Cipher Pharmaceuticals Inc.

Interim condensed consolidated financial statements

Unaudited

For the three months ended March 31, 2020

Cipher Pharmaceuticals Inc.

Interim consolidated statements of financial position

[in thousands of United States dollars – unaudited]

As at

	March 31, 2020	**December 31, 2019**
	$	$
Assets		
Current assets		
Cash	**8,840**	6,346
Accounts receivable	**6,982**	8,878
Inventory	**629**	1,043
Prepaid expenses and other assets	**546**	963
Total current assets	**16,997**	17,230
Property and equipment, net	**2,097**	2,198
Intangible assets, net	**10,139**	10,378
Goodwill	**15,706**	15,706
Deferred tax assets	**612**	943
Total assets	**45,551**	46,455
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities *[notes 10 & 12]*	**7,270**	8,594
Contract liability *[note 12]*	**174**	274
Current portion of lease obligation *[note 4]*	**113**	127
Credit facility *[note 3]*	**5,656**	7,620
Total current liabilities	**13,213**	16,615
Derivative financial instrument *[note 3]*	**6**	8
Lease obligation *[note 4]*	**1,626**	1,821
Total liabilities	**14,845**	18,444
Commitments and contingencies *[note 10]*		
Shareholders' equity		
Share capital *[note 5]*	**18,727**	18,677
Contributed surplus	**4,985**	4,981
Accumulated other comprehensive loss	**(9,514)**	(9,514)
Retained earnings	**16,508**	13,867
Total shareholders' equity	**30,706**	28,011
Total liabilities and shareholders' equity	**45,551**	46,455

See accompanying notes

Approved on behalf of the Board:

(Signed) "Craig Mull"
Craig Mull
Chair of the Board

(Signed) "Harold Wolkin"
Harold Wolkin
Director

Cipher Pharmaceuticals Inc.

Interim consolidated statements of income and comprehensive income

[in thousands of United States dollars – unaudited]

For the three months ended March 31	2020	2019
	$	$
Revenue		
Licensing revenue *[note 6]*	**3,346**	3,331
Product revenue	**2,554**	1,812
Net revenue	**5,900**	5,143
Operating expenses		
Cost of products sold	**849**	644
Research and development	**24**	55
Selling, general and administrative *[notes 7 & 8]*	**1,441**	2,943
Total operating expenses	**2,314**	3,642
Other expenses (income)		
Interest expense *[note 3]*	**124**	275
Change in fair value of derivative financial instrument	**(2)**	(12)
Interest income	**(28)**	(53)
Foreign exchange loss (gain)	**(81)**	52
Total other expenses (income)	**13**	262
Income before income taxes from continuing operations	**3,573**	1,239
Current income tax expense	**765**	150
Deferred income tax expense	**331**	273
Total income tax expense	**1,096**	423
Income and comprehensive income from continuing operations	**2,477**	816
Income and comprehensive Income from discontinued operations *[note 12]*	**164**	—
Net income and comprehensive income for the period	**2,641**	816
Net income from continuing operations per common share *[note 9]*		
Basic	**0.09**	0.03
Diluted	**0.09**	0.03
Net income from discontinued operations per common share *[note 9]*		
Basic	**0.01**	—
Diluted	**0.01**	—

See accompanying notes

Cipher Pharmaceuticals Inc.

Interim consolidated statements of changes in shareholders' equity

[in thousands of United States dollars – unaudited]

For the three months ended March 31

	Share capital		Contributed surplus	Other comprehensive loss	Retained earnings	Total shareholders' equity
	[000s]	$	$	$	$	$
Balance, January 1, 2019	26,821	18,324	5,324	(9,514)	10,625	24,759
Net income for the period	—	—	—	—	816	816
Shares issued under the share purchase plan *[note 5]*	26	37	—	—	—	37
Shares issued under the Restricted Share Unit Plan	65	208	(208)	—	—	—
Share-based compensation expense *[note 5]*	—	—	26	—	—	26
Balance, March 31, 2019	26,912	18,569	5,142	(9,514)	11,441	25,638
Balance, January 1, 2020	**26,991**	**18,677**	**4,981**	**(9,514)**	**13,867**	**28,011**
Net income for the period	**—**	**—**	**—**	**—**	**2,641**	**2,641**
Shares issued under the share purchase plan *[note 5]*	**17**	**12**	**—**	**—**	**—**	**12**
Shares issued under the Restricted Share Unit Plan	**22**	**38**	**(38)**	**—**	**—**	**—**
Share-based compensation expense *[note 5]*	**—**	**—**	**42**	**—**	**—**	**42**
Balance, March 31, 2020	**27,030**	**18,727**	**4,985**	**(9,514)**	**16,508**	**30,706**

See accompanying notes

Cipher Pharmaceuticals Inc.

Interim consolidated statements of cash flows

[in thousands of United States dollars – unaudited]

For the three months ended March 31	2020 $	2019 $
Operating activities		
Income for the period from continuing operations	**2,477**	816
Add (deduct) items not affecting cash:		
Depreciation of property and equipment	**68**	87
Amortization of intangible assets	**239**	212
Share-based compensation	**44**	32
Foreign exchange gain on cash and lease obligation	**(107)**	(26)
Change in fair value of derivative	**(2)**	(12)
Interest on long-term debt	**124**	275
Deferred income taxes	**331**	273
	3,174	**1,657**
Changes in working capital balances related to operating operations:		
Accounts receivable	**1,896**	1,371
Inventory	**414**	202
Prepaid expenses and other assets	**234**	244
Accounts payable and accrued liabilities	**(393)**	(1,943)
Contract liability	**64**	26
Cash provided by operating activities	**5,389**	1,557
Investing activities		
Purchase of property and equipment	**—**	(685)
Gain on disposal of property and equipment	**—**	23
Acquisition of intangible assets	**(750)**	(515)
Cash used in investing activities	**(750)**	(1,177)
Financing activities		
Interest payments	**(48)**	(259)
Principal repayments	**(2,000)**	(2,000)
Payment of lease obligation	**(53)**	(22)
Proceeds from shares issued under the share purchase plan	**10**	31
Cash used in financing activities	**(2,091)**	(2,250)
Cash used in discontinued operations	**—**	(589)
Net increase (decrease) in cash during the period	**2,548**	(2,459)
Impact of foreign exchange on cash	**(54)**	26
Cash, beginning of period	**6,346**	10,357
Cash, end of period	**8,840**	7,924

See accompanying notes

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

1. Nature of operations

Cipher Pharmaceuticals Inc. ["Cipher"] and its subsidiaries [together the "Company"] is a specialty pharmaceutical company with a diversified portfolio of commercial and early to late stage products. The Company acquires products that fulfill unmet medical needs, manages the required clinical development and regulatory approval process, and markets those products either directly in Canada and the United States ["U.S."] or indirectly through partners in the U.S., Canada and Latin America. The Company is building its business through product licensing and acquisitions. Cipher was incorporated under the *Business Corporations Act* of Ontario on January 9, 2004 and is located at 209 Oak Park Blvd., Suite 501, Oakville, Ontario.

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*. The disclosures contained in these interim condensed consolidated financial statements do not include all of the requirements of International Financial Reporting Standards ["IFRS"] as issued by the International Accounting Standards Board for annual financial statements. The interim condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2019, which have been prepared in accordance with IFRS, and are available on SEDAR at www.sedar.com. The interim condensed consolidated financial statements are based on accounting policies as described in the 2019 annual consolidated financial statements, except for the adoptions of new standards effective as of January 1, 2020.

The interim condensed consolidated financial statements include the accounts of the Company and its wholly owned legal subsidiaries: Cipher US Holdings Inc., Cipher US Holdco LLC and Cipher Pharmaceuticals US LLC. On February 1, 2020, Cardiome Pharma Corp was amalgamated with Cipher. All significant inter-company balances and transactions have been eliminated upon consolidation.

The Board of Directors approved these interim condensed consolidated financial statements on May 7, 2020.

The Company is closely monitoring the developments of the Coronavirus-19 ["COVID-19"] situation. It is too soon to assess the impacts of the current outbreak on the Company, given the many unknowns related to COVID-19. The global response to the COVID-19 outbreak has resulted in, among other things, border closures, severe travel restrictions and extreme fluctuations in financial and commodity markets. Additional measures may be implemented by one or more governments in jurisdictions where the Company operates. Labour shortages due to illness, Company or government imposed isolation programs, or restrictions on the movement of personnel or possible supply chain disruptions could result in a reduction or cessation of all or a portion of the Company's operations. The extent to which COVID-19 and any other pandemic or public health crisis impacts the Company's business, affairs, operations, financial condition, liquidity, availability of credit and results of operations will depend on future developments that are highly uncertain and cannot be predicted with any meaningful precision, including new information which may emerge concerning the severity of COVID-19 and the actions required to contain the COVID-19 or remedy its impact, among others.

The actual and threatened spread of COVID-19 globally could also have a material adverse effect on the regional economies in which we operate, could continue to negatively impact stock markets, including any future trading price of our shares, could adversely impact our ability to raise capital, could cause continued interest rate volatility and movements that could make obtaining financing or renegotiating the terms of our existing financing more challenging or more expensive.

Any of these developments, and others, could have a material adverse effect on our business and results of operations. In addition, because of the severity and global nature of the COVID-19 pandemic, it is reasonably possible that the estimates in the financial statements will change in the near term and the effect of the change will be material. Potential impacts may include, but are not limited to, impairment of long-lived assets and a change in the estimated credit loss on accounts receivable.

Fair value of financial instruments

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is quoted bid or ask prices in an active market. Quoted prices are not always available for over-the-counter transactions, as well as transactions in inactive or illiquid markets. In these instances, pricing models, normally with observable market-based inputs, are used to estimate fair value. Financial instruments traded in a less active market have been valued using indicative market prices, present value or other valuation techniques. Where financial instruments trade in inactive markets or when using models where observable parameters do not exist, greater management judgment is required for valuation purposes. In addition, the calculation of estimated fair value is based on market conditions at a specific point in time and, therefore, may not be reflective of future fair values.

As at March 31, 2020, the Company's financial instruments consisted of cash, accounts receivable, accounts payable and accrued liabilities, the credit facility and a derivative financial instrument. The derivative financial instrument is measured at fair value with any changes recognized through the interim consolidated statements of income and comprehensive income and is classified as Level 2 [as defined under IFRS]. Cash, accounts receivable, accounts payable and accrued liabilities are measured at amortized cost and their fair values approximate carrying values.

The credit facility is measured at amortized cost. As at March 31, 2020, the fair value of the credit facility is approximately $5,656. The fair value is based on cash flows discounted using a rate based on the borrowing rate.

3. Credit facility

In November 2017, the Company entered into a credit agreement with a Canadian lender to extinguish its existing senior secured notes and replace with a credit facility. In connection with the credit agreement, the Company used the proceeds of $20,000 to fully extinguish the remaining balance of the senior secured notes. The credit facility has a three-year term, maturing November 3, 2020 and carries an interest rate of LIBOR plus an applicable margin ranging from 1.5%–2.5% based on the total debt to EBITDA ratio, as defined in the credit agreement. Principal and interest payments are payable quarterly in arrears. The credit facility also carries an accordion feature that allows for an additional US$10,000 of capacity, subject to customary terms and conditions. The Company is subject to certain financial and non-financial covenants. The credit facility is secured by the assets of the Company. The interest rate and effective interest rate applicable in the first quarter was approximately 3.2% and 3.3%, respectively.

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

The following is the continuity of the credit facility from January 1, 2020 to March 31, 2020:

	$
Balance, January 1, 2020	**7,620**
Accrued interest expense	**63**
Interest paid	**(48)**
Imputed interest accretion	**21**
Repayment	**(2,000)**
Balance, March 31, 2020	**5,656**

Derivative financial instrument

In April 2015, the Company issued 600,000 common share purchase warrants to the lender of the senior secured notes with an option for a cashless exercise in which the settlement price caused the conversion ratio to be variable. Accordingly, the warrants are classified as a Level 2 financial liability. Gains and losses on re-measurement are presented separately in the interim consolidated statements of income and comprehensive income. The exercise price of the warrants is $9.22 [equal to the five-day volume-weighted average price on the Toronto Stock Exchange prior to closing, converted to U.S. dollars] and expire seven years from the date of issuance. Black-Scholes with observable market-based inputs was used to estimate the fair value of the warrants issued. The estimated fair value of the warrants as at March 31, 2020 and December 31, 2019 were $6 and $8, respectively.

The variables used to compute the fair value as at March 31, 2020 and December 31, 2019 are follows:

	March 31, 2020	**December 31, 2019**
Share price	**$0.49**	$1.15
Expected life	**2.0 years**	2.3 years
Volatility	**90.4%**	61.8%

4. Lease obligation

The Company has an office lease for its corporate operations head office. The term of the lease is 10 years and three months and commenced on January 1, 2019. The undiscounted commitment for the remaining lease term as at March 31, 2020 is approximately CDN$3,584.

5. Share capital

Authorized share capital

The authorized share capital consists of an unlimited number of preference shares, issuable in series, and an unlimited number of voting common shares, with no par value.

The Company has three share-based compensation plans: The Stock Option Plan ["SOP"], the Employee and Director Share Purchase Plan ["ESPP"] and the Restricted Share Units and Performance Share Units. Full descriptions of the three share-based compensation plans are included in note 14 "Share Capital" to the Company's annual consolidated financial statements for the year ended December 31, 2019.

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

Share purchase plan

The Company's ESPP allows employees and directors to share in the growth of the Company through share ownership. Through the ESPP, employees and directors may contribute amounts to purchase shares of the Company at a 15% discount from the prevailing trading price. Plan members must hold their shares for a period of at least six months before they can be sold. During the three months ended March 31, 2020, 17,028 shares were issued under the ESPP [three months ended March 31, 2019 – 25,864] at weighted average trading price of CDN $0.93 [three months ended March 31, 2019 – CDN $1.89]. Included in share-based compensation expense is $2 [three months ended March 31, 2019 – $6], which is the discount on the shares issued during the period.

Stock option plan

The following is a summary of the changes in the stock options outstanding from January 1, 2020 to March 31, 2020:

	Number of options [000s]	**Weighted average exercise price** [CDN $]
Balance, January 1, 2020	**618**	**3.70**
Forfeited/expired during the period	**(202)**	**4.20**
Balance, March 31, 2020	**416**	**3.46**

As at March 31, 2020, 226,460 options were fully vested and exercisable [March 31, 2019 – 368,975]. During the quarter, no stock options were exercised [three months ended March 31, 2019 – nil]. The Company's SOP provides that an option holder may elect to receive a number of shares equivalent to the growth value of vested options, which is the difference between the market price and the exercise price of the options.

The total stock option expense for the three months ended March 31, 2020 is $30 [three months ended March 31, 2019 – $9 recovery].

The following information relates to stock options that were outstanding as at March 31, 2020:

Range of exercise prices [CDN $]	**Number of options** [000s]	**Weighted average remaining contractual life** [years]	**Weighted average exercise price** [CDN $]
1.16 – 2.88	**163**	**5.7**	**1.47**
3.04 – 5.39	**112**	**5.1**	**3.29**
6.19 – 13.88	**141**	**5.0**	**5.91**
	416	**5.3**	**3.46**

Restricted Share Unit [RSU] and Performance Share Unit [PSU] Plan

On May 13, 2015, the Company adopted an RSU and PSU Plan. RSUs and PSUs are notional share units exchangeable for common shares of the Company. RSUs are granted to all employees and directors of the Company and PSUs are granted to certain executives. RSUs granted to employees vest annually over three or

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

four years and RSUs granted to directors' vest over a one year period. There are no PSUs outstanding as at March 31, 2020.

A summary of the RSUs granted and outstanding as at March 31, 2020 is as follows:

	RSUs number of units [000s]
Balance, January 1, 2020	**65**
Granted during the period	**—**
Vested during the period	**22**
Forfeited/cancelled during the period	**—**
Balance, March 31, 2020	**43**

The total expense for RSUs for the three months ended March 31, 2020 is $12 [three months ended March 31, 2019 – $35].

6. Revenue

The Company earns licensing revenue from both royalties and product sales to its partners; the breakdown is as follows:

	Three months ended March 31, 2020 $	**Three months ended March 31, 2019** $
Licensing revenue		
Royalty revenue	**2,831**	3,015
Licensing product sales	**515**	316
Total licensing revenue	**3,346**	3,331

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

7. Expenses by nature

The interim consolidated statements of income and comprehensive income include the following expenses by nature:

	Three months ended March 31, 2020 $	Three months ended March 31, 2019 $
Employee salaries and benefits expenses		
Salaries, bonuses and benefits	**280**	1,460
Share-based compensation	**44**	32
Total employee costs	**324**	1,492

For the three months ended March 31, 2020 and March 31, 2019, all employee salaries and benefits are recorded in selling, general and administrative expenses.

8. Compensation of key management

Key management includes directors and executives of the Company. The compensation paid or payable to key management for services is shown below:

	Three months ended March 31, 2020 $	Three months ended March 31, 2019 $
Salaries, bonuses and benefits	**133**	306
Share-based compensation	**27**	(26)
Directors' fees	**53**	61
	213	341

The interim Chief Executive Officer of the Company did not receive compensation in that capacity; however, directors' fees were paid.

9. Net income per common share

Net income per share is calculated using the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the three months ended March 31, 2020 was 27,000,865 [three months ended March 31, 2019 – 26,844,988].

Diluted net income per common share is calculated using the weighted average number of common shares outstanding taking into consideration the weighted average impact of dilutive securities. The dilutive weighted average for the three months ended March 31, 2020 was 27,043,581 [three months ended March 31, 2019 – 27,080,040].

10. Commitments and contingencies

In the normal course of business, the Company may be the subject of litigation or other potential claims. While management assesses the merits of each lawsuit and defends itself accordingly, the Company may be required to incur significant expenses or devote significant resources to defending itself against litigation.

Licensing agreements with Galephar

In 2002, the Company entered into a Master Licensing and Clinical Supply Agreement [the 'Agreement"] with Galephar, a Puerto Rico based pharmaceutical research and manufacturing company. Under the Agreement, the Company acquired the rights to package, test, obtain regulatory approvals and market CIP-FENOFIBRATE, CIP-ISOTRETINOIN and CIP-TRAMADOL ER [the "CIP Products"] in various countries. In accordance with the Agreement, the Company retains 50% of all revenue from licensing and distribution arrangements entered into with respect to the CIP Products, with the other 50% due to Galephar. Galephar retains the right to manufacture and supply the CIP Products. With respect to licensing and distribution arrangements, the Company manages the product supply arrangements with their respective marketing partners and Galephar; product is shipped directly from Galephar to the respective marketing partners. Where the Company has opted to market and sell the CIP Product directly, the Company purchases the finished goods from Galephar directly.

In 2016, Galephar entered into a contract with another party [the "Assignee"] to assign certain rights relating to CIP-ISOTRETINOIN under the Agreement. The Company is a party to this contract, agreeing to remit revenue on the same terms as the Agreement, from licensing and distribution within the U.S. for CIP-ISOTRETINOIN directly to the Assignee.

During the three months ended March 31, 2020, the Company paid royalties of $413 [three months ended March 31, 2019 – $698] to Galephar. As at March 31, 2020, the amounts in accounts payable and accrued liabilities owed to Galephar were $1,831 [December 31, 2019 – $1,997]. Amounts payable to Galephar are remitted quarterly, after the Company collects from its licensing partners. Accordingly, the Company's accounts receivable has a corresponding balance representing amounts owed by its licensing partners.

11. Segmented information

The Company's operations are categorized into one reporting segment, being specialty pharmaceuticals. Prior to the disposal of the U.S. business, the Company managed its operations geographically in Canada and the United States, representing two segments. Following the disposal of the U.S. operations, the Company has one reportable segment.

The Company generated approximately 43% [2019 – 35%] of its net revenue within Canada, with the remainder attributable to the U.S. There are no significant assets located outside of Canada.

12. Discontinued operations

In May 2017, the Company entered into an Asset Purchase Agreement and completed the sale of substantially all of the assets comprising the U.S. segment.

As at March 31, 2020, the liabilities retained by the Company are $56 [December 31, 2019 – $237] recorded in accounts payable and accrued liabilities and nil [December 31, 2019 – $164] recorded in contract liability. During

Notes to interim condensed consolidated financial statements

the quarter, there was a reduction in the contract liability of $164, due to fewer product returns than what was provided for and the returns window related to those products have expired.