$124,787). The majority of these amounts include down payments for licensing/distribution agreements and Health Canada filing fees. For the twelve months ended March 31, 2017, cash flows used in investing activities was \$442,124 (twelve months ended March 31, 2016 – \$659,127). The majority of these amounts included down payments for licensing/distribution agreements and Health Canada filing fees.

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## Financing activities

In the three months ended March 31, 2017 and in the three months ended March 31, 2016, there was no significant activity to report. In the twelve months ended March 31, 2017, there was no significant activity to report. In the twelve months ended March 31, 2016, the Company received \$92,460 from the issuance of shares as a result of the exercise of warrants and options that were issued to third parties.

## SUMMARY OF ANNUAL RESULTS

The following tables set out financial performance highlights for the past three fiscal years.

	Twelve months ended March 31, 2017	Twelve months ended March 31, 2016	Twelve months ended March 31, 2015
Revenues from Products	\$5,951,474	\$3,504,696	\$2,496,828
Revenues from Commissions	\$255,665	\$245,540	\$571,855
Total Revenue	\$6,207,139	\$3,750,236	\$3,068,683
Gross Profit	\$3,428,746	\$2,454,237	\$2,105,862
Selling and Administrative Expenses	\$6,803,665	\$6,750,581	\$7,063,517
Other Income	\$2,570,200	\$3,134,249	-
Operating Loss	(\$789,545)	(\$1,339,717)	(\$5,048,176)
Total Comprehensive Loss	(\$1,831,887)	(\$2,299,294)	(\$4,998,949)
Cash flow from (used in) operations	(\$1,258,273)	(\$1,286,300)	(\$4,575,755)
Cash & cash equivalents, end of period	\$3,241,097	\$4,941,494	\$6,798,770
Assets	\$7,727,641	\$7,653,194	\$9,072,290
Long-term liabilities	\$4,323,821	\$3,910,695	\$3,583,146
Dividends	\$0	\$0	\$0

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## SUMMARY OF QUARTERLY RESULTS

	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended
	31-Mar-17	31-Dec-16	30-Sep-16	30-Jun-16	31-Mar-16	31-Dec-15	30-Sep-15	30-Jun-15
Revenues from Products	\$1,642,538	\$1,694,294	\$1,803,397	\$811,245	\$571,570	\$935,498	\$1,455,459	\$542,169
Revenues from Commissions	\$16,250	\$78,750	\$78,750	\$81,915	\$78,750	\$87,041	\$16,275	\$63,474
Total Revenue	\$1,658,788	\$1,773,044	\$1,882,147	\$893,160	\$650,320	\$1,022,539	\$1,471,734	\$605,643
Gross Profit	\$712,385	\$891,893	\$1,220,919	\$603,549	\$416,672	\$689,358	\$954,480	\$393,726
Selling and Administrative Expenses	\$1,871,811	\$1,656,245	\$1,788,085	\$1,487,524	\$1,763,543	\$1,534,995	\$1,688,949	\$1,763,095
Operating Profit (Loss)	(\$1,117,704)	(\$783,509)	(\$580,116)	\$1,691,784	\$1,910,221	(\$1,094,932)	(\$760,755)	(\$1,394,251)
Net Profit (Loss)	(\$1,388,613)	(\$1,047,750)	(\$838,320)	\$1,442,796	\$1,537,383	(\$1,288,020)	(\$954,011)	(\$1,594,646)
Cash flow from (used in) operations	(\$747,391)	(\$765,650)	(\$1,303,782)	\$1,558,550	\$1,731,941	(\$547,889)	(\$1,133,694)	(\$1,336,658)
Cash & cash equivalents, end of period	\$3,241,097	\$4,115,394	\$5,110,318	\$6,499,670	\$4,941,494	\$3,351,101	\$4,115,708	\$5,526,526
Assets	\$7,727,641	\$8,493,672	\$8,891,210	\$9,542,163	\$7,653,194	\$6,164,096	\$6,980,730	\$7,723,984
Long-term liabilities	\$4,323,821	\$4,211,429	\$4,105,344	\$4,005,210	\$3,910,695	\$3,712,303	\$3,669,124	\$3,625,945
Dividends	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0

The main reasons explaining volatility in the Company's quarterly revenue are:

- The addition of Relaxa to the portfolio of Pediapharm's products. This occurred on September 19, 2016.
- The seasonality of NYDA which, prior to the addition of Relaxa, represented more than 85% of the Company's revenue. Historically, approximately 65-70% of revenue from NYDA is generated in the July-December period.

## LIQUIDITY, CAPITAL RESOURCES AND SOURCES OF FINANCING

Pediapharm finished the twelve-month period ended March 31, 2017 with cash amounting to \$3,241,097, which is in excess of future expected cash outflows for at least the next twelve months. With the exception of the interest payments related to the \$5,500,000 convertible debenture, there are no substantial debt or contractual commitment for the next twelve months.

## 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 (for the year ended March 31, 2016 – \$171,590) to a company owned by the current Chief Financial Officer of the Company and no amount was included in accounts payables and accruals as at year ended March 31, 2017 (March 31, 2016 - \$25,500).

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

## Pediapharm Inc.

Management discussion for the 12-month period ended March 31, 2017

### **CAPITAL RESOURCES**

Pediapharm manages its capital structure and brings about adjustments related to changes in the economic environment and underlying risks of its assets. To preserve or modify its capital structure and to carry on the development and commercialization of technology and fulfill its various financial obligations, Pediapharm may issue additional shares or negotiate new loans.

### **CONTRACTUAL 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.

### **DESCRIPTION OF THE SECURITIES**

Pediapharm authorized share capital consists of an unlimited number of Pediapharm Common Shares. As of June 27, 2017, Pediapharm has 72,709,103 shares outstanding and 14,705,883 reserved in trust, subject to the approval of the TSX Venture Exchange. There have been no dividends declared during the current period.

### **OFF -BALANCE SHEET ARRANGEMENTS**

The Company has no off-balance sheet arrangements.

### **SIGNIFICANT ACCOUNTING POLICIES**

The Company prepares its consolidated financial statements in accordance with IFRS, which require management to make estimates and assumptions that affect the amounts of its assets and liabilities, the information provided with regard to future assets and liabilities as well as the amounts of revenues and expenses for the relevant periods.

The elements in the financial statements that require more use of estimates include valuation of stock options and warrants and impairment of fixed and intangible assets. Actual results may differ from these estimates, but management believes they will not result in material changes versus the results being presented. Readers are invited to refer to the audited consolidated financial statements for the year ended March 31, 2017 for a full description of the significant accounting policies of the Company at that date.

### **NEW STANDARDS NOT YET 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 is currently evaluating the impact of the standard on its consolidated financial statements.

# Pediapharm Inc.

Management discussion for the 12-month period ended March 31, 2017

## ***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: IFRIC 13, Customer Loyalty Programmes, IFRIC 15, Agreements for the Construction of Real Estate, IFRIC 18, Transfers of Assets from Customers, and 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.

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.

## Pediapharm Inc.

Management discussion for the 12-month period ended March 31, 2017

### 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).

### 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. 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).

# Pediapharm Inc.

Management discussion for the 12-month period ended March 31, 2017

## **FINANCIAL INSTRUMENTS**

### **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.

### **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.

### **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, 2016 and 2015. 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.

### **Disclosure controls and procedures**

Disclosure controls and procedures have been established by the Company to ensure that financial information disclosed by the Company in this MD&A, the related annual consolidated financial statements and its interim filings are properly recorded, processed, summarized and reported to its audit committee, its Board of Directors and its shareholders.

### **Internal controls over financial reporting**

As an issuer on the TSX Venture Exchange, the CEO and the CFO are not required to certify that they have designed and evaluated the effectiveness of disclosure controls and procedures and internal controls over financial reporting. Instead, the Company files a Certification of Annual Filings – Venture Issuer Basic Certificate that certifies the performance of a review of the information, no knowledge of misrepresentations and the fair presentation of the information in the annual filings.

Readers are referred to the more detailed information described in other disclosure documents filed with the applicable Canadian securities regulatory authorities and available at [www.sedar.com](http://www.sedar.com).

Management of Pediapharm Inc.