
Capha Pharmaceuticals Inc.
Consolidated Financial Statements
For the years ended December 31, 2017 and 2016
(Expressed in Canadian Dollars)



Independent Auditor's Report

To the Shareholders of Capha Pharmaceuticals Inc.

We have audited the accompanying consolidated financial statements of Capha Pharmaceuticals Inc., which comprise the consolidated statements of financial position as at December 31, 2017, December 31, 2016, and January 1, 2016 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, 2017 and December 31, 2016, 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. as at December 31, 2017, December 31, 2016, and January 1, 2016 and its financial performance and its cash flows for the years ended December 31, 2017 and December 31, 2016 in accordance with International Financial Reporting Standards.

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 ability to continue as a going concern.

Vancouver, B.C.
April 27, 2018

"D&H Group LLP"

Chartered Professional Accountants

Capha Pharmaceuticals Inc.

Consolidated Statements of Financial Position

(Expressed in Canadian Dollars)

	December 31, 2017 \$	December 31, 2016 \$	January 1, 2016 \$
		(Note 16)	(Note 16)
Assets			
Current assets			
Cash	977	4,013	641,447
Restricted cash (Note 8)	617,500	-	-
Amounts receivable (Note 6)	1,555	-	36,185
Prepaid expenses	<u>3,505</u>	<u>-</u>	<u>76,400</u>
	623,537	4,013	754,032
Equipment (Note 7)	<u>4,486</u>	<u>1,541</u>	<u>19,507</u>
	628,023	5,554	773,539
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities (Note 12)	205,806	100,742	53,962
Loan payable (Note 12)	322,053	154,149	-
Warrant liability (Note 10)	-	467	53,619
Subscription receipt liability (Note 8)	<u>617,500</u>	<u>-</u>	<u>-</u>
	<u>1,145,359</u>	<u>255,358</u>	<u>107,581</u>
Shareholders' equity			
Share capital (Note 9)	10,954,455	10,954,455	10,954,455
Share-based payment reserve	3,564,621	3,564,621	3,564,621
Currency translation reserve	126,725	126,725	158,729
Deficit	<u>(15,163,137)</u>	<u>(14,895,605)</u>	<u>(14,011,847)</u>
	<u>(517,336)</u>	<u>(249,804)</u>	<u>665,958</u>
	628,023	5,554	773,539

Nature of operations and going concern (Note 1)

Litigation (Note 15)

Events after the reporting period (Note 17)

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

These consolidated financial statements were approved for issue by the Board of Directors on April 27, 2018 and are signed on its behalf by:

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

/s/ Janice Brown, Director
Janice Brown

Capha Pharmaceuticals Inc.

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

	2017	2016
	\$	\$
		(Note 16)
Expenses		
Consulting	-	170,152
Depreciation of equipment	960	3,666
Investor relations	-	33,568
Management fees (Note 12)	120,640	238,465
Office and miscellaneous (Note 12)	28,828	118,831
Office services (Note 12)	-	13,248
Professional fees	33,727	104,837
Share-based compensation (Note 11)	-	-
Transfer agent fees and regulatory fees	19,643	19,383
Travel and meals	<u>67,390</u>	<u>191,770</u>
Loss before other items	<u>(271,188)</u>	<u>(893,920)</u>
Other items		
Change in fair value of warrant liability	467	50,866
Write-off of assets (Note 1)	-	(56,400)
Other income	-	18,663
Foreign exchange gain (loss)	13,389	(2,967)
Settlement (Note 15)	<u>(10,200)</u>	<u>-</u>
	<u>3,656</u>	<u>10,162</u>
Net income (loss) for the year	(267,532)	(883,758)
Other comprehensive income (loss) for the year		
Foreign currency translation	-	(32,004)
Net income (loss) and comprehensive income (loss) for the year	(267,532)	(915,762)
Income (loss) per common share	(0.00)	(0.02)
Weighted average number of common shares outstanding	54,431,030	54,431,030

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

Capha Pharmaceuticals Inc.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

	<u>Common shares</u>		Share-based payment reserve \$	Currency translation reserve \$	Deficit \$	Total equity \$
	Number of shares	Amount \$				
Balance at January 1, 2016 (Note 16)	54,431,030	10,954,455	3,564,621	158,729	(14,011,847)	665,958
Net income (loss) for the year	-	-	-	-	(883,758)	(883,758)
Other comprehensive income	<u>-</u>	<u>-</u>	<u>-</u>	<u>(32,004)</u>	<u>-</u>	<u>(32,004)</u>
Balance at December 31, 2016 (Note 16)	54,431,030	10,954,455	3,564,621	126,725	(14,895,605)	(249,804)
Net income (loss) for the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(267,532)</u>	<u>(267,532)</u>
Balance at December 31, 2017	54,431,030	10,954,455	3,564,621	126,725	(15,163,137)	(517,336)

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

Capha Pharmaceuticals Inc.

Consolidated Statements of Cash Flows

For the years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

	2017	2016
	\$	\$
Cash flows from (used in) operating activities		
Net income (loss) for the year	(267,532)	(883,758)
Items not affecting cash		
Depreciation of equipment	960	3,666
Change in warrant liability	(467)	(50,866)
Disposal of equipment	-	13,151
Changes in non-cash working capital		
Decrease (increase) in		
Restricted cash	(617,500)	-
Amounts receivable	(1,555)	36,185
Prepaid expenses	(3,505)	76,400
Subscription receipt liability	617,500	-
Increase (decrease) in		
Accounts payable and accrued liabilities	<u>105,064</u>	<u>46,780</u>
	<u>(167,035)</u>	<u>(758,442)</u>
Cash flows from (used in) investing activity		
Purchase of equipment	<u>(3,905)</u>	<u>-</u>
Cash flows from financing activity		
Loan from shareholder	<u>167,904</u>	<u>154,149</u>
Increase (decrease) in cash during the year	(3,036)	(604,293)
Effect of exchange rate	-	(33,141)
Cash, beginning of year	<u>4,013</u>	<u>641,447</u>
Cash, end of year	977	4,013

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

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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

Since 2015, the Company was exploring opportunities in the pharmaceutical distribution business with minimal success and the Company has had little activity since the middle of 2016.

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 \$ 56,400 relating to prepaid expenses and equipment.

In December 2017, the Company entered into a Letter of Intent (“LOI”) with Blockagram Inc. (“Blockagram”) to carry out a business combination transaction; the LOI is to be replaced with a Share Exchange Agreement whereby all of Blockagram’s 7,000,000 issued shares will be exchanged for a total of 7,000,000 common shares of the Company, subject to all regulatory approvals, including a change in the name of the Company to Blockagram Corp. and the approval of the listing of the Company’s common shares on the Canadian Securities Exchange. (See also Note 17).

As at December 31, 2017, the Company had a working capital deficit of \$ 521,822 and an accumulated deficit of \$ 15,163,137. The Company’s ability to continue its business is dependent upon its ability to obtain additional financing, in the immediate term. There is material uncertainty about whether the Company will be able to obtain the required financing. This material uncertainty casts significant doubt about the Company’s ability to continue as a going concern. Should the Company be unable to obtain additional financing, it may have no alternative but to significantly curtail, or cease to carry on, business operations. 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”).

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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.

On December 31, 2016, the Company closed all the offices of its 100% owned sole subsidiary, FPS Pharma Asia Limited, Hong Kong.

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 were presented in United States dollars for the years ended December 31, 2016 and 2015. In January 2017, its functional currency reverted back to Canadian dollars and its financial statements are now presented in Canadian 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 Canadian dollar-related exposure an entity has, the more likely the Canadian 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 do not 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 are not "operations" in the sense of revenue and expenses, other factors such as financing are considered. For all of 2017, all financing has been done in Canadian dollars through loans from an officer and shareholder.
- 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 Canadian dollars;
 - b. the Company's common shares are currently not listed for trading, but the Company has applied to have its shares listed on the CSE in Canadian dollars, and future share issuances would likely be Canadian dollar-denominated as a consequence; and
 - c. the Company is of the view that the Canadian 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 Canadian dollars on a retrospective basis using historical exchange rates. Foreign exchange gains and losses resulting from the conversion are recognized in comprehensive loss.

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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 denominated 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 also Note 2).

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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%

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian Dollars)

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 asset's 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, 2017, 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.

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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 employee 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 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.

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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.

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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 and accounts payable and accrued liabilities and loan payable approximate their fair value due to their short-term natures. The fair value of cash, restricted 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, restricted cash, amounts receivable, accounts payable and accrued liabilities, loan payable and warrant liability. 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, 2017	December 31, 2016
	\$	\$
Canadian Goods & Services Tax	1,555	-

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7. Equipment			2017
			\$
	Computer equipment	Office equipment	Total
Cost:			
Balance, December 31, 2016	25,793	6,128	31,921
Additions	<u>3,905</u>	<u>-</u>	<u>3,905</u>
Balance, December 31, 2017	29,698	6,128	35,826
Depreciation and cumulative impairment loss:			
Balance, December 31, 2016	25,128	5,252	30,380
Depreciation	<u>785</u>	<u>175</u>	<u>960</u>
Balance, December 31, 2017	<u>25,913</u>	<u>5,427</u>	<u>31,340</u>
Carrying value, December 31, 2017	3,785	701	4,486
			2016
			\$
	Computer equipment	Office equipment	Total
Cost:			
Balance, December 31, 2015	29,015	21,189	50,204
Sale of equipment	(3,222)	(5,371)	(8,593)
Write-off	<u>-</u>	<u>(9,690)</u>	<u>(9,690)</u>
Balance, December 31, 2016	25,793	6,128	31,921
Depreciation and cumulative impairment loss:			
Balance, December 31, 2015	25,222	6,493	31,715
Sale of equipment	(1,100)	(1,262)	(2,362)
Write-off	-	(2,688)	(2,688)
Depreciation	<u>1,006</u>	<u>2,709</u>	<u>3,715</u>
Balance, December 31, 2016	<u>25,128</u>	<u>5,252</u>	<u>30,380</u>
Carrying value, December 31, 2016	665	876	1,541

Capha Pharmaceuticals Inc.

Notes to the Consolidated Financial Statements

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8. Subscription receipts

In December 2017, the Company received proceeds of \$ 617,500 in exchange for 12,350,000 subscription receipts. The subscription receipts and the gross proceeds are being held in escrow pending approval of the listing of the Company's common shares on the Canadian Securities Exchange. The Company has until April 30, 2018 to satisfy the listing conditions. Upon release from escrow, each subscription receipt will automatically be exchanged for one common share and one share purchase warrant exercisable at \$ 0.10 for two years from the date of issuance.

As the share subscriptions are repayable should the Company not receive approval to list on the Canadian Securities Exchange, the amount is recorded as current liabilities and the funds received have been accounted for as restricted cash. (See also Note 17).

9. Share capital

At December 31, 2017, 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. No common shares were issued during the years ended December 31, 2016 or 2017.

Warrants

Details of share purchase warrant transactions during the years ended December 31, 2017 and 2016 are as follows:

	2017	2016
	\$	\$
Outstanding, beginning of year	705,884	705,884
Expired	<u>(705,884)</u>	<u>-</u>
Balance, end of period	-	705,884

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 was the U.S. dollar. As a result of having exercise prices denominated in other than the Company's functional currency, these warrants met the definition of derivatives and were therefore classified as derivative liabilities measured at fair value with adjustments to fair value recognized through net income. The liability was recognized prospectively in accordance with IAS 21. All of the outstanding warrants expired in March 2017.

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10. **Warrant liability** - continued

The fair value of warrants outstanding at December 31, 2017 and 2016 was determined using the Black-Scholes option pricing model, using the following assumptions:

	2017	2016
Risk-free interest rate	-	0.52%
Expected volatility	-	175%
Expected life (years)	-	0.25

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.

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.

No options were issued in the years ended December 31, 2017 and 2016.

A summary of the Company’s share options as at December 31, 2017 and 2016 and the changes to those dates are as follows:

	Number of options outstanding	Weighted average exercise price CDN \$
Outstanding, December 31, 2015	3,429,412	0.37
Expired	<u>(482,354)</u>	1.16
Outstanding, December 31, 2016	2,947,058	0.24
Expired	<u>(1,447,058)</u>	1.19
Outstanding, December 31, 2017	<u>1,500,000</u>	0.12

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11. Share-based compensation - continued

The following summarizes information about share options outstanding at December 31, 2017:

Exercise price CDN \$	Number outstanding	Number exercisable	Expiry date	Weighted average remaining life
0.10	800,000	800,000	November 2018	0.90 years
0.145	<u>700,000</u>	<u>700,000</u>	May 2020	2.36 years
	1,500,000	1,500,000		1.58 years

12. Related party disclosures

Transactions with key management personnel

Management fees of \$ 120,640 (2016 - \$ 238,465), office services of \$ 12,292 (2016 - \$ 12,862) and rent of \$ Nil (2016 - \$ 3,312) were paid to the Chief Executive Officer ("CEO"), the President and Chief Operating Officer ("COO"), and the Chief Financial Officer ("CFO") during the year ended December 31, 2017.

Included in accounts payable and accrued liabilities at December 31, 2017 is \$ 182,854 (2016 - \$ 62,461) due to the CEO and CFO.

During the year ended December 31, 2017, management fees of \$ Nil (2016 - \$ 211,969) were paid to the CEO of the Company's former wholly owned subsidiary FPS Pharma Asia Limited.

As at December 31, 2017, loans payable of \$ 323,208 (2016 - \$ 154,149) were due to the CEO and CFO. The loans do not bear interest.

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% (2016 - 26.00%) to the Company's net loss. The difference results from the following items:

	2017 \$	2016 \$
Expected income tax expense (recovery)	(61,000)	(230,000)
Impairment of exploration and evaluation assets	-	15,000
Other	9,000	(7,000)
Non-deductible foreign expenses	-	165,000
Effect of future income tax rate changes	(75,000)	-
Unrecognized benefit (use) of loss carryforwards	<u>127,000</u>	<u>57,000</u>
Provision for income taxes (recovery)	-	-

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13. **Income taxes** - continued

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

	2017	2016
	\$	\$
<i>Deferred income tax assets</i>		
Non-capital losses carry-forwards	819,000	764,000
Exploration and evaluation assets	1,182,000	1,138,000
Transaction costs	25,000	26,000
Equipment	11,000	10,000
Share issue costs	-	-
	<u>2,037,000</u>	<u>1,938,000</u>
Valuation allowance	<u>(2,037,000)</u>	<u>(1,938,000)</u>
	-	-

The Company has non-capital losses for income tax purposes of approximately \$ 3,034,282 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 2018 and 2037 fiscal years.

14. **Segmented information**

The Company operated in two geographic segments until December 31, 2016.

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

	2016		
	\$		
	<u>North America</u>	<u>Asia</u>	<u>Total</u>
Total assets	5,554	-	5,554
Net income (loss)	(192,201)	(691,557)	(883,758)
Depreciation of equipment	624	3,042	3,666
Sale of equipment	-	8,593	8,593

15. **Litigation**

In fiscal 2016, the Company was named as a defendant in an action initiated by a staffing company in Alabama. The staffing company was seeking damages in the amount of USD \$ 30,000 plus additional costs. In May 2017, the action was settled and the Company paid USD \$ 7,500.

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16. **Change in accounting policy**

During 2017, the Company changed its accounting policy with respect to its presentation currency from the U.S. dollar to the Canadian dollar. The change in presentation currency is applied retroactively in accordance with IAS 8. For comparative purposes, the consolidated statements of financial position as at December 31, 2016 and January 1, 2016 include adjustments to reflect the change in accounting policy resulting from the change in presentation currency. The Company also changed its functional currency from the U.S. dollar to the Canadian dollar. The change in functional currency is applied prospectively.

The effects of the change in accounting policy related to the change in presentation currency are as follows:

Reconciliation of statements of financial position

	<u>December 31, 2016</u>		<u>January 1, 2016</u>	
	As previously reported USD \$	Restated in CDN \$	As previously reported USD \$	Restated in CDN \$
Assets				
Current assets				
Cash	2,990	4,013	463,473	641,447
Amounts receivable	-	-	26,145	36,185
Prepaid expenses	-	-	<u>55,202</u>	<u>76,400</u>
	2,990	4,013	544,820	754,032
Equipment	<u>1,402</u>	<u>1,541</u>	<u>14,095</u>	<u>19,507</u>
	4,392	5,554	558,915	773,539
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities	75,141	100,742	38,990	53,962
Loan payable	114,805	154,149	-	-
Warrant liability	<u>348</u>	<u>467</u>	<u>38,742</u>	<u>53,619</u>
	<u>190,294</u>	<u>255,358</u>	<u>77,732</u>	<u>107,581</u>
Shareholders' equity				
Share capital	10,883,164	10,954,455	10,883,164	10,954,455
Share-based payment reserve	3,465,384	3,564,621	3,465,384	3,564,621
Currency translation reserve	42,462	126,725	42,462	158,729
Deficit	<u>(14,576,912)</u>	<u>(14,895,605)</u>	<u>(13,909,827)</u>	<u>(14,011,847)</u>
	<u>(185,902)</u>	<u>(249,804)</u>	<u>481,183</u>	<u>665,958</u>
	4,392	5,554	558,915	773,539

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16. **Change in accounting policy** - continued

Reconciliation of statement of comprehensive loss

	Year ended December 31, 2016	
	As previously reported USD \$	Restated in CDN \$
Expenses		
Consulting	128,435	170,152
Depreciation of equipment	2,767	3,666
Investor relations	25,338	33,568
Management fees	180,000	238,465
Office and miscellaneous	89,697	118,831
Office services	10,000	13,248
Professional fees	79,134	104,837
Transfer agent fees and regulatory fees	14,631	19,383
Travel and meals	<u>144,753</u>	<u>191,770</u>
Loss before other items	(674,755)	(893,920)
Other items		
Change in fair value of warrant liability	38,395	50,866
Write-off of assets	(42,572)	(56,400)
Other income	14,087	18,663
Foreign exchange loss	<u>(2,240)</u>	<u>(2,967)</u>
Net income (loss) for the year	(667,085)	(883,758)
Other comprehensive income for the year		
Foreign currency translation	<u>-</u>	<u>(32,004)</u>
Net income (loss) and comprehensive income (loss) for the year	(667,085)	(915,762)
Income (loss) per common share	(0.01)	(0.02)
Weighted average number of common shares outstanding	54,431,030	54,431,030

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17. Events after the reporting period

Subsequent to December 31, 2017, the Company:

- a) Issued 10,000,000 common shares at \$ 0.05 per share to retire amounts, including fees, expenses, and loans (the “indebtedness”) due to a shareholder of the Company. As at December 31, 2017, the indebtedness was \$ 500,000.
- b) Has not been able to receive approval from securities regulators, including the approval of the listing of the Company’s common shares on the Canadian Securities Exchange within the required timeframe, and therefore, the transaction will not be completed as referred to in Note 1, and the proceeds will be returned to the subscribers as referred to in Note 8.