Pediapharm inc.

Canada's Leading Pediatric Pharmaceutical Company

MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE THREE MONTH PERIOD ENDED JUNE 30, 2016

DATED AUGUST 18, 2016

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 August 18, 2016, and complements the unaudited condensed interim consolidated financial statements of Pediapharm Inc. ("Pediapharm" or the "Company"), which include Pediapharm Licensing Inc., its wholly owned subsidiary, for the three month period ended June 30, 2016, which are compared to the three month period ended June 30, 2015.

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, 2016.

The unaudited condensed interim consolidated financial statements and the MD&A have been reviewed by the audit committee and approved by the Company's Board of Directors on August 18, 2016. These documents and more information about the Company are available on SEDAR at 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.

KEY HIGHLIGHTS-PERIOD ENDED JUNE 30, 2016

In the three month period ended June 30, 2016, total revenue reached $893,161 (three months ended June 30, 2015 - $605,642), representing an increase of 47%, including:

- 57% increase from NYDA®, following the 55% growth from last fiscal year
- 110% increase from Naproxen Suspension after one year of detailing to physicians

In the three month period ended June 30, 2016, the Company achieved an operating income of $1,691,784 compared to an operating loss of $1,396,963 in the three month-period ended June 30, 2015.

In the three month period ended June 30, 2016, the Company's selling and administrative expenses were reduced by $275,500, representing a reduction of 15.5% compared with the three months ended June 30, 2015.

The Company has $6,499,670 of cash and cash equivalents as of June 30, 2016.

On May 11, 2016, the Company received Food and Drug Administration ("FDA") approval regarding the manufacturing site transfer of Naproxen Suspension for the United States market. This approval triggered the second and final payment of US$2 million in cash included in the transaction valued at US$4.25 million regarding the United States rights to Naproxen Suspension.

SUBSEQUENT EVENTS

On July 21, 2016, the Company announced Health Canada's approval of rupatadine (Tablet 10mg and Oral Solution 1mg/mL) 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.

Rupatadine 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. It will be launched in the Canadian antihistamine market estimated at $130 million (IMS Data). Moreover, it will benefit from 8.5 years of market exclusivity (ie. no possibility of generics) granted by Health Canada's Office of Patented Medicines and Liaison under section C.08.004.1 of the Food and Drug Regulations.

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.

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 over $3,200,000 in revenue in fiscal 2016, is expected to reach $4,400,000 in fiscal 2017 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).

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. As described below, projected annual peak sales to be generated from existing licenses/products that have not yet been launched

and/or require Health Canada approval are estimated at $15,000,000 (IMS data and Management's estimate).

The chart below contains information on the secured exclusive agreements that are expected to be launched in the next year. This chart has been updated since the last MD&A dated June 27, 2016 to reflect Health Canada's approval of rupatadine received on July 21, 2016.

PRODUCT	PARTNER-COUNTRY	INDICATION	MARKET SIZE (CDN $)	EST. ANNUAL PEAK SALES (CDN$) (2) (6)	EST. LAUNCH DATE (Calendar Year) (7)
Rupatadine	Uriach - Spain	Antihistamine (RX Indication)	120M (5)	6M-10M	APPROVED JULY 21, 2016
Cetraxal-Plus (Otixal) (1)	Salvat Laboratories - Spain	Ear Infection, Swimmer's Ear	25M (4)	4M	Q-4 2016
Cuvposa (1)	Merz Pharma – USA	Severe Drooling – Cerebral Palsy	25M (3)	5M	Q-2 2017
TOTAL			**170M+**	**15M- 19M**	

(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 prevalence of Cerebral Palsy patients from the Public Health Agency of Canada
(4) IMS Data – December 2014
(5) IMS Data – December 2013
(6) Based on Market Data (see above footnotes) and Management's estimates
(7) Based on Health Canada's timelines regarding approval of submitted files

Now that Pediapharm has positioned itself with a strong pipeline as shown above, for which most 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 pursuing the regulatory process of the agreements signed in 2014. In parallel, Pediapharm will still assess additional exclusive licensing agreements (commonly known as "in-licensing").

In summary, with the recent sale of its United States rights to Naproxen Suspension, the Company has a solid cash position to execute its business plan, including the upcoming launch of rupatadine in the second-half of 2016 as well as the potential launch of Otixal®, assuming Health Canada's approval. Furthermore, the strong revenue growth from Pediapharm branded products such as NYDA®, combined with the reduction of some of its operating expenses, are important steps towards generating positive cash flows. 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. The Board of Directors of the Company has decided, following the amalgamation with Chelsea Acquisition Corporation completed on December 10, 2013, to change the Company's financial year-end from December 31 to March 31. Pursuant to section 4.8 of National Instrument 51-102 – *Continuous Disclosure Obligations*, the Company has filed on SEDAR a Notice of Change in Year End providing information about the length and filing dates of its annual audited financial statements and interim financial statements for both its transition year and subsequent financial years.

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 the Company distributes originate from transactions whereby Pediapharm either acquires intellectual property rights through a licensing agreement (commonly known as "in-licensing") that enables Pediapharm to register the drug products with Health Canada in order to commercialize them. As such, Pediapharm does not produce, manufacture or develop products, but rather licenses finished products and sells them. Pediapharm may also acquire products that are already commercialized in Canada. Pediapharm also commercializes non-prescription products (non-prescription drugs, medical devices, diagnostic products) that are innovative and fulfill unmet medical needs of children.

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 if its products are being prescribed for this patient population.

SELECTED FINANCIAL INFORMATION

FINANCIAL POSITION ANALYSIS

ASSETS

At June 30, 2016, total assets were $9,542,163 as opposed to $7,653,194 at March 31, 2016. Cash was impacted positively by the second and final payment of US$2 million in cash from the sale of the US rights to the drug Naproxen Suspension in a transaction valued at approximately US$4.25 million. Accounts receivable have increased by $90,533 mainly due to the significant increased sales generated during the three months ended June 30, 2016. Inventories have increased by $234,766 as the Company enters the peak season for NYDA.

LIABILITIES

At June 30, 2016, total current liabilities were $1,200,705 compared with $935,648 at March 31, 2016. Accounts payable and accrued liabilities have incresed by $265,437 due to the payables related to the aforementioned increased inventory of NYDA in preparation for lice treatment's peak season. In both the three months ended June 30, 2016 and 2015, there is $166,833 in interest payable related to the March 30, 2015 private placement of secured, convertible debenture for aggregate gross proceeds of $5,500,000.

At June 30, 2016, total long-term liabilities were $4,005,210 compared with $3,910,695 at March 31, 2016, as a result of the March 30, 2015 private placement of secured, convertible debenture.

EQUITY

At June 30, 2016, Shareholders' equity was $4,336,248 compared with $2,806,851 as at March 31, 2016, mainly due to the operating income during the three months ended June 30, 2016.

OPERATING RESULTS ANALYSIS

	June 30, 2016 (3 months)	June 30, 2015 (3 months)
Revenue from Products	$811,246	$542,168
Revenue from Commissions	81,915	63,474
TOTAL Revenue	893,161	605,642
Cost of sales	289,612	211,916
Gross Profit	603,549	393,726
Selling and administrative expenses	1,487,524	1,763,095
Other Income	2,570,200	-
Operating profit (loss)	1,691,784	(1,396,963)
Net profit (loss)	1,442,796	(1,594,646)
Cash flow from (used in) operating activities	1,558,550	(1,339,369)
Cash flow from (used in) investing activities	-	(3,840)
Cash flow from (used in) financing activities	(374)	70,965

FINANCIAL INFORMATION COMPARISON

REVENUE
For the three months ended June 30, 2016, total revenue reached $893,161 compared with revenue of $605,642 in the three months ended June 30, 2015, representing a 47% increase. Revenue from NYDA® increased by 57% and revenue from Pediapharm naproxen suspension increased by 110%.

SELLING AND ADMINISTRATIVE EXPENSES
For the three months ended June 30, 2016, selling and administrative expenses decreased by $275,571 to reach $1,487,524, (three months ended June 30, 2015 - $1,763,095). The decrease in selling and administrative expenses is mainly due to the fact most of the expenses in business development and medical affairs related to the filing of agreements signed in 2014 occurred in the fiscal year ended March 31, 2016.

OTHER INCOME
In the three months ended June 30, 2016 the Company received the second and final payment of US$2 million in cash 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 profit for the three months ended June 30, 2016 was $1,691,784 compared to an operating loss of $1,396,963 in the three months ended June 30, 2015. The increase in revenue and gross profit, along with the aforementioned reduction in selling and administrative expenses, helped generate an improvement of $518,547 over the three-month period ended June 30, 2015. Furthermore, the Company benefited from the aforementioned sale of its US rights to the drug Naproxen Suspension, which had a positive impact of

$2,570,200 in the three months ended June 30, 2016, bringing the total operating profit improvement to $3,088,747 when compared to the three-month period ended June 30, 2015.

NET PROFIT OR LOSS

The net profit for the three months ended June 30, 2016 was $1,442,796 compared to a net loss of $1,594,646 in the three months ended June 30, 2015. In the three months ended June 30, 2016, the difference between operating loss and net loss is mainly due to $261,352 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 June 30, 2016, cash flows from operating activities was $1,558,550 compared with cash flows used in operating activities of $1,339,369 for the three months ended June 30, 2015. In addition to an increase in gross profit of $209,823 and the reduction of $275,571 in selling and administrative expenses, the Company benefited from the aforementioned sale of its US rights to the drug Naproxen Suspension, which had a positive impact of $2,570,200 in the three months ended June 30, 2016.

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 months ended June 30, 2016 and for the three months ended June 30, 2015, there was no significant investing activity to report.

Financing activities

In the three months ended June 30, 2016, there was no significant activity to report. In the three months ended June 30, 2015, the Company received $72,000 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, 2016	Twelve months ended March 31, 2015	Fifteen months ended March 31, 2014
Revenues from Products	$3,504,696	$2,496,828	$1,795,058
Revenues from Commissions	$245,540	$571,855	$2,886,718
Total Revenue	$3,750,236	$3,068,683	$4,681,776
Gross Profit	$2,454,237	$2,105,863	$4,042,689
Selling and Administrative Expenses	$6,750,581	$7,063,517	$5,516,570
Other Income	$3,134,249	-	-
Operating Loss	($1,339,717)	($5,048,176)	($1,534,828)
Total Comprehensive Loss	($2,299,294)	($4,998,949)	($4,079,633)
Cash flow from (used in) operations	($1,286,300)	($4,575,755)	($2,010,333)
Cash & cash equivalents, end of period	$4,941,494	$6,798,770	$7,092,224
Assets	$7,653,194	$9,072,290	$8,597,175
Long-term liabilities	$3,910,695	$3,583,146	$4,693

Dividends	$0	$0	$0

SUMMARY OF QUARTERLY RESULTS

	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended	Quarter ended
	30-Jun-16	**31-Mar-16**	**31-Dec-15**	**30-Sep-15**	**30-Jun-15**	**31-Mar-15**	**31-Dec-14**	**30-Sep-14**
Revenues from Products	$811,246	$571,570	$935,498	$1,455,459	$542,168	$479,065	$749,246	$837,007
Revenues from Commissions	$81,915	$78,750	$87,041	$16,275	$63,474	($72,410)	$99,265	$91,250
Total Revenue	$893,161	$650,320	$1,022,539	$1,471,734	$605,642	$406,655	$848,511	$928,257
Gross Profit	$603,549	$416,672	$689,358	$954,480	$393,726	$104,103	$594,347	$612,128
Selling and Administrative Expenses	$1,487,524	$1,763,543	$1,534,995	$1,688,949	$1,763,095	$1,958,510	$1,702,252	$1,789,763
Operating Profit (Loss)	$1,691,784	$1,910,221	($1,094,932)	($760,755)	($1,394,251)	($1,883,051)	($1,125,460)	($1,193,712)
Net Profit (Loss)	$1,442,796	$1,537,383	($1,288,020)	($954,011)	($1,594,646)	($1,878,160)	($1,121,145)	($1,186,937)
Cash flow from (used in) operations	1,558,550	1,731,941	($547,889)	($1,133,694)	($1,336,657)	($1,200,010)	($968,162)	($821,947)
Cash & cash equivalents, end of period	6,499,670	4,941,494	$3,351,101	$4,115,708	$5,526,526	$6,798,770	$2,723,241	$4,401,313
Assets	$9,542,163	$7,653,194	$6,164,096	$6,980,730	$7,723,984	$9,072,290	$5,150,150	$6,178,755
Long-term liabilities	$4,005,210	$3,910,695	$3,712,303	$3,669,124	$3,625,945	$3,583,146	$1,500	$6,688
Dividends	$0		$0	$0	$0	$0	$0	$0

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

- The termination of the Company's promotional sales agreements with Sanofi Canada in the first quarter of 2014. Quarterly revenue from Sanofi commissions used to be approximately $400,000-500,000. The quarter ended June 30, 2014 was the last one that included revenue from Sanofi commissions ($325,000).

- The seasonality of NYDA, which represented more than 85% of the Company's revenue in the twelve months ended March 31, 2016. Historically, approximately 68-72% of revenue from NYDA is generated in the July-December period.

LIQUIDITY, CAPITAL RESOURCES AND SOURCES OF FINANCING

Pediapharm finished the three-month period ended June 30, 2016 with cash amounting to $6,499,670, 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

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

For the three-month period ended June 30, 2016, the Company paid management fees in the amount of $69,310 (for the three-month period ended June 30, 2015 – $37,500) to a company owned by the current Chief Financial Officer of the Company.

For the three-month period ended June 30, 2016, the Company paid legal fees in the amount of Nil (for the

three-month period ended June 30, 2015 – $7,125) to a firm of which a Director of the Company is a partner.

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:

	$
2017	121,240
2018	119,288
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 August 18, 2016, Pediapharm has 72,512,438 shares outstanding. 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 period ended March 31, 2016 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.

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.

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 as 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.

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.

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.

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 .

Management of Pediapharm Inc.