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Capha Pharmaceuticals Inc.  
(formerly FPS Pharma Inc.)  
Consolidated Financial Statements  
For the years ended December 31, 2016 and 2015  
(Expressed in United States Dollars)

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## Independent Auditor's Report

To the Shareholders of Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

We have audited the accompanying consolidated financial statements of Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.), which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, and the consolidated statements of comprehensive income (loss), consolidated statements of changes in equity and consolidated statements of cash flows for the years ended December 31, 2016 and December 31, 2015, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.) as at December 31, 2016 and December 31, 2015, and its financial performance and its cash flows for the years ended December 31, 2016 and December 31, 2015 in accordance with International Financial Reporting Standards.



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## Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about Capha Pharmaceuticals Inc.'s (formerly FPS Pharma Inc.) ability to continue as a going concern.

Vancouver, B.C.  
April 28, 2017

*"D&H GROUP LLP"*

Chartered Professional Accountants

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Consolidated Statements of Financial Position

(Expressed in United States Dollars)

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	December 31, 2016 \$	December 31, 2015 \$
<hr/>		
Assets		
Current assets		
Cash	2,990	463,473
Amounts receivable (Note 6)	-	26,145
Prepaid expenses	-	55,202
	<u>2,990</u>	<u>544,820</u>
Equipment (Note 7)	<u>1,402</u>	<u>14,095</u>
	<u>4,392</u>	<u>558,915</u>
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Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (Note 12)	75,141	38,990
Loan payable (Note 12)	114,805	-
Warrant liability (Note 10)	348	38,742
	<u>190,294</u>	<u>77,732</u>
Shareholders' equity		
Share capital (Note 9)	10,883,164	10,883,164
Share-based payment reserve	3,465,384	3,465,384
Currency translation reserve	42,462	42,462
Deficit	<u>(14,576,912)</u>	<u>(13,909,827)</u>
	<u>( 185,902)</u>	<u>481,183</u>
	<u>4,392</u>	<u>558,915</u>
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Nature of operations and going concern (Note 1)

Contingent liability (Note 15)

Events after the reporting period (Note 16)

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

These consolidated financial statements were approved for issue by the Board of Directors on April 28, 2017 and are signed on its behalf by:

/s/ James R. Brown, Director  
*James R. Brown*

/s/ Janice Brown, Director  
*Janice Brown*

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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	2016	2015
	\$	\$
Expenses		
Consulting	128,435	127,000
Depreciation of equipment	2,767	2,040
Investor relations	25,338	24,000
Management fees	180,000	222,000
Office and miscellaneous	89,697	72,287
Office services	10,000	144,700
Professional fees	79,134	112,437
Share-based compensation	-	196,272
Transfer agent fees and regulatory fees	14,631	33,284
Travel and meals	<u>144,753</u>	<u>86,068</u>
Loss before other items	<u>(674,755)</u>	<u>(1,020,088)</u>
Other items		
Impairment of exploration and evaluation assets (Note 8)	-	(355,960)
Change in fair value of warrant liability	38,395	(38,743)
Gain on forgiveness of loan (Note 1)	-	1,527,750
Write-off of assets (Note 1)	(42,572)	-
Other income	14,087	-
Foreign exchange loss	<u>(2,240)</u>	<u>(4,075)</u>
	<u>7,670</u>	<u>1,128,972</u>
Net income (loss) for the year	(667,085)	108,884
Other comprehensive income for the year		
Foreign currency translation	-	12,802
Comprehensive income (loss) for the year	<u>(667,085)</u>	<u>121,686</u>
Loss per common share	<u>(0.01)</u>	<u>-</u>
Weighted average number of common shares outstanding	54,431,030	55,225,001

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

# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Consolidated Statements of Changes in Equity

For the years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

	Common shares		Share-based payment reserve \$	Currency translation reserve \$	Deficit \$	Total equity \$
	Number of shares	Amount \$				
Balance at December 31, 2014	53,977,030	10,861,349	3,279,857	29,660	(14,018,711)	152,155
Common shares issued for:						
Options exercised	454,000	21,815	(10,745)	-	-	11,070
Share-based compensation	-	-	196,272	-	-	196,272
Net income (loss) for the year	-	-	-	-	108,884	108,884
Other comprehensive income	-	-	-	12,802	-	12,802
Balance at December 31, 2015	54,431,030	10,883,164	3,465,384	42,462	(13,909,827)	481,183
Net income (loss) for the year	-	-	-	-	(667,085)	(667,085)
Balance at December 31, 2016	54,431,030	10,883,164	3,465,384	42,462	(14,576,912)	(185,902)

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

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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	2016	2015
	\$	\$
Cash flows from (used in) operating activities		
Net income (loss) for the year	(667,085)	108,884
Items not affecting cash		
Depreciation of equipment	2,767	2,040
Share-based compensation	-	196,272
Impairment of exploration and evaluation assets	-	355,960
Change in warrant liability	(38,395)	38,743
Gain on forgiveness of debt	-	(1,527,750)
Disposal of equipment	9,927	-
Changes in non-cash working capital		
Decrease (increase) in		
Amounts receivable	26,145	(14,308)
Prepaid expenses	55,202	(55,202)
Increase (decrease) in		
Accounts payable and accrued liabilities	<u>36,151</u>	<u>(118,884)</u>
	<u>(575,288)</u>	<u>(1,014,245)</u>
Cash flows from (used in) investing activities		
Purchase of equipment	-	(13,713)
Expenditures on exploration and evaluation assets	<u>-</u>	<u>(10,201)</u>
	<u>-</u>	<u>(23,914)</u>
Cash flows from financing activities		
Issuance of common shares	-	11,070
Loan from shareholder	114,805	(53,005)
Loan proceeds	<u>-</u>	<u>1,527,750</u>
	<u>114,805</u>	<u>1,485,815</u>
Increase (decrease) in cash during the year	(460,483)	447,656
Effect of exchange rate	-	12,802
Cash, beginning of year	<u>463,473</u>	<u>3,015</u>
Cash, end of year	2,990	463,473

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

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 1. Nature of operations and going concern

Capha Pharmaceuticals Inc. (hereafter referred to as the "Company" or "Capha") is incorporated under the laws of the Province of British Columbia and was formed as a result of an amalgamation on September 1, 2004. On January 16, 2017, the Company changed its name from FPS Pharma Inc. to Capha Pharmaceuticals Inc.

The Company's corporate office is located at:

Suite 324 - 4205 Gellatly Road  
West Kelowna, BC V4T 2K2  
Canada

During 2015, the Company determined to cease carrying on a mineral exploration business. The Company's existing mineral exploration agreement was terminated and all related carrying costs were written off. The Company began exploring opportunities in the pharmaceutical distribution business.

During 2015, the Company attempted to acquire a 100% equity interest in Florida Pharmacy Solutions, Inc. ("FPSI"). FPSI was based in Florida, United States of America, and carried on a pharmacy compounding business. The Company was ultimately not successful in completing the acquisition. As part of the attempted acquisition, the Company received net loans of \$ 1,527,750, which were forgiven as partial consideration for the Company ceasing to pursue the acquisition. The Company also received reimbursement of certain legal and other expenses it had incurred.

During 2015, the Company incorporated a subsidiary in Hong Kong, called FPS Pharma Asia Limited and set up offices in Asia. All offices in Asia were closed in December 2016 and the Company recognized a write-off of \$ 42,572 relating to prepaid expenses and equipment.

As at December 31, 2016, the Company had a working capital deficit of \$ 187,304 and an accumulated deficit of \$ 14,576,912. These financial statements have been prepared on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business. These financial statements do not include any adjustment for the recoverability and classification of assets and classification of liabilities that might be necessary, should the Company be unable to continue as a going concern.

### 2. Basis of presentation

#### Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the IFRS Interpretations Committee ("IFRIC").

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 2. Basis of presentation - continued

#### Details of the group

In addition to the Company, the consolidated financial statements include a subsidiary. Subsidiaries are corporations over which the Company is able, directly or indirectly, to control financial and operating policies, which is the authority usually connected with holding majority voting rights. Subsidiaries are fully consolidated from the date on which control is acquired by the Company. Inter-company transactions and balances are eliminated upon consolidation. They are de-consolidated from the date that control by the Company ceases

As at December 31, 2016, the Company's subsidiary is as follows:

§ FPS Pharma Asia Limited, Hong Kong - 100% owned

#### Foreign currency translation

##### *Functional and presentation currency*

Historically, the Company's functional currency and its financial statements have been presented in Canadian dollars. In August 2015, its functional currency changed to United States dollars and its financial statements are now presented in United States dollars for the following reasons:

- i) Functional currency is defined in International Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* ("IAS 21") as the "currency of the primary economic environment in which the entity operates." In determining functional currency, the more United States dollar-related exposure an entity has, the more likely the United States dollar is the entity's functional currency;
- ii) A major factor that venture companies use to access their functional currency under IAS 21, where they don't have the factors referred to in paragraph 9 of IAS 21, is their sources of financing as noted in paragraph 10a of IAS 21. Where there aren't "operations" in the sense of revenue and expenses, other factors such as financing are considered. The Company's most recent financing was comprised mainly of the United States dollar;
- iii) Other factors in determining the Company's functional currency include the fact that:
  - a. the vast majority of the Company's expenses are denominated in United States dollars (e.g. management fees, office services and rent). The Company's only expenses denominated in Canadian dollars are its legal, accounting, transfer agent and regulatory fees; and
  - b. the Company's common shares have been listed for trading on the CSE in United States dollars, and future share issuances would likely be United States dollar-denominated as a consequence; and
  - c. The Company notes that the proceeds received from the United States dollar denominated loan continue to be held in United States dollars and have not been converted to Canadian dollars other than as necessary to pay for Canadian dollar denominated expenses noted in subparagraph (a) above. The Company is of the view that the United States dollar will continue to be the appropriate functional currency given management's current plans and intentions.

The Company's financial statements have accordingly been converted to United States dollars on a retrospective basis using historical exchange rates. Foreign exchange gains and losses resulting from the conversion are recognized in comprehensive loss.

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 2. Basis of presentation - continued

#### *Foreign currency transactions*

Foreign currency transactions are translated into the functional currency using the exchange rates published by the Bank of Canada and prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, at year end exchange rates, of monetary assets and liabilities dominated in foreign currencies are recognized in comprehensive loss.

### 3. Summary of significant accounting policies

#### Basis of measurement

The Company's financial statements have been prepared on the historical cost basis except for the revaluation of certain financial assets and financial liabilities to fair value.

#### Critical judgments and sources of estimation uncertainty

The preparation of these financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### *Critical judgments*

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the financial statements:

- i) The determination of categories of financial assets and financial liabilities has been identified as an accounting policy which involves judgments or assessments made by management.
- ii) The assessment of the probability of future taxable income in which deferred tax assets can be utilized is based on the Company's estimates of future profits or losses adjusted for significant non-taxable income and expenses and specific limits to the use of any unused tax loss or credit. If a positive forecast of taxable income indicates the probable use of a deferred tax asset, especially when it can be utilized without a time limit, that deferred tax asset is usually recognized in full. The recognition of deferred tax assets that are subject to certain legal or economic limits or uncertainties is assessed individually by management based on the specific facts and circumstances.
- iii) Management is required to assess the functional currency of each entity of the Company. (See Note 2).

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 3. Summary of significant accounting policies - continued

#### *Estimation uncertainty*

The following are key assumptions concerning the future and other key sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year:

- i) Provisions for income taxes are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period; however, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were originally recorded, such differences will affect the tax provisions in the period in which such determination is made.
- ii) Depreciation expense is allocated based on assumed asset lives. Should the asset life differ from the initial estimate, an adjustment would be made in the consolidated statements of comprehensive loss.
- iii) Warrants issued with exercise prices denominated in currency other than the Company's functional currency meet the definition of derivatives and are therefore classified as derivative liabilities measured at fair value with adjustments to fair value recognized through net income (loss). The fair value of the warrants is estimated using the Black-Scholes option pricing model at the end of each reporting period. Such estimates are subject to change each period and the differences will affect the warrant liability provision in the period in which the estimate is made.

#### Cash

Cash includes cash in bank and demand deposits.

#### Amounts receivable

Receivables are recognized initially at fair value and are subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

#### Accounts payable and accrued liabilities

Payables are obligations to pay for materials or services that have been acquired in the ordinary course of business from suppliers. Payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Payables are classified as other financial liabilities and are initially measured at fair value and are subsequently measured at amortized cost using the effective interest method.

#### Equipment

Equipment is recorded at historical cost less depreciation and, where necessary, write-downs for impairment. Depreciation is calculated using the declining-balance method at the following annual rates:

Office equipment	-	20%
Computer equipment	-	30%

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 3. Summary of significant accounting policies - continued

#### Impairment of long-lived assets

Impairment tests for long-lived assets are performed when there is an indication of impairment. At each reporting date, an assessment is made to determine whether there are any indications of impairment. If any indication of impairment exists, an estimate of the long-lived assets recoverable amount is calculated. The recoverable amount is determined as the higher of the fair value less direct costs to sell and the asset's value in use. If the carrying value of a long-lived asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to profit and loss so as to reduce the carrying amount of the long-lived asset to its recoverable amount.

#### Revenue recognition

Interest income is recognized as earned, provided that collection is assessed as being reasonably assured.

#### Financial instruments

##### *Financial assets*

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held to maturity, available for sale, loans and receivables or at fair value through profit or loss.

Financial assets classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized through comprehensive loss. Cash is classified as fair value through profit and loss.

Financial assets classified as loans and receivables and held to maturity are measured at amortized cost. Amounts receivable are classified as loans and receivables.

Financial assets classified as available for sale are measured at fair value with unrealized gains and losses recognized in other comprehensive loss except for losses in value that are considered other than temporary. At December 31, 2016, the Company has not classified any financial assets as available for sale.

Transaction costs associated with financial assets at fair value through profit or loss are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

##### *Financial liabilities*

All financial liabilities are initially recorded at fair value and designated upon inception as fair value through profit or loss or other financial liabilities.

Financial liabilities classified as other financial liabilities are measured at amortized cost. Accounts payable and accrued liabilities and loan payable are classified as other financial liabilities.

Financial liabilities classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized through comprehensive loss. Warrant liability is classified as fair value through profit or loss.

#### Share capital

Common shares issued by the Company are classified as equity. Costs directly attributable to the issue of common shares, share purchase warrants and share options are recognized as a deduction from equity, net of any related income tax effects.

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 3. Summary of significant accounting policies - continued

#### Private placements

The Company engages in equity financing transactions to obtain the funds necessary to continue operations. These equity financing transactions may involve issuance of common shares or units. Units are typically comprised of common shares and share purchase warrants. Depending on the terms and conditions of each equity financing transaction, the warrants are exercisable into additional common shares at a price prior to expiry as stipulated by the terms of the transaction. The Company has adopted a residual value method with respect to the measurement of common shares and share purchase warrants issued as private placement units. The fair value of the common shares issued in the private placements is determined by the closing quoted bid price on the announcement date. The balance, if any, is allocated to the attached share purchase warrants.

#### Share-based payments

The fair value, at the grant date, of equity-settled share-based awards is charged to comprehensive loss over the period for which the benefits of employees and others providing similar services are expected to be received. The corresponding accrued entitlement is recorded in the share-based payment reserve. The fair value of awards is calculated using an option pricing model which considers the following factors:

- Exercise price
- Expected volatility
- Risk-free interest rate
- Expected life of the award
- Current market price of the underlying shares
- Expected forfeitures

For employees the fair value is measured at the grant date and each tranche is recognized separately on a straight line basis over the period during which the share options vest. The fair value of the share options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share options were granted. At the end of each reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Share-based payment transactions with non-employees are measured at the fair value of the goods or services received. However, if the fair value cannot be estimated reliably, the share-based payment transaction is measured at the fair value of the equity instruments granted at the date the non-employee provides the goods or the services.

#### Income taxes

Income tax expense is comprised of current and deferred income taxes. Current and deferred income taxes are recognized in comprehensive loss, except to the extent that it relates to items recognized directly in equity or other comprehensive income (loss).

Current income taxes, if any, is the expected amount payable or receivable on the taxable income or loss for the year, calculated in accordance with applicable taxation laws and regulations, using income tax rates enacted or substantively enacted at the end of the reporting year, and any adjustments to amounts payable or receivable relating to previous years.

Deferred income taxes are provided using the liability method based on temporary differences arising between the income tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred income taxes are determined using income tax rates and income tax laws that have been enacted or substantially enacted at the end of the reporting period and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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# Cappha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 3. Summary of significant accounting policies - continued

Deferred income tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized.

#### Loss per share

Basic and diluted loss per share is determined by dividing the loss attributable to common shareholders by the weighted average number of common shares outstanding during the reporting period. Diluted loss per share is not separately presented, as the effect of securities exercisable into common shares would reduce the amount presented as loss per share.

#### New standards and interpretations not yet adopted

The following is an overview of accounting standard changes that the Company will be required to adopt in future years. The Company does not expect to adopt any of these standards before their effective dates. The Company continues to evaluate the impact of these standards on its financial statements.

*IFRS 9 - Financial Instruments.* This standard partially replaces IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 measures financial assets, after initial recognition, at either amortized cost or fair value. Existing IAS 39 classifies financial assets into four measurement categories. The standard is effective for annual periods beginning on or after January 1, 2018. In the year of adoption, the Company is required to provide additional disclosures relating to the reclassified financial assets and liabilities. The Company may, but is not required to, apply the standard retroactively. In and after the year of adoption, certain disclosures relating to financial assets will change to conform to the new categories.

*IFRS 15 - Revenue from Contracts with Customers.* The standard is effective for annual periods beginning on or after January 1, 2018. IFRS 15 specifies how and when to recognize revenue as well as requires entities to provide users of financial statements with more informative, relevant disclosures. The standard supersedes IAS 18 - *Revenue*, IAS 11 - *Construction Contracts*, and a number of revenue-related interpretations. The new standard will apply to nearly all contracts with customers; the main exceptions are leases, financial instruments and insurance contracts.

*IFRS 16 - Leases.* This standard is effective for annual periods beginning on or after January 1, 2019. IFRS 16 specifies how and when to recognize, measure, present, and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance. The standard supersedes IAS 17 - *Leases*.

### 4. Capital risk management

The Company manages, as capital, the components of shareholders' equity. The Company's objectives, when managing capital, are to safeguard its ability to continue as a going concern.

The Company manages its capital structure, and makes adjustments to it, in light of changes in economic conditions and the risk of characteristics of the underlying assets. To maintain or adjust its capital structure, the Company may attempt to issue common shares, borrow and acquire or dispose of assets.

In order to maximize ongoing exploration efforts, the Company does not pay out dividends. The Company's policy is to invest its excess cash, if any, in highly liquid, short-term, interest-bearing investments with maturities of one year or less from the date of acquisition.

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# Cappha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 5. Financial instruments

#### Fair value

IFRS 7 establishes a fair value hierarchy, for financial instruments measured at fair value that reflects the significance of inputs in making fair value measurement as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly (i.e. as prices) or indirectly (i.e. from derived prices); and
- Level 3 - inputs for the asset or liability that are not based upon observable market data

The recorded amounts for amounts receivable, accounts payable and accrued liabilities and loan payable approximate their fair value due to their short-term natures. The fair value of cash and warrant liability under the fair value hierarchy is determined using Level 1 and Level 2 inputs respectively.

#### Financial risk management objectives and policies

The Company's financial instruments include cash, amounts receivable, accounts payable and accrued liabilities, warrant liability and loan payable. The risk associated with these financial instruments and the policies regarding their management are discussed below. Management monitors these risk exposures to ensure appropriate measures are implemented in a timely and effective manner.

#### Interest rate risk

The Company is not exposed to significant interest rate risk.

#### Credit risk

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to cash and amounts receivable. Management believes that the credit risk concentration with respect to financial instruments included in cash and amounts receivable is remote.

6. Amounts receivable	December 31, 2016 \$	December 31, 2015 \$
Canadian Goods & Services Tax	-	8,957
Other	<u>-</u>	<u>17,188</u>
	-	26,145

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

7. Equipment	2016 \$		
	Computer Equipment	Office Equipment	Total
Cost:			
Balance, December 31, 2015	24,977	16,678	41,655
Sale of equipment	(2,400)	(4,000)	(6,400)
Write-off	-	(7,314)	(7,314)
Balance, December 31, 2016	22,577	5,364	27,941
Depreciation and cumulative impairment loss:			
Balance, December 31, 2015	21,971	5,589	27,560
Sale of equipment	(819)	(940)	(1,759)
Write-off	-	(2,029)	(2,029)
Depreciation	749	2,018	2,767
Balance at December 31, 2016	21,901	4,638	26,539
Carrying value at December 31, 2016	676	726	1,402
			2015 \$
	Computer Equipment	Office Equipment	Total
Cost:			
Balance, December 31, 2014	22,577	5,364	27,941
Additions	2,400	11,314	13,714
Balance, December 31, 2015	24,977	16,678	41,655
Depreciation and cumulative impairment loss:			
Balance, December 31, 2014	21,197	4,230	25,427
Depreciation	774	1,359	2,133
Balance at December 31, 2015	21,971	5,589	27,560
Carrying value at December 31, 2015	3,006	11,089	14,095

## 8. Exploration and evaluation assets

The Company's only exploration and evaluation asset was the Croxall Property located in Northern Ontario under an option and joint venture agreement with Temex Resources Corp. ("Temex"). During 2015, the Company's agreement with Temex was terminated and all related costs were written-off.

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# Cappha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

Years ended December 31, 2016 and 2015

(Expressed in United States Dollars)

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### 9. Share capital

At December 31, 2016, the Company's authorized share capital consisted of an unlimited number of voting common shares without par value, an unlimited number of first preferred shares, and an unlimited number of second preferred shares. No first preferred shares or second preferred shares have been issued. All issued common shares are fully paid.

During the year ended December 31, 2015, 454,000 stock options were exercised at a price of CDN\$ 0.03 per share for proceeds of CDN\$ 13,620 (USD\$ 10,831).

Details of share purchase warrant transactions during the year ended December 31, 2016 and 2015 are as follows:

	2016	2015
Outstanding, beginning and end of year	705,884	705,884

As at December 31, 2016, the Company had outstanding share purchase warrants as follows:

Number	Exercise price CDN \$	Expiry date	Weighted average remaining life
705,884	0.85	March 30, 2017	0.25 years

### 10. Warrant liability

Equity offerings were completed in previous years whereby warrants were issued with exercise prices denominated in Canadian dollars. Effective August 2015, the Company's functional currency is the United States dollar. As a result of having exercise prices denominated in other than the Company's functional currency, these warrants meet the definition of derivatives and are therefore classified as derivative liabilities measured at fair value with adjustments to fair value recognized through net income. The liability has been recognized prospectively in accordance with IAS 21.

The fair value of warrants outstanding at December 31, 2016 and 2015 was determined using the Black-Scholes option pricing model, using the following assumptions:

	2016	2015
Risk-free interest rate	0.52%	0.488%
Expected volatility	175%	156%
Expected life (years)	0.25	1.25

Option pricing models require the input of highly subjective assumptions regarding volatility. The Company has used historical volatility to estimate the volatility of the share price.

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

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### 11. Share-based compensation

The Company has an incentive share option plan (the "plan"). Under the plan, the Company may issue options to directors, officers, employees and consultants for up to 20% of the Company's issued common shares to purchase common shares at a price determined by the Board of Directors on the date of award for a period of not more than five years. The Board of Directors may determine and impose terms upon which each option shall become vested.

The weighted average exercise price, as at December 31, 2016, of share options outstanding is CDN\$ 0.24 and the weighted average remaining contractual life is 2.59 years.

During fiscal 2015 the Company granted options to purchase 1,700,000 common shares and recorded a compensation expense of \$ 196,272. No options were granted in fiscal 2016.

The fair value of share options awarded to directors and consultants in the year ended December 31, 2015 was estimated on the dates of award using the Black-Scholes option pricing model with the following assumptions:

	2016	2015
Risk-free interest rates	-	0.96% - 1.08%
Expected volatility	-	211% - 238%
Expected lives	-	5 years
Expected forfeiture rate	-	0 years

A summary of the Company's share options as at December 31, 2016 and 2015 and the changes to those dates are as follows:

	Number of options outstanding	Weighted average exercise price CDN \$
Outstanding, December 31, 2014	2,577,530	0.57
Awarded	1,700,000	0.145
Exercised	(454,000)	0.03
Expired	<u>(394,118)</u>	1.25
Outstanding, December 31, 2015	3,429,412	0.37
Expired	<u>(482,354)</u>	1.16
Outstanding, December 31, 2016	<u>2,947,058</u>	0.24

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# Cappha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

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### 11. Share-based compensation - continued

The following summarizes information about share options outstanding at December 31, 2016:

Exercise price CDN \$	Number outstanding	Number exercisable	Expiry date	Weighted average remaining life
0.85	447,058	447,058	October 2017	0.75 years
*0.10	800,000	800,000	November 2018	1.90 years
0.145	1,200,000	1,200,000	May 2020	3.36 years
0.16	<u>500,000</u>	<u>500,000</u>	May 2020	3.41 years
	2,947,058	2,947,058		2.59 years

\* On September 10, 2015, 800,000 stock options were re-priced from CDN\$ 0.03 to CDN\$ 0.10

### 12. Related party disclosures

#### Transactions with key management personnel

- a) Management fees of \$ 20,000 (2015 - \$ 180,000), office services of \$ 10,000 (2015 - \$ 90,000), and rent of \$ 2,500 (2015 - \$ 22,500) were paid to the Chief Executive Officer and the Chief Financial Officer during the year ended December 31, 2016.

Included in accounts payable and accrued liabilities at December 31, 2016 is \$ 46,519 (2015 - \$ Nil) due to directors.

During the year ended December 31, 2016, management fees of \$ 160,000 (2015 - \$ 42,000) and consulting fees of \$ Nil (2015 - \$127,000) were paid to the Chief Executive Officer of the Company's wholly owned subsidiary FPS Pharma Asia Limited.

- b) Transactions with other related parties

Included in share-based compensation expense is \$ Nil (2015 - \$ 196,272) relating to directors.

- c) As at December 31, 2016, a loan payable of \$ 114,805 (2015 - \$ Nil) was due to a director. The loan does not bear interest.

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# Cappha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

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### 13. Income taxes

The provision for income taxes differs from the amount that would have been obtained by applying the statutory income tax rate of 26.00% (2015 - 26%) to the Company's net loss. The difference results from the following items:

	2016	2015
	\$	\$
Expected income tax expense (recovery)	(173,000)	28,000
Share-based compensation	-	51,000
Impairment of exploration and evaluation assets	11,000	93,000
Other	(6,000)	21,000
Non-deductible foreign expenses	125,000	44,000
Unrecognized benefit (use) of loss carryforwards	<u>43,000</u>	<u>(237,000)</u>
Provision for income taxes (recovery)	-	-

The income tax effects of temporary differences that give rise to significant components of deferred income tax assets and liabilities are as follows:

	2016	2015
	\$	\$
Deferred income tax assets and liabilities are as follows:		
<i>Deferred income tax assets</i>		
Non-capital loss carry-forwards	569,000	562,000
Exploration and evaluation assets	848,000	890,000
Transaction costs	19,000	20,000
Equipment	7,000	5,000
Share issue costs	<u>-</u>	<u>1,000</u>
	1,443,000	1,478,000
Valuation allowance	<u>(1,443,000)</u>	<u>(1,478,000)</u>
	-	-

The Company has non-capital losses for income tax purposes of approximately \$ 2,187,000 available to reduce future years' taxable income. The benefit of these non-capital losses has not been recognized in the Company's accounts as it is not probable such benefit will be realized. The non-capital losses expire between the 2017 and 2036 fiscal years.

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# Capha Pharmaceuticals Inc. (formerly FPS Pharma Inc.)

## Notes to the Consolidated Financial Statements

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### 14. Segmented information

The Company operated in two geographic segments from September 2015 to December 2016.

Geographic distribution of operating results in the two geographic segments is as follows:

	North America	Asia	2016 \$ Total
Total assets	4,392	-	4,392
Net income (loss)	(145,082)	(522,003)	(667,085)
Depreciation of equipment	471	2,296	2,767
Sale of equipment	-	6,400	6,400

  

	North America	Asia	2015 \$ Total
Total assets	496,490	62,425	558,915
Net income (loss)	277,323	(168,439)	108,884
Depreciation of equipment	549	1,491	2,040

### 15. Contingent liability

In fiscal 2016, the Company was named as a defendant in an action initiated by a staffing company in Alabama. The staffing company is seeking damages in the amount of \$ 30,000 plus additional costs. As at December 31, 2016, the Company believes the likelihood of loss is not determinable and the amount is not reasonably estimable. No amount has been provided for this claim in the financial statements.

### 16. Events after the reporting period

Subsequent to December 31, 2016, 705,884 share purchase warrants expired unexercised.