Merus Labs International Inc.

Third Quarter Report Fiscal 2016

For the Three and Nine Months Ended June 30, 2016 and 2015

Merus Labs International Inc.
Condensed Consolidated Interim Statements of Financial Position
(Unaudited)
(Expressed in Canadian dollars)

As at:		June 30 2016	September 30 2015
Assets			
Current assets			
Cash and cash equivalents		$ 3,942,145	$ 40,987,177
Short-term investments		3,108	3,234
Trade and other receivables		21,883,879	14,202,624
Inventories	*note 2*	11,004,485	6,799,805
Prepaid expenses		366,165	332,274
		37,199,782	62,325,114
Non-current assets			
Property and equipment	*note 4*	515,607	119,205
Intangible assets	*note 2, 5*	331,371,195	201,539,290
Total assets		$ 369,086,584	$ 263,983,609
Liabilities and Equity			
Current liabilities			
Operating line	*note 7*	5,000,000	-
Accounts payable and accrued liabilities		9,369,922	8,314,307
Income taxes payable		478,620	1,150,791
Derivative liabilities	*note 3*	862,833	893,666
Long term debt due within one year	*note 7*	30,840,421	15,463,595
		46,551,796	25,822,359
Non-current liabilities			
Provisions	*note 6*	263,030	167,656
Long term debt	*note 7*	118,019,681	47,248,414
Preferred shares	*note 9*	9,947,730	9,947,730
Total liabilities		174,782,237	83,186,159
Equity			
Share capital	*note 8*	210,756,585	184,534,553
Equity reserve	*note 8*	38,583,768	37,215,779
Accumulated deficit		(70,665,062)	(61,271,614)
Accumulated other comprehensive income		15,629,056	20,318,732
Total equity		194,304,347	180,797,450
Total liabilities and equity		$ 369,086,584	$ 263,983,609

Commitments and contingencies (note 10)

Approved on behalf of the Board:

(signed)
Tim Sorensen,
Director

(signed)
Dave Guebert,
Director

Merus Labs International Inc.
Condensed Consolidated Interim Statements of Operations
(Unaudited)
(Expressed in Canadian dollars)

		Three months ended June 30		Nine months ended June 30	
		2016	2015 (restated - note 16)	**2016**	2015 (restated - note 16)
Revenues		**$ 25,656,987**	$ 9,505,483	**$ 61,286,391**	$ 32,813,946
Cost of goods sold		**8,820,789**	812,503	**19,111,949**	3,515,261
Gross margin		**16,836,198**	8,692,980	**42,174,442**	29,298,685
Operating expenses:					
Selling and marketing		**2,018,805**	631,505	**4,601,833**	1,581,542
General and administrative	*note 10, 11*	**2,814,745**	1,706,452	**5,993,895**	4,413,682
Share-based compensation	*note 8, 11*	**476,717**	600,942	**2,052,112**	2,036,464
Acquisition costs		**134,653**	-	**2,417,572**	-
Amortization of intangible assets	*note 5*	**10,267,400**	6,165,104	**26,777,544**	17,853,026
Depreciation	*note 4*	**9,640**	3,833	**17,259**	11,524
Foreign exchange losses (gains)		**2,967,869**	(184,336)	**3,019,603**	(1,412,476)
		18,689,829	8,923,500	**44,879,818**	24,483,762
Operating (loss) income		**(1,853,631)**	(230,520)	**(2,705,376)**	4,814,923
Interest expense, net		**2,334,558**	1,357,534	**6,304,667**	4,738,040
Derivative losses (gains)	*note 3, 7*	**664,634**	101,268	**(77,862)**	(33,108)
Investment loss (income)		**17**	46	**101**	(566)
(Loss) income before income taxes		**(4,852,840)**	(1,689,368)	**(8,932,282)**	110,557
Income tax expense	*note 12*	**199,728**	118,616	**461,166**	370,948
Net loss for the period		**$ (5,052,568)**	$ (1,807,984)	**$ (9,393,448)**	$ (260,391)
Loss per share					
Basic		**$ (0.04)**	$ (0.03)	**$ (0.09)**	$ -
Diluted		**$ (0.04)**	$ (0.03)	**$ (0.09)**	$ -
Weighted average number of common shares outstanding - basic		**116,948,807**	54,027,137	**108,901,444**	81,235,579
Weighted average number of common shares outstanding - diluted		**116,948,807**	54,027,137	**108,901,444**	81,235,579

(Expressed in Canadian dollars)

	Three months ended June 30		Nine months ended June 30	
	2016	2015	**2016**	2015
Loss for the period	**$ (5,052,568)**	$ (1,807,984)	**$ (9,393,448)**	$ (260,391)
Other comprehensive loss				
Items that may be reclassified to income:				
Currency translation differences	**(3,165,617)**	(5,152,633)	**(4,689,676)**	(6,539,759)
Other comprehensive loss for the period	**(3,165,617)**	(5,152,633)	**(4,689,676)**	(6,539,759)
Total comprehensive loss	**$ (8,218,185)**	$ (6,960,617)	**$ (14,083,124)**	$ (6,800,150)

Merus Labs International Inc.
Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
(Expressed in Canadian dollars)

	Three months ended June 30		Nine months ended June 30	
	2016	2015	**2016**	2015
Operating activities				
Net loss for the period	**$ (5,052,568)**	$ (1,807,984)	**$ (9,393,448)**	$ (260,391)
Adjustments for the following items:				
Amortization of intangible assets	**10,267,400**	6,165,104	**26,777,544**	17,853,026
Depreciation	**9,640**	3,833	**17,259**	11,524
Interest expense	**2,334,558**	1,357,534	**6,304,667**	4,738,040
Income tax expense	**199,728**	118,616	**461,166**	370,948
Unrealized losses on foreign exchange	**1,948,137**	768,707	**2,784,087**	342,664
Share-based compensation	**476,717**	600,942	**2,052,112**	2,036,464
Change in fair value of derivative financial instruments	**828,963**	264,318	**(30,833)**	388,252
Interest paid	**(1,994,435)**	(1,198,738)	**(4,462,050)**	(4,239,304)
Income taxes paid	**(1,032,045)**	-	**(1,032,045)**	-
Net change in non-cash working capital balances:				
Provisions	**(67,831)**	(36,297)	**95,374**	(142,381)
Trade and other receivables	**(3,829,322)**	1,620,923	**(7,681,255)**	(2,732,488)
Prepaid expenses	**(19,245)**	(1,055)	**(33,891)**	(95,328)
Inventories	**(2,639,054)**	(583,187)	**(2,558,130)**	(714,554)
Accounts payable and accrued liabilities	**199,776**	(1,724,509)	**1,055,615**	(752,787)
Income taxes payable	**(75,361)**	37,289	**(89,963)**	-
Net cash provided by operating activities	**1,555,058**	5,585,496	**14,266,209**	16,803,685
Financing activities				
Proceeds from debt issuance, net of issuance costs	**-**	-	**172,620,265**	-
Repayment of long-term debt	**(8,013,728)**	(4,000,000)	**(73,589,337)**	(12,000,000)
Private placement proceeds	**-**	-	**25,289,411**	-
Proceeds from prospectus offering	**-**	59,562,323	**-**	59,562,323
Proceeds from exercise of stock options	**248,498**	431,250	**248,498**	733,665
Net cash provided by (used in) financing activities	**(7,765,230)**	55,993,573	**124,568,837**	48,295,988
Investing activities:				
Acquisition of businesses or products	**-**	(36,439,154)	**(175,052,582)**	(36,439,154)
Purchase of property and equipment	**(418,067)**	-	**(418,067)**	-
Capitalized development costs	**(73,709)**	(904,116)	**(409,555)**	(1,435,756)
Short-term investments	**17**	46	**126**	(566)
Net cash used in investing activities	**(491,759)**	(37,343,224)	**(175,880,078)**	(37,875,476)
Net change in cash and cash equivalents	**(6,701,931)**	24,235,845	**(37,045,032)**	27,224,197
Cash and cash equivalents, beginning of period	**10,644,076**	17,346,919	**40,987,177**	14,358,567
Cash and cash equivalents, end of period	**$ 3,942,145**	$ 41,582,764	**$ 3,942,145**	$ 41,582,764

(Expressed in Canadian dollars)

	Share capital	Equity reserve	Accumulated deficit	Accumulated other comprehensive income (AOCI)	Total equity
Balance, September 30, 2014	**$ 123,808,971**	**$ 35,132,914**	**$ (61,033,735)**	**$ 6,780,105**	**$ 104,688,255**
Share-based compensation (note 8)	-	2,036,464	-	-	**2,036,464**
Stock option exercise (note 8)	489,269	(186,854)	-	-	**302,415**
Cancellation of shares in escrow (note 8)	(68,333)	68,333	-	-	**-**
Net loss for the period	-	-	(260,391)	-	**(260,391)**
Other comprehensive loss	-	-	-	(6,539,759)	**(6,539,759)**
Balance, June 30, 2015	**$ 124,229,907**	**$ 37,050,857**	**$ (61,294,126)**	**$ 240,346**	**$ 100,226,984**

	Share capital	Equity reserve	Accumulated deficit	Accumulated other comprehensive income (AOCI)	Total equity
Balance, September 30, 2015	**$ 184,534,553**	**$ 37,215,779**	**$ (61,271,614)**	**$ 20,318,732**	**$ 180,797,450**
Private placement (note 8)	25,289,411	-	-	-	**25,289,411**
Share-based compensation (note 8)	535,533	1,516,579	-	-	**2,052,112**
Stock option exercise (note 11)	397,088	(148,590)	-	-	**248,498**
Net loss for the period	-	-	(9,393,448)	-	**(9,393,448)**
Other comprehensive loss	-	-	-	(4,689,676)	**(4,689,676)**
Balance, June 30, 2016	**$ 210,756,585**	**$ 38,583,768**	**$ (70,665,062)**	**$ 15,629,056**	**$ 194,304,347**

1. Presentation of Financial Statements

Nature of Business

Merus Labs International Inc., incorporated under the Business Corporations Act (British Columbia), and its subsidiaries (the "Company"), operate in Canada and Europe. The head office of the Company is 100 Wellington St. West, Ste. 2110, Toronto, Ontario M5K 1H1. The Company is a specialty pharmaceutical company engaged in the acquisition and licensing of branded prescription pharmaceutical products.

Basis of Preparation

These unaudited condensed consolidated interim financial statements ("interim financial statements") of the Company have been prepared on a historical cost basis, except for certain financial assets which are presented at fair value, in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB") ("IFRS") for interim financial statements. The interim financial statements have been prepared on a basis consistent with the Company's annual audited consolidated financial statements for the year ended September 30, 2015. The interim financial statements are in compliance with International Accounting Standard 34, *Interim Financial Reporting* ("IAS 34"). Accordingly, certain information and note disclosure normally included in annual financial statements prepared in accordance with IFRS, have been omitted or condensed. During the quarter ended June 30, 2016, there were no significant changes in accounting policies or their application.

The preparation of the Company's interim financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements have been set out in note 2 of the Company's annual audited consolidated financial statements for the year ended September 30, 2015. These interim financial statements should be read in conjunction with the Company's annual audited consolidated financial statements for the year ended September 30, 2015.

These interim financial statements were authorized for issue by the Company's Board of Directors on August 12, 2016.

(Expressed in Canadian dollars)

2. Acquisitions

Elantan, Isoket, and Deponit

On February 4, 2016, the Company completed the acquisition from UCB Pharma GmbH ("UCB") of the nitrates business of UCB comprised of the rights to the Elantan®, Isoket® and Deponit® pharmaceutical products (the "UCB Products") in Europe and select other markets. The UCB Products were purchased pursuant to a purchase agreement entered into among the Company, one of its indirectly wholly owned subsidiaries.

The UCB Products acquired include a variety of formats, including tablet, spray, patch and injectable presentations. The UCB Products belong to a category of pharmaceuticals called nitrates, and are used to treat both acute and chronic coronary artery disease.

The Company acquired the exclusive rights to manufacture, market and sell the products in twenty European countries, Mexico, Turkey and South Korea. The European countries include France, Germany, Italy, Spain and the United Kingdom. Approximately 80% of revenues from the UCB Products are derived from countries where the Company's existing products are currently sold.

The UCB Products acquisition was structured as an all cash transaction pursuant to which the Company's wholly owned subsidiary paid a purchase price of €92 million on closing. In addition, the Company has agreed to purchase existing UCB Product inventory subsequent to the closing date. The Company funded the acquisition with a combination of cash-on-hand and proceeds from a new Euro-denominated debt facility (see note 7).

The acquisition is considered to be a business combination under IFRS 3 with Merus as the acquirer and the UCB Products as the acquiree. Accordingly, the purchase price calculations and the purchase price allocations are dependent upon fair value estimates and assumptions as at the acquisition date.

Costs incurred to complete the acquisition were approximately $532,000, which were expensed during the period. The fair value of the acquired identifiable net assets was $141,413,200 (€92,000,000). The preliminary purchase price allocation to the following identifiable assets is based on their estimated fair values:

Product rights - Elantan	**$ 73,073,734**
Product rights - Isoket	**38,458,242**
Product rights - Deponit	**29,881,224**
Net assets acquired	**$141,413,200**

The above allocation of the purchase price is preliminary. The Company is continuing to assess and review the fair value of net assets acquired pursuant to the acquisition and finalize the associated purchase price accounting. As a result, the final allocation of the purchase price could vary significantly from the amounts used in the unaudited consolidated interim financial statements.

(Expressed in Canadian dollars)

Surgestone, Provames, Speciafoldine and Tredemine

On March 7, 2016, the Company acquired the rights to manufacture, market and sell Surgestone®, Provames®, Speciafoldine®, and Tredemine® pharmaceutical products in France from Sanofi S.A. ("Sanofi") for a purchase price of €22.5 million. Surgestone® and Provames® are used in a variety of women's health indications, Speciafoldine® is used to treat macrocytic anemia and Tredemine® is a World Health Organization recognized essential medicine to treat tapeworm.

The acquisition of the Sanofi Products pursuant to the Sanofi Purchase Agreement was funded by (i) the proceeds of the special warrants (note 8), together with (ii) an additional advance under the Company's credit facility (note 7).

The acquisition is considered to be a business combination under IFRS 3 with Merus as the acquirer and the Sanofi products as the acquiree. Accordingly, the purchase price calculations and the purchase price allocations are dependent upon fair value estimates and assumptions as at the acquisition date.

Costs incurred to complete the acquisition were approximately $1,885,000, which were expensed during the period. The fair value of the acquired identifiable net assets was $33,639,382 (€22,984,000). The preliminary purchase price allocation to the following identifiable assets is based on their estimated fair values:

Inventory	**$ 1,646,550**
Product rights - Surgestone	**18,293,536**
Product rights - Provames	**1,369,930**
Product rights - Speciafoldine	**11,585,858**
Product rights - Tredemine	**743,509**
Net assets acquired	**$ 33,639,382**

The above allocation of the purchase price is preliminary. The Company is continuing to assess and review the fair value of net assets acquired pursuant to the acquisition and finalize the associated purchase price accounting. As a result, the final allocation of the purchase price could vary significantly from the amounts used in the unaudited consolidated interim financial statements.

Salagen and Estraderm

On May 21, 2015, the Company acquired the rights to manufacture, market, and sell two established specialty pharmaceutical products in certain European and other markets.

(Expressed in Canadian dollars)

Salagen ® (pilocarpine hydrochloride) is indicated for xerostomia following radiation therapy, in addition to Sjogren's syndrome. Estraderm MX® is a transdermal delivery format of estradiol used for symptomatic treatment of menopause.

Pursuant to the acquisition, the Company acquired the product rights, certain related intellectual property, and other information and materials required to continue marketing and selling the brands in the territories acquired. Total consideration for the product acquisition was US$29,500,000 funded from cash on hand. The transaction was accounted for as the acquisition of assets.

Costs incurred to complete the acquisition were approximately $73,000, which were capitalized to the cost of the assets acquired. The fair value of the acquired identifiable net assets was $36,439,154 (US$29,500,000 plus transaction costs) and was allocated as follows:

Product rights - Salagen	**$ 27,818,515**
Product rights - Estraderm	**8,620,639**
Net assets acquired	**$ 36,439,154**

3. Derivative financial instruments

	June 30 2016	September 30 2015
Liabilities:		
Forward foreign exchange contracts	**$ -**	$ 648,326
Interest rate swap	**862,833**	245,340
Total derivative liabilities	**$ 862,833**	$ 893,666

In prior periods, in connection with its European operations, the Company used foreign currency contracts in order to partially hedge the risk associated with its Euro currency source revenue. At June 30, 2016, the Company no longer had forward foreign exchange contracts outstanding (notional value at September 30, 2015: $23,330,400). For the nine months ended June 30, 2016, gains of $384,926 (June 30, 2015: gains of $12,855) were recognized in derivatives losses (gains) in the statements of operations in connection with these contracts.

In accordance with the terms of the Company’s long-term debt (note 7), during the third quarter of fiscal 2016 the Company entered into an interest rate swap for approximately 50% of the outstanding balance, effectively fixing the maximum rate on that portion of the loan at 4.99% until maturity. Also, during the second quarter of fiscal 2015 the Company had entered into an interest rate swap for 50% of the outstanding balance of the previous senior secured facility, effectively fixing the rate on that portion of the loan at 5.72% until maturity. On January 22, 2016, the Company terminated the interest rate swap contract resulting in a payment of $296,100, which represented the fair value of the liability on the settlement date.

(Expressed in Canadian dollars)

4. Property and equipment

Continuity of property and equipment as at June 30, 2016 was as follows:

	Computer Equipment	Computer Software	Leasehold Improve-ments	Furniture and Fixtures	Manufact-uring Equipment	Total
Cost at September 30, 2015	$ 2,762	$ -	$ -	$ 11,891	$ 127,566	$ 142,219
Additions	21,555	207,941	122,917	65,654	-	418,067
Foreign exchange differences	(110)	-	-	(75)	(5,093)	(5,278)
Cost at June 30, 2016	**$ 24,207**	**$ 207,941**	**$ 122,917**	**$ 77,470**	**$ 122,473**	**$ 555,008**
Accumulated Depreciation at September 30, 2015	$ 2,762	$ -	$ -	$ 7,496	$ 12,756	$ 23,014
Depreciation charge	648	-	2,049	5,151	9,411	17,259
Foreign exchange differences	(110)	-	-	(27)	(735)	(872)
Accumulated Depreciation at June 30, 2016	**$ 3,300**	**$ -**	**$ 2,049**	**$ 12,620**	**$ 21,432**	**$ 39,401**
Carrying amount at September 30, 2015	$ -	$ -	$ -	$ 4,395	$ 114,810	$ 119,205
Carrying amount at June 30, 2016	**$ 20,907**	**$ 207,941**	**$ 120,868**	**$ 64,850**	**$ 101,041**	**$ 515,607**

(Expressed in Canadian dollars)

5. Intangible assets

Continuity of intangible assets as at June 30, 2016 was as follows:

	Product Rights	Patents	Total
Cost at September 30, 2015	$ 244,406,192	$ 23,200,220	$ 267,606,412
Product acquisitions (note 2)	173,406,032	-	173,406,032
Additions arising from internal development	409,555	-	409,555
Foreign exchange differences	(18,958,936)	(926,395)	(19,885,331)
Cost at June 30, 2016	**$ 399,262,843**	**$ 22,273,825**	**$ 421,536,668**
Accumulated Amortization at September 30, 2015	$ 49,479,172	$ 16,587,950	$ 66,067,122
Amortization charge	22,953,481	3,824,063	26,777,544
Foreign exchange differences	(1,908,105)	(771,088)	(2,679,193)
Accumulated amortization at June 30, 2016	**$ 70,524,548**	**$ 19,640,925**	**$ 90,165,473**
Carrying amount at September 30, 2015	$ 194,927,020	$ 6,612,270	$ 201,539,290
Carrying amount at June 30, 2016	**$ 328,738,295**	**$ 2,632,900**	**$ 331,371,195**

6. Provisions

	Nine months ended June 30, 2016	Twelve months ended September 30, 2015
Balance at beginning of period	**$ 167,656**	$ 330,789
Charges	**433,608**	189,227
Utilization	**(334,096)**	(363,409)
Foreign exchange	**(4,138)**	11,049
Balance at end of period	**$ 263,030**	$ 167,656
Less: current portion of provisions	**-**	-
Non-current portion of provisions	**$ 263,030**	$ 167,656

The Company's provisions are comprised of the following product-related liabilities:

Product Returns Liability:

The Company accepts all product returns relating to North American and certain European product sales. Management estimates the fair value of the product returns liability by taking into consideration the amount of units previously sold, returns experience to date, expiry of product currently in inventory, forecast sales volumes, and changes in the marketplace.

(Expressed in Canadian dollars)

7. Long-term debt

	June 30 2016	September 30 2015
Current		
Operating line	$ 5,000,000	$ -
Senior secured facility, €22,331,692 net of unamortized transaction costs of $1,214,490	30,840,421	15,463,595
Total	$ 35,840,421	$ 15,463,595
Non-Current		
Senior secured facility, €89,326,764 net of unamortized transaction costs of $2,186,228	$ 118,019,681	$ 47,248,414
Total	$ 118,019,681	$ 47,248,414

On February 1, 2016, in connection with the acquisition of the Nitrates Portfolio and Sanofi Portfolio, the Company refinanced its existing senior secured debt facility with a new Euro-denominated facility ("Euro Facility"). The Euro Facility was advanced under an amendment and restatement to the Company's existing credit agreement. Pursuant to the terms of the amended credit agreement, the lenders agreed to provide senior secured credit facilities in the aggregate amount of $180 million, comprising of a senior secured revolving credit facility in the principal amount of $10 million and senior secured term facilities in the aggregate principal amount of $170 million, which were committed in Euros upon closing of the facility at a EUR:CAD exchange rate of 1.5225.

The proceeds from the senior secured term facility were used as follows: 1) €39,408,867 ($60,000,000) was used to refinance the Old Debt Facility (see below) on close; 2) €65,681,445 ($100,000,000) was used towards the acquisition of the Nitrates Portfolio on February 4, 2016; and 3) €6,568,144 ($10,000,000) was used towards the acquisition of the Sanofi Portfolio on March 7, 2016. In addition, $6,575,609 was drawn from the senior secured revolving credit facility upon closing of the Nitrates Portfolio acquisition on February 4, 2016, which was partially repaid prior to the period end.

Finance costs of $3,955,344 were capitalized to the loan balance and will be amortized over the term of the loan using the effective interest rate method. The unamortized portion of finance costs relating to the Old Debt Facility of $1,096,102 were written off during the period as the refinancing of the Old Debt Facility was determined to be an extinguishment of debt.

The senior secured term facility has a five year term at an initial coupon rate of 4.5% per annum, decreasing as the Company de-leverages, and quarterly principal repayments starting with June 30, 2016. The senior secured revolving credit facilities are due on demand and have an interest rate of EURIBOR (0% floor) plus 4.5% per annum.

In accordance with the terms of the Euro Facility, during the third quarter of fiscal 2016, the Company entered into an interest rate swap for approximately 50% of the outstanding balance, effectively fixing the maximum rate on that portion of the loan at 4.99% until maturity.

All of the Company's obligations under the amended facility are guaranteed by all material subsidiaries of the Company and are secured by the material assets of the Company and the assets of, and all equity interests in its material subsidiaries. The Euro Facility contains affirmative and negative covenants including compliance with laws and restrictions on additional debt, as well as financial covenants such as debt to earnings and fixed charge coverage ratios. The Company was in compliance with all covenants of the senior secured credit facility during the year and at June 30, 2016.

On September 5, 2014, the Company entered into a renegotiated secured debt facility ("Old Debt Facility") with a syndicate of Canadian lenders. The Old Debt Facility provided additional funds for the purchase of Sintrom and refinanced the Company's then-existing senior secured debt at a lower rate and extended term. The facility matured on September 5, 2019 and provided for an $80 million term loan at the Canadian BA rate plus 4.5%, or 5.3% effective rate, with principal repayments of $4,000,000 per quarter and monthly interest payments. Finance costs of $1,986,786 were capitalized to the loan balance and were amortized over the term of the loan.

In accordance with the terms of the Old Debt Facility, during the second quarter of fiscal 2015, the Company entered into an interest rate swap for 50% of the outstanding balance, effectively fixing the rate on that portion of the loan at 5.72% until maturity. The swap was unwound prior to the commencement of the new Euro Facility and all costs relating the unwinding were expensed.

(Expressed in Canadian dollars)

8. Share capital

(a) Authorized:

Unlimited common shares without par value.

Issued:

	Nine months ended June 30, 2016		Year ended September 30, 2015	
	Number of shares	**Amount**	Number of shares	Amount
Balance, beginning of period	**102,301,641**	**$ 184,534,553**	81,245,724	$ 123,808,971
Common shares cancelled pursuant to escrow agreement	-	-	(33,333)	(68,333)
Common shares issued pursuant to prospectus offerings	**14,250,000**	**25,289,411**	20,672,750	59,562,323
Common shares issued pursuant performance share units	**298,265**	**535,533**	-	-
Common shares issued pursuant to options exercise	**150,000**	**397,088**	416,500	1,231,592
Balance, end of period	**116,999,906**	**$ 210,756,585**	102,301,641	$ 184,534,553

(b) Special warrants

On March 1, 2016, the Company completed, on a private placement basis, an offering of 14,250,000 subscription receipts of the Company (the "Subscription Receipts"), at a price of $1.90 per Subscription Receipt, for aggregate gross proceeds of $27,075,000 (the "Offering"). The proceeds of the Subscription Receipts were held in escrow and released to the Company upon the completion of a prospective acquisition. Upon closing of the acquisition, each Subscription Receipt was converted into one special warrant of the Company (the "Special Warrants"), with each Special Warrant being convertible into one common share of the Company. On May 18, 2016, the Special Warrants were converted into common shares under the Company's existing Base Shelf Prospectus, resulting in the issuance of 14,250,000 shares.

Transaction costs of $1,785,589 were incurred and have been capitalized against the proceeds from the Subscription Receipts.

On March 7, 2016, upon completion of the Sanofi products acquisition, the proceeds of the Offering, together with an advance under the Company's amended and restated credit facility announced on February 1, 2016, were used to fund the acquisition.

(c) Escrow shares

On December 4, 2014, the Company cancelled 33,333 shares still held in escrow pursuant to the acquisition of Orbis Pharma, Inc. As per the terms of the agreement, any shares remaining in escrow were cancelled upon termination of employment of the Company's former Chief Executive Officer in October 2014.

(d) Prospectus offerings

On April 30, 2015, the Company completed a prospectus offering of 20,672,750 shares, including the underwriter over-allotment option, at a price of $3.05 per share for gross proceeds of $63,051,888. Proceeds were used for acquisitions and general corporate purposes. Costs of the offering were approximately $3,489,000.

(e) Performance Share Unit Plan

In December 2014, the Company granted 800,000 Performance Share Units to an executive officer in connection with his employment agreement. The grant was subject to the Performance Share Unit Plan (the "Plan") being approved by the Board of Directors as well as regulatory and shareholder approval. In January 2015, the Board approved the Plan, subject to ratification by the shareholders, in addition to approving the grant of 150,000 Units to two other executive officers. The plan was approved by the Company's shareholders on March 26, 2015. During the prior fiscal year, 90,000 Units were forfeited in connection with a resignation, while 100,000 new Units were issued to a new executive. During the current fiscal period, a total of 297,500 Units were issued to several executives as part of their ongoing compensation. Share based compensation expense in the amount of $207,960 and $1,013,043 was recognized in the three months and nine months ended June 30, 2016 (2015: $172,746 and $293,748), respectively, in connection with these grants. The purpose of the plan is to provide the Company with greater flexibility with respect to equity compensation arrangements.

On December 10, 2015, the Company determined that performance conditions with respect to fiscal 2015 metrics had been met and, as such, authorized the issuance of a total of 298,265 shares pursuant to the grants in satisfaction of those amounts earned under the Performance Share Unit plan.

(f) Stock option plan

The Company has reserved 11,699,990 common shares under a 10% rolling reloading stock option plan. Under the plan, the options are exercisable for one common share and the exercise price of the option must equal the market price of the underlying share at the grant date. The options have vesting periods ranging from the date of grant up to three years. Once vested, options are exercisable at any time until expiry.

During the nine months ended June 30, 2016, the Company granted 1,815,000 options (2015: 1,935,000 options) to management, staff and directors, with exercise prices ranging from $1.64 to $1.71 per share (2015: $1.69 to $2.92 per share). The options have a term of five years and vest over a period of two years from the date of grant.

(Expressed in Canadian dollars)

The estimated fair value of the options granted during the three months ended June 30, 2016, using the Black-Scholes option pricing model, was $53,215 (2015: $250,065). $268,757 and $1,521,049 was expensed in the financial statements during the three months and nine months ended June 30, 2016 (2015: $353,877 and $1,742,716), respectively, relating to current and prior period grants and has been included in share-based compensation in the statements of operations and in equity as equity reserves. The remaining expense will be recognized over the balance of the vesting periods.

(g) Stock option details

The fair value of each option granted was estimated on the date of the grant using the Black-Scholes fair value option pricing model with the following assumptions:

	Nine months ended June 30	
	2016	2015
Weighted-average fair value of options	**$0.96**	$1.15
Risk-free interest rate	**0.80%**	1.24%
Volatility of the Company's common shares	**68%**	71%
Weighted average expected life of the options	**5 years**	5 years
Forfeiture rate	**8.7%**	8.7%
Expected dividends	**Nil**	Nil

Volatility was determined based on daily observations of the historical stock price over a period consistent with the expected life of the options at the date of grant.

Details of the options are as follows:

	Number of options	Weighted average price per share
Options outstanding, September 30, 2014	3,465,667	$ 1.82
Options granted	1,935,000	1.97
Options expired	(1,006,667)	2.01
Options forfeited	(150,000)	1.73
Options exercised	(416,500)	1.76
Options outstanding, September 30, 2015	3,818,500	$ 1.86
Options granted	1,815,000	1.71
Options expired	(75,000)	1.64
Options exercised	(150,000)	1.66
Options outstanding, June 30, 2016	**5,408,500**	**$ 1.82**

(Expressed in Canadian dollars)

The range of exercise prices for outstanding and exercisable options at June 30, 2016 are as follows:

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable
$0.50 - $1.00	158,500	2.01	158,500
$1.01 - $1.50	50,000	1.13	50,000
$1.51 - $2.00	4,625,000	3.20	3,465,000
$2.01 - $2.50	200,000	0.56	200,000
$2.51 - $3.00	375,000	3.80	250,000
	5,408,500	3.09	4,123,500

9. Preferred shares

On July 11, 2014, the Company completed a private placement subscription agreement to issue $10,000,000 of Series A convertible preferred shares (the "Series A Preferred Shares") to a large Canadian institutional investor.

The Series A Preferred Shares pay a dividend of 8% per annum, subject to adjustment if the Company does not redeem after October 31, 2019. After October 31, 2019 the dividend rate is set to increase to LIBOR plus 10% for one year. Thereafter, the dividend rate will increase to LIBOR plus 12% into perpetuity. At any time at the option of the holder, the Series A Preferred Shares may be converted into the Company's common shares at a conversion price of $2.20 per share. The Series A Preferred Shares are redeemable at the option of the Company at any time after October 31, 2019. The Series A Preferred Shares are also redeemable by the Company at any time in the event of a change of control subject to payment of a change of control premium. Costs associated with this transaction were approximately $52,000.

Based on management's assessment of the various components of the Preferred Shares it was determined that the entire instrument should be recorded as a liability. Accordingly, dividends paid on the Preferred Shares are included in interest expense in the statements of operations.

(Expressed in Canadian dollars)

10. Commitments and contingencies

(a) Operating lease commitments

The Company has entered into non-cancellable operating lease agreements for office premises and equipment with minimum annual lease payments to expiry as follows:

	June 30 2016	September 30 2015
Less than 1 year	**$ 300,540**	$ 105,576
1 to 2 years	**300,540**	105,576
2 to 3 years	**300,540**	26,394
3 to 4 years	**300,540**	-
Thereafter	**250,450**	-
Total	**$ 1,452,610**	$ 237,546

Lease expense recognized during the three and nine months ended June 30, 2016 was $82,807 and $172,542 (2015: $31,566 and $136,808), respectively, which has been included in general and administrative expenses in the statements of operations.

(b) Legal proceedings

Arbitration Proceeding

In August 2014, the Company received notice of a request for arbitration from LG Life Sciences (“LGLS”), the original owner of the Company’s former Factive® product. This request for arbitration was based on the original license agreement entered into by LGLS and Cornerstone Therapeutics, Inc. (now Chiesi USA, Inc.). The request for arbitration named Merus as a respondent together with Cornerstone and Vansen Pharma, Inc. The request for arbitration included the allegation that Cornerstone did not have the legal right to transfer the Factive product to Merus. LGLS sought an award for damages relating to an alleged breach of contract, as well as disgorgement of revenue and other benefits derived by us from sales of Factive. The Company has successfully defended this claim. Additionally, Merus and Cornerstone have each asserted claims against one another, seeking indemnity and damages related to LGLS’s claim. These claims have also been resolved. The Company has contingent liabilities remaining however in the form of (i) the cost of damages incurred by LGLS resulting from Vansen’s failure to return the license to sell Factive to LGLS; and (ii) Merus’ indemnification of Cornerstone’s liability under the Factive asset purchase agreement that may include the cost of reimbursing wholesalers for expired goods on behalf of Cornerstone, the cost of paying for government reimbursement programs on behalf of Cornerstone, and legal costs incurred by Cornerstone to defend themselves against LGLS’s original claim. The Company is assessing its legal options relative to these claims and will challenge the merit of each claim, the amounts claimed, and the Company’s responsibility under each claim as appropriate.

(Expressed in Canadian dollars)

(c) Revenue based commitments

Pursuant to the Company's exclusive license agreement with EISAI, the Company is subject to a royalty fee of 20% based on the net sales of Salagen.

Pursuant to the Company's technology transfer and manufacturing agreement with a contract manufacturer, the Company is subject to a royalty fee based on the capsule volume of Vancocin sold.

(d) Purchase commitments

Pursuant to the Company's raw materials supply agreement with a contract manufacturer, the Company is committed to purchasing approximately $485,000 of product per calendar year from 2016 to 2023.

11. Related party transactions

At June 30, 2016, there were no amounts owing to or from related parties. The remuneration of directors and other members of key management personnel recorded in the general and administrative line of operating expenses are as follows:

	Three months ended June 30		**Nine months ended June 30**	
	2016	2015	**2016**	2015
Salaries	**$ 815,889**	$ 320,519	**$ 1,884,568**	$ 1,159,311
Share based compensation	**476,717**	600,942	**2,052,112**	2,036,464
	$ 1,292,606	$ 921,461	**$ 3,936,680**	$ 3,195,745

12. Income taxes

The major components of income tax expense for the three and nine months ended June 30, 2016 and 2015 are:

	Three months ended June 30		**Nine months ended June 30**	
	2016	2015	**2016**	2015
Income tax recognized in statements of operations				
Current tax	**$ 199,728**	$ 118,616	**$ 461,166**	$ 370,948
Provision for income taxes	**$ 199,728**	$ 118,616	**$ 461,166**	$ 370,948

The Company has recognized an estimated current tax expense based on an approximation of tax liabilities due with respect to its operations in Luxembourg.

(Expressed in Canadian dollars)

13. Management of capital

The Company includes the following in its definition of capital:

	June 30 2016	September 30 2015
Debt comprised of:		
Secured facility	**$ 153,860,102**	$ 62,712,009
Preferred shares	**9,947,730**	9,947,730
Equity comprised of:		
Share capital	**210,756,585**	184,534,553
Equity reserve	**38,583,768**	37,215,779
Deficit and AOCI	**(55,036,006)**	(40,952,882)
	$ 358,112,179	$ 253,457,189

The Company's objectives when managing capital are:

(a) to allow the Company to respond to changes in economic and/or marketplace conditions;

(b) to give shareholders sustained growth in shareholder value by increasing shareholders' equity;

(c) to ensure that the Company maintains the level of capital necessary to meet the requirements of its long-term debt;

(d) to comply with financial covenants required under its debt facilities; and

(e) to maintain a flexible capital structure which optimizes the cost of capital at acceptable levels of risk

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. The Company maintains or adjusts its capital level to enable it to meet its objectives by:

(a) raising capital through equity financings;

(b) utilizing leverage in the form of third party debt; and

(c) realizing proceeds from the disposition of its investments

The Company is not subject to any capital requirements imposed by a regulator. The Company is subject to certain capital requirements and negative covenants with respect to its Senior Secured Facility (refer to note 7). There were no changes in the Company's approach to capital management during the year. To date, the Company has not declared any cash dividends to its common shareholders as part of its capital management program. The Company's management is responsible for the management of capital and monitors the Company's use of various forms of leverage on a regular basis.

(Expressed in Canadian dollars)

14. Financial instruments and financial risk management

a) Fair Value Estimation

The Company's carrying value of cash and cash equivalents, short-term investments, trade and other receivables, and accounts payable and accrued liabilities approximate their fair values due to the immediate or short term maturity of these instruments. The fair value of long-term liabilities is not materially different than its carrying value due to the recent issuance of these liabilities.

Carrying value and fair value of financial assets and liabilities are summarized as follows:

Classification	**Carrying value**	**June 30, 2016** **Fair value**
Financial assets at FVTPL	**$**	**$**
- Short-term investments	**3,108**	**3,108**
Loans and receivables		
- Cash and cash equivalents	**3,942,145**	**3,942,145**
- Trade and other receivables	**21,883,879**	**21,883,879**
Other financial liabilities		
- Accounts payable and accrued liabilities	**9,199,430**	**9,199,430**
- Operating line	**5,000,000**	**5,000,000**
- Long term debt	**148,860,102**	**152,260,820**
Financial liabilities at FVTPL		
- Derivative liabilities	**862,833**	**862,833**

Classification	Carrying value	September 30, 2015 Fair value
Financial assets at FVTPL	$	$
- Short-term investments	3,234	3,234
Loans and receivables		
- Cash and cash equivalents	40,987,177	40,987,177
- Trade and other receivables	14,202,624	14,202,624
Other financial liabilities		
- Accounts payable and accrued liabilities	8,314,307	8,314,307
- Long term debt	62,712,009	64,000,000
Financial liabilities at FVTPL		
- Derivative liabilities	893,666	893,666

(Expressed in Canadian dollars)

The Company is required to present information about its financial assets and liabilities with respect to the hierarchy of the valuation techniques the Company utilized to determine fair value. The different levels have been defined as follows:

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves
- Level 3 inputs are unobservable data points for the asset or liability, and includes situations where there is little, if any, market activity for the asset or liability.

At June 30, 2016, the Company's financial assets and liabilities would be classified as follows:

	June 30, 2016	Significant Observable Inputs (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Short-term investments	**$ 3,108**	$ 3,108	$ -	$ -
	$ 3,108	$ 3,108	$ -	$ -
Liabilities:				
Derivative liabilities	**$ 862,833**	$ -	$ 862,833	$ -
	$ 862,833	$ **-**	$ 862,833	**$ -**

At September 30, 2015, the Company's financial assets and liabilities would be classified as follows:

	September 30, 2015	Significant Observable Inputs (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Short-term investments	$ 3,234	$ 3,234	$ -	$ -
	$ 3,234	$ 3,234	$ -	$ -
Liabilities:				
Derivative liabilities	$ 893,666	$ -	$ 893,666	$ -
	$ 893,666	$ -	$ 893,666	$ -

The fair value of financial instruments traded in active markets is based on quoted market prices at the statement of financial position date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

(Expressed in Canadian dollars)

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

If one or more significant inputs are not based on observable market data, the instrument is included in Level 3.

b) Financial Risk Factors

The use of financial instruments can expose the Company to several risks, including market, credit and liquidity risks. Apart from the risks listed below, management is of the opinion that they are not exposed to any other significant risks. A discussion of the Company's use of financial instruments and its risk management is provided below.

(i) Liquidity risk

Liquidity risk is the risk that the Company will not have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital markets is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company. In order to mitigate this risk, the Company maintains a sufficient cash balance in order to satisfy short-term liabilities as they come due and actively pursues raising capital through various public and private financing mechanisms to satisfy longer term needs.

The table below analyzes the Company's non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows and do not include capitalized transaction costs.

				Year ended September 30
At June 30, 2016	**2016**	**2017**	**2018**	**Thereafter**
Operating line	$ 5,000,000			
Debt	8,013,727	$ 32,054,909	$ 32,054,909	$ 80,137,275
Accounts payable and accrued liabilities	9,369,922	-	-	-
Income taxes payable	478,620	-	-	-
Total	**$ 22,862,269**	**$ 32,054,909**	**$ 32,054,909**	**$ 80,137,275**

			Year ended September 30	
At September 30, 2015	**2015**	**2016**	**2017**	**Thereafter**
Debt	$ 16,000,000	$ 16,000,000	$ 16,000,000	$ 16,000,000
Accounts payable and accrued liabilities	8,314,307	-	-	-
Income taxes payable	1,150,791	-	-	-
Total	**$ 25,465,098**	**$ 16,000,000**	**$ 16,000,000**	**$ 16,000,000**

(ii) Market risk:

Market risk is the risk that the fair value of, or future cash flows from, the Company's financial instruments will significantly fluctuate because of changes in market prices. The value of the financial instruments can be affected by changes in interest rates, foreign exchange rates, and equity and commodity prices. The Company is not exposed to significant market risk given the low value of its investments.

(iii) Currency risk:

The Company is subject to currency risk through its sales of products denominated in foreign currencies, purchases of inventory in US dollars and product acquisitions denominated in foreign currencies. As such, changes in the exchange rate affect the operating results of the Company. Dependent on the nature, amount and timing of foreign currency receipts and payments, the Company may from time to time enter into foreign currency derivative contracts to reduce its exposure to foreign currency risk as discussed in note 3.

The following significant monetary financial assets and liabilities were denominated in foreign currencies at June 30, 2016 (U.S. dollar 1.2917, Euro 1.4354, British pound 1.7305, Swiss franc 1.3458) and September 30, 2015 (U.S. dollar 1.3345, Euro 1.4951, British pound 2.0244, Swiss franc 1.3704):

	June 30 2016	September 30 2015
Canadian Dollar Equivalent :		
Denominated in US dollars	**$ (1,083,271)**	$ 17,778,635
Denominated in Euros	**(141,708,989)**	13,102,315
Denominated in British pounds	**2,044,485**	732,432
Denominated in Swiss francs	**317,249**	(68,211)
Hedge contracts denominated in Euros	**-**	(23,921,600)
Net (liabilities) assets denominated in foreign currencies	**$ (140,430,526)**	$ 7,623,571

(Expressed in Canadian dollars)

The following table shows the estimated sensitivity of the Company's total comprehensive gain (loss) for the period ended June 30, 2016 from a change in foreign currencies with all other variables held constant as at June 30, 2016:

Percentage change in foreign currencies	Change in net after-tax gain from % increase in foreign currencies	Change in net after-tax loss from % decrease in foreign currencies
2%	$ (2,800,669)	$ 2,800,669
4%	(5,601,337)	5,601,337
6%	(8,402,006)	8,402,006
8%	(11,202,674)	11,202,674
10%	(14,003,343)	14,003,343

(iv) Credit risk:

Certain of the Company's financial assets, including cash and cash equivalents and short-term investments are exposed to the risk of financial loss occurring as a result of default of a counterparty on its obligations to the Company. The Company may, from time to time, invest in debt obligations. The Company is also exposed, in the normal course of business, to credit risk from customer receivables. These amounts are continually monitored by management for collectability, and, in general, are lower risk as they are typically due from large institutions or multinational distributors.

(v) Interest rate risk:

Merus has significant current and long-term debt in the form of our senior secured debt which currently bears interest at a floating interest rate (Euribor plus 4.5%) and will incur greater interest expenses if the Euribor rate rises. Management has reduced this risk by entering into an interest rate swap arrangement as allowed for through facilities in its credit agreement. Interest rate swaps effectively fix the interest rate on the debt to which they are applied. At June 30, 2016, Merus had interest rate swaps applied to approximately 50% of its debt and it is management's opinion that Merus is not exposed to significant interest rate risk at this time.

(Expressed in Canadian dollars)

15. Segment information

The Company operates in a single reportable segment focused on acquiring, in-licensing, marketing and distributing pharmaceutical products in Canada and internationally. The Company carries out business principally in Canada and Europe.

Revenues by geographic region are detailed as follows:

	Three months ended June 30		Nine months ended June 30	
	2016	2015	**2016**	2015
Canada	**$ 1,400,913**	$ 1,495,017	**$ 4,360,426**	$ 4,878,053
International	**24,256,074**	8,010,466	**56,925,965**	27,935,893
	$ 25,656,987	$ 9,505,483	**$ 61,286,391**	$ 32,813,946

Other than Canada, the Company derived more than 10% of its revenues in the nine months ended June 30, 2016 or nine months ended June 30, 2015 period from Germany and Spain. Revenues in Germany of $8,865,184 (2015: $8,255,964) and Spain of $14,276,769 (2015: $4,983,633) are included in International in the table above.

Long-term assets by geographic region are comprised of product rights and patents and property and equipment, detailed as follows:

	June 30	September 30
	2016	2015
Canada	**$ 2,339,716**	$ 2,979,402
International	**329,547,086**	198,679,093
	$ 331,886,802	$ 201,658,495

16. Prior period reclassification

Preferred Shares

During the year ended September 30, 2014, the Company issued $10,000,000 of Series A convertible preferred shares (see note 12). The preferred shares pay a dividend of 8% per annum, subject to adjustments after October 31, 2019 as described in note 9. The preferred shares were originally treated as a component of equity. Due to the non-discretionary nature of the dividends, it was determined that the entire instrument should have been treated as a liability from inception. Accordingly, the fair value of the instrument at inception should be recorded as a liability. Any dividends declared should be recorded through profit and loss. The comparatives of the prior period have been adjusted to reflect this.

Foreign Exchange Losses (Gains) and Derivative Losses (Gains)

The Company enters into forward foreign exchange contracts from time to time to hedge its foreign currency exposures. Historically, the Company has included any gains and losses with respect to the settlement and fair value mark-to-market adjustments of these contracts in the foreign exchange losses (gains) line on the statement of operations. To conform to the authoritative guidance and industry practise, certain amounts have been reclassified from foreign exchange gains to derivative losses (gains) in the prior year to conform to current year presentation. There has been no impact to net income or deficit as a result of this reclassification.

Selling and Marketing and General and Administrative Expenses

The operating expense line item sales and marketing in the Company's statement of operations has historically included any direct marketing activities related to the Company's products (e.g. sales force, marketing materials, conferences, etc.). The operating expense line item general and administrative however has historically combined all other expenses related to the Company's products (i.e. distribution, customs, regulatory, IP maintenance, third-party logistics/warehousing, etc.) as well as traditional general and administrative costs associated with the Company's administrative operations (i.e. salaries and benefits, professional and consulting fees, public company costs, travel, leases, share-based-compensation, etc.).

Based on Management's internal approach for analysing the Company's financial performance as well as feedback from investors and analysts, Management has determined that the relevance, reliability, and comparability of the Company's financial statements can be improved by reclassifying all costs directly related to the selling and marketing function for the Company's products from general and administrative to selling and marketing expenses. Further, the addition of a separate line for share-based compensation in the statement of operations will further improve the relevance and reliability of the general and administrative expense line item. There has been no impact to net income or deficit as a result of this reclassification.

Thus, certain amounts have been reclassified from general and administrative to selling and marketing and share-based compensation in the prior year to conform to current year presentation.

(Expressed in Canadian dollars)

Impact of Reclassification

The impact of the above reclassification adjustments have been summarized below. These reclassification adjustments impact net income (loss) and by extension equity (accumulated deficit only), therefore adjustments to the statement of equity have also been disclosed.

For the three months ended June 30, 2015	As previously reported	Adjustment	As restated
Statement of Operations:			
Revenues	$ 9,505,483	-	$ 9,505,483
Cost of goods sold	812,503	-	812,503
Gross margin	8,692,980	-	8,692,980
Operating expenses:			
Selling and marketing	252,332	379,173	631,505
General and administrative	2,686,567	(980,115)	1,706,452
Share-based compensation	-	600,942	600,942
Amortization of intangible assets	6,165,104	-	6,165,104
Depreciation	3,833	-	3,833
Foreign exchange gains	(83,068)	(101,268)	(184,336)
	9,024,768	(101,268)	8,923,500
Operating income (loss)	(331,788)	101,268	(230,520)
Interest expense, net	1,155,890	201,644	1,357,534
Derivative losses (gains)	-	101,268	101,268
Investment income	(46)	-	46
Loss before income taxes	(1,487,724)	(201,644)	(1,689,368)
Income tax expense	118,616	-	118,616
Net loss for the period	$ (1,606,340)	(201,644)	$ (1,807,984)

(Expressed in Canadian dollars)

For the Nine months ended June 30, 2015	As previously reported	Adjustment	As restated
Statement of Operations:			
Revenues	$ 32,813,946	-	$ 32,813,946
Cost of goods sold	3,515,261	-	3,515,261
Gross margin	29,298,685	-	29,298,685
Operating expenses:			
Selling and marketing	737,831	843,711	1,581,542
General and administrative	7,293,857	(2,880,175)	4,413,682
Share-based compensation	-	2,036,464	2,036,464
Amortization of intangible assets	17,853,026	-	17,853,026
Depreciation	11,524	-	11,524
Foreign exchange gains	(1,445,584)	33,108	(1,412,476)
	24,450,654	33,108	24,483,762
Operating income	4,848,031	(33,108)	4,814,923
Interest expense, net	4,135,300	602,740	4,738,040
Derivative losses (gains)	-	(33,108)	(33,108)
Investment income	(566)	-	(566)
Income (loss) before income taxes	713,297	(602,740)	110,557
Income tax expense	370,948	-	370,948
Net income (loss) for the period	$ 342,349	(602,740)	$ (260,391)

For the Nine months ended June 30, 2015	As previously reported	Adjustment	As restated
Statement of Changes in Equity (Accumulated deficit)			
Balance, September 30, 2014	**$ (61,033,735)**	**-**	**$ (61,033,735)**
Net income for the period	342,349	(602,740)	(260,391)
Dividends to preferred shareholders	(602,740)	602,740	-
Balance, June 30, 2015	**$ (61,294,126)**	**-**	**$ (61,294,126)**

17. Net Investment in Foreign Operation

The Company previously recognized any foreign exchange gains and losses on its intercompany loans in other comprehensive income as it considered these amounts as part of its net investment in a foreign operation. These intercompany loans have since been started to be repaid and as such the Company expects that going forward they will be settled. Accordingly, these loans no longer meet the definition of a net investment in a foreign operation under IAS 21. Prospectively, any foreign exchange gains and losses on these loans will be recorded through net income. Any historical amounts ($9,822,703 accumulated gain) recorded will be recycled out of AOCI on the disposal of the foreign operations.