

Pediapharm Inc.

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

For the three month periods ended June 30, 2016
and 2015

Notice to Reader

The accompanying unaudited condensed interim consolidated financial statements of PEDIAPHARM INC. (the "Company") for the periods of three months ended on June 30, 2016 and 2015 have been prepared by the management and are its responsibility. These unaudited condensed interim consolidated financial statements, together with the accompanying notes, have been reviewed and approved by the members of the Company's audit committee. These unaudited condensed interim consolidated financial statements have not been reviewed by the Company's auditors.

Pediapharm Inc.

Condensed Interim Consolidated Statements of Financial Position (unaudited)

(expressed in Canadian dollars)

	Note	As at June 30, 2016 \$	As at March 31, 2016 \$
Assets			
Current assets			
Cash and cash equivalents		6,499,670	4,941,494
Accounts receivable		390,641	300,108
Prepaid expenses		88,653	52,808
Inventories		844,224	609,458
		<u>7,823,188</u>	<u>5,903,868</u>
Property and equipment		34,750	39,625
Intangible assets		<u>1,684,225</u>	<u>1,709,701</u>
		<u>9,542,163</u>	<u>7,653,194</u>
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		1,033,872	768,435
Interest payable	3, 4	166,833	166,833
Current portion of long-term debt			380
		<u>1,200,705</u>	<u>935,648</u>
Convertible debentures	3	<u>4,005,210</u>	<u>3,910,695</u>
		<u>5,205,915</u>	<u>4,846,343</u>
Shareholders' Equity			
Share capital		20,966,018	20,966,018
Contributed surplus		3,687,307	3,600,707
Deficit		<u>(20,317,077)</u>	<u>(21,759,874)</u>
		<u>4,336,248</u>	<u>2,806,851</u>
		<u>9,542,163</u>	<u>7,653,194</u>

Approved by the Board of Directors on August 18, 2016

(Sylvain Chretien) Director (Normand Chartrand) Director
Sylvain Chretien Normand Chartrand

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

Pediapharm Inc.

Condensed Interim Consolidated Statements of Comprehensive Income (Loss) - (unaudited)

(expressed in Canadian dollars)

	Note	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Revenue			
Products		811,246	542,168
Commissions		81,915	63,474
		<u>893,161</u>	<u>605,642</u>
Cost of sales		<u>289,612</u>	<u>211,916</u>
Gross Profit		603,549	393,726
Selling & administrative expenses	5 , 8	1,487,524	1,763,095
Depreciation & Amortization		20,763	24,883
Foreign exchange loss (gain)		(26,322)	2,712
Other Income	9	<u>(2,570,200)</u>	<u>-</u>
Operating Income (Loss)		1,691,784	(1,396,963)
Finance costs	4	261,352	211,955
Interest income		<u>(12,364)</u>	<u>(14,272)</u>
Net Income (Loss) and Comprehensive Income (Loss)		<u>1,442,796</u>	<u>(1,594,646)</u>
Income (Loss) per share from continuing operations attributable to equity holders of the Company			
Basic and diluted		<u>0.02</u>	<u>(0.02)</u>
Weighted average number of common shares outstanding		<u>72,512,438</u>	<u>72,275,856</u>

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

Pediapharm Inc.

Condensed Interim Consolidated Statements of Changes in Equity (unaudited)

(expressed in Canadian dollars)

	Note	Share capital \$	Contributed surplus \$	Deficit \$	Total shareholders' equity (deficiency) \$
Balance – April 1, 2015		20,779,567	3,171,121	(19,460,580)	4,490,108
Loss and comprehensive loss for the year		-	-	(1,594,646)	(1,594,646)
Share-based compensation – Stock option plan		-	89,761	-	89,761
Exercise of warrants and options		97,970	(25,970)	-	72,000
Balance – June 30, 2015		20,877,537	3,234,912	(21,055,226)	3,057,223
Balance – April 1, 2016		20,966,018	3,600,707	(21,759,874)	2,806,851
Net income and comprehensive income for the period (loss)		-	-	1,442,796	1,442,796
Share-based compensation – Stock option plan		-	86,601	-	86,601
Balance – June 30, 2016		20,966,018	3,687,307	(20,317,077)	4,336,248

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

Pediapharm Inc.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(expressed in Canadian dollars)

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Cash flows from		
Operating activities		
Income (Loss) for the period	1,442,796	(1,594,646)
Adjustments for		
Depreciation of property and equipment	4,875	5,522
Amortization of intangible assets	25,476	29,754
Amortization of financing fees	32,447	43,179
Share-based compensation expense	86,601	89,762
Interest on convertible debentures	166,836	168,779
Convertible debentures interest accretion	62,068	
Interest income	(12,364)	-
	<u>1,808,735</u>	<u>(1,257,650)</u>
Changes in non-cash operating working capital items	7 (95,713)	(81,719)
Interest paid	(166,836)	
Interest received	12,364	-
	<u>1,558,550</u>	<u>(1,339,369)</u>
Investing activities		
Purchases of property and equipment	-	(3,840)
Purchases of intangible assets	-	-
	<u>-</u>	<u>(3,840)</u>
Financing activities		
Proceeds from issuance of shares, net of issuance costs	-	72,000
Repayment of long-term debt	(374)	(1,035)
	<u>(374)</u>	<u>70,965</u>
Net change in cash and cash equivalents during the period	1,558,176	(1,272,244)
Cash and cash equivalents – Beginning of period	<u>4,941,494</u>	<u>6,798,770</u>
Cash and cash equivalents – End of period	<u>6,499,670</u>	<u>5,526,526</u>

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

1 Incorporation and nature of activities

Pediapharm Inc. (the “Company”) was incorporated under the Canada Business Corporations Act and offers sales and marketing services to the pharmaceutical industry, particularly related to pediatric care. 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 Stock Exchange.

2 Basis of presentation and summary of significant accounting policies

Basis of presentation

The key accounting policies applied in the preparation of these condensed interim consolidated financial statements are consistent with those disclosed in Note 2 of the Company’s consolidated financial statements for the year ended March 31, 2016. These policies have been consistently applied to all periods presented. These condensed consolidated interim financial statements should be read in conjunction with the Company’s most recent annual consolidated financial statements for the year ended March 31, 2016.

These consolidated interim financial statements have been prepared in accordance with Part I of the CPA Canada Handbook (referred to as IFRS) as issued by the International Accounting Standards Board (IASB) applicable to the preparation of interim financial statements, IAS 34, *Interim Financial Reporting*.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of August 18, 2016.

The accompanying condensed interim consolidated financial statements were prepared on a going concern basis under the historical cost convention.

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.

3 Convertible debentures

On March 31, 2015, the Company closed a private placement of secured, convertible debentures of the Company and share purchase warrants of the Company for aggregate gross proceeds of \$5,500,000.

The fair value of the liability component was estimated at \$3,882,394 using a discount rate of 25% and the estimated fair value of the warrants was \$367,606. The residual amount attributed to the equity conversion feature was \$1,250,000.

The proceeds received from the convertible debentures were allocated between the convertible debentures and the determined fair value of the warrants and the equity conversion feature. The resulting debentures discount of \$1,617,605 is accreted to the face value of the convertible debentures until maturity.

Issuance costs of \$299,629 were also capitalized and are being amortized using the effective interest method.

4 Finance costs

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Interest on convertible debentures	166,836	168,779
Amortization of deferred financing fees	32,448	18,727
Convertible debentures interest accretion	62,068	24,452
	<u>261,352</u>	<u>211,958</u>

5 Employee benefit expense

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

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Salaries and benefits	372,013	461,648
Share-based compensation	41,302	52,025
	<u>413,315</u>	<u>513,673</u>

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

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Key management compensation		
Short-term employee benefits and consulting fees	245,945	227,923
Share-based compensation	45,300	37,737
	<u>291,245</u>	<u>265,660</u>

Key management compensation is included in selling and administrative expenses.

6 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.

7 Cash flows

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

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Decrease (increase) in		
Accounts receivable	(90,533)	(25,711)
Prepaid expenses	(35,844)	75,740
Inventories	(234,766)	(5,406)
 Increase (decrease) in		
Accounts payable and accrued liabilities	<u>265,430</u>	<u>(126,342)</u>
	<u>(95,713)</u>	<u>(81,719)</u>

8 Selling and administrative expenses

	For the 3-month period ended June 30, 2016 \$	For the 3-month period ended June 30, 2015 \$
Sales and marketing expenses	812,701	880,616
Business development and regulatory affairs	278,744	501,725
General administrative	<u>396,079</u>	<u>380,754</u>
Total	<u>1,487,524</u>	<u>1,763,095</u>

9 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 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 is 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, which was recognized as other income in the consolidated statement of comprehensive loss for the year ended March 31, 2016.

10 Subsequent event

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.