

# **SUPREME PHARMACEUTICALS INC.**

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SIX MONTHS ENDED DECEMBER 31, 2016

(Expressed in Canadian Dollars)

**MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**

**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**

**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

**CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

## Management's Responsibility for Financial Reporting

To the Shareholders of Supreme Pharmaceuticals Inc. (the "**Company**"):

Management is responsible for the preparation and presentation of the accompanying condensed interim consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards ("**IFRS**"). This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the condensed interim consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the consolidated financial statements.

The Board of Directors and the Audit Committee is composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the consolidated financial statements. The Audit Committee has the responsibility of meeting with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

March 1, 2017

(signed)

/Navdeep Dhaliwal/  
Director

(signed)

/Scott Walters/  
Director

**Notice of No Auditor Review of Condensed Interim Financial Statements**

The accompanying unaudited condensed interim consolidated financial statements of Supreme Pharmaceuticals Inc. (the "**Company**") have been prepared by and are the responsibility of management and are approved by the Company Board of Directors.

The Company's independent auditor has not performed a review of these condensed interim consolidated financial statements in accordance with the standards of the Chartered Professional Accountants of Canada for a review of interim financial statements.

**Supreme Pharmaceuticals Inc.**

**Condensed Interim Consolidated Statements of Financial Position  
(Expressed in Canadian Dollars)  
(Unaudited)**

As at:	Note	December 31, 2016	June 30, 2016
<b>ASSETS</b>			(Audited)
Current assets			
Cash		\$ 71,226,751	\$ 3,730,569
Short term investments	2	500,000	1,200,000
Receivables		242,661	331,665
Prepaid expenses		14,710	235,215
		71,984,122	5,497,449
Non-current assets			
Property, plant & equipment	4	12,957,677	10,274,903
Intangible Assets	3	8,396,914	8,396,914
Investments	6	100,000	100,000
Other Assets	5	15,000	15,000
		\$ 93,453,713	\$ 24,284,266
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities			
Accounts payable and accrued liabilities	10	\$ 1,392,696	\$ 883,012
Mortgage payable	7	4,000,000	3,500,000
		5,392,696	4,383,012
Long-term liabilities			
Convertible debt	8	38,675,398	536,700
		44,068,094	4,919,712
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	9	55,506,141	32,063,452
Reserves		33,252,033	10,945,375
Shares to be issued		8,569	430,000
Accumulated deficit		(39,381,124)	(24,074,273)
<b>Total Shareholders' Equity</b>		49,385,619	19,364,554
		\$ 93,453,713	\$ 24,284,266

**Subsequent events (Note 15)**

Approved and authorized by the Board of Directors on March 1, 2017:

“Navdeep Dhaliwal” \_\_\_\_\_ Director

“Scott Walters” \_\_\_\_\_ Director

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

**Supreme Pharmaceuticals Inc.**  
**Condensed Interim Consolidated Statements of**  
**Comprehensive Loss**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**

For the six months ended December 31,		Six Months Ended December 31, 2016	Six Months Ended December 31, 2015	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015
	Notes				
<b>Operating Expenses</b>					
Wages and benefits	11	\$ 1,115,289	\$ 348,558	\$ 598,721	\$ 168,763
Rent and facilities		434,963	125,028	250,980	62,365
Professional fees		233,909	168,823	208,843	93,299
Marketing		263,636	47,138	123,572	28,358
General and administrative		145,949	114,240	85,492	74,111
Consulting		33,349	15,072	12,425	7,580
Amortization	4	205,868	9,915	95,950	4,958
Interest, accretion, and bank charges	7,8	665,324	201,431	444,842	65,545
Share based payments	11	12,208,564	26,785	10,283,980	26,785
<b>Net loss and comprehensive loss for the period</b>		<b>\$ (15,306,851)</b>	<b>\$ (1,056,990)</b>	<b>\$ (12,104,805)</b>	<b>\$ (531,764)</b>
<b>Basic and Diluted Loss per common share</b>		<b>\$ (0.10)</b>	<b>\$ (0.01)</b>	<b>\$ (0.08)</b>	<b>\$ (0.01)</b>
<b>Weighted average number of shares</b>		<b>160,379,280</b>	<b>92,951,624</b>	<b>160,414,211</b>	<b>92,951,624</b>

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

**Supreme Pharmaceuticals Inc.****Condensed Interim Consolidated Statements of Cash Flows  
(Expressed in Canadian Dollars)  
(Unaudited)**

<b>For the six months ended December 31,</b>	<b>2016</b>	<b>2015</b>
<b>Operating activities:</b>		
Net loss for the period	\$ (15,306,851)	\$ (1,056,990)
Items not involving cash		
Amortization	205,868	9,915
Accrued interest and accretion	610,873	201,432
Flow-through share interest and penalties	4,372	4,482
Share based payments	12,208,564	26,785
Changes in non-cash working capital:		
Receivables	89,003	(4,694)
Prepaid expenses	(13,786)	42,911
Due to related parties	-	(89,439)
Accounts payable and accrued liabilities	582,327	29,561
	(1,619,630)	(836,037)
<b>Investing activities:</b>		
Acquisition of equipment	(73,404)	(2,638)
Facility under development	(2,815,238)	(309,529)
Proceeds on sale of short-term investment	700,000	-
	(2,188,642)	(312,167)
<b>Financing activities:</b>		
Common shares issued (net of issuance costs)	10,628,349	667,082
Warrants exercised	6,583,527	1,394,087
Stock options exercised	1,164,950	267,500
Convertible debentures issued (net of issuance costs)	52,927,628	-
	71,304,454	2,328,669
Net change in cash	67,496,182	1,180,465
Cash, beginning of period	3,730,569	570,170
<b>Cash, end of period</b>	<b>\$ 71,226,751</b>	<b>\$ 1,750,635</b>

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

**SUPREME PHARMACEUTICALS INC.**  
**Condensed Interim Consolidated Statements of Changes**  
**in Shareholders' Equity**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**

	Common Shares			Reserves	Deficit	Total Shareholders' (Deficiency) Equity
	Number of Shares	Share Capital	Shares to be Issued			
Balance, June 30, 2015	82,939,792	\$ 26,391,482	\$ -	\$ 3,605,673	\$ (16,409,802)	\$ 13,587,353
Private Placements	4,026,469	315,166	-	351,916	-	667,082
Warrants exercised	8,200,512	2,583,676	-	(1,189,589)	-	1,394,087
Shares issued for debt	233,313	39,664	-	-	-	39,664
Share based payments	215,000	26,875	-	-	-	26,875
Debenture Conversion	1,716,764	218,333	-	-	-	218,333
Convertible debt equity	-	341,939	-	(341,939)	-	-
Stock options exercised	750,000	499,900	-	(232,400)	-	267,500
Net loss for the period	-	-	-	-	(1,056,990)	(1,056,990)
Balance, December 31, 2015	98,081,850	30,417,035	-	2,193,661	(17,466,792)	15,143,904
Private Placements (net of fees)	9,039,700	1,841,427	-	1,609,179	-	3,450,606
Shares to be issued	-	-	430,000	-	-	430,000
Warrants exercised	7,723,367	(988,238)	-	2,776,388	-	1,788,150
Warrant modification	-	-	-	3,277,684	(3,277,684)	-
Share based payments	1,820,000	709,800	-	937,185	-	1,646,985
Debenture conversion	867,648	221,017	-	(111,311)	-	109,706
Convertible debt equity	-	(341,939)	-	341,939	-	-
Stock options exercised	500,000	204,350	-	(79,350)	-	125,000
Net loss for the period	-	-	-	-	(3,329,797)	(3,329,797)
Balance, June 30, 2016	118,032,565	\$ 32,063,452	\$430,000	\$ 10,945,375	\$ (24,074,273)	\$ 19,364,554
Private Placements (net of fees)	28,334,689	5,965,745	(430,000)	5,092,604	-	10,628,349
Warrants exercised	15,356,115	7,398,439	8,569	(823,481)	-	6,583,527
Debenture conversion	6,038,234	1,013,469	-	(465,586)	-	547,883
Stock options exercised	2,685,000	1,986,181	-	(821,231)	-	1,164,950
Convertible debt	-	7,078,855	-	7,115,788	-	14,194,643
Share based payments	-	-	-	12,208,564	-	12,208,564
Net loss for the period	-	-	-	-	(15,306,851)	(15,306,851)
<b>Balance, December 31, 2016</b>	<b>170,446,603</b>	<b>\$ 55,506,141</b>	<b>\$ 8,569</b>	<b>\$ 33,252,033</b>	<b>\$ (39,381,124)</b>	<b>\$ 49,385,619</b>

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

**SUPREME PHARMACEUTICALS INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**June 30, 2016 and 2015**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**

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**1. Nature of Operations:**

Supreme is a federally incorporated Canadian medical cannabis company with its common shares publicly traded on the Canadian Securities Exchange ("**CSE**") under the symbol "SL" and are quoted on the Over-the-Counter Bulletin Board ("**OTCBB**") under the symbol "SPRWF". Supreme's primary asset 7 ACRES, an Ontario corporation, is wholly owned by Supreme. 7 ACRES is a Licensed Producer (as such term is defined in the Access to Cannabis for Medical Purposes Regulations ("**ACMPR**") which replaced the Marihuana for Medical Purposes Regulations (the "**MMPR**")). 7 ACRES became a Licensed Producer on March 11, 2016 when it was issued a license to cultivate medical cannabis, pursuant to the MMPR (the "License"), at its hybrid greenhouse (the "**Hybrid Greenhouse**") facility in Kincardine, Ontario. Supreme has positioned 7 ACRES to be a leading supplier and distributor of medical cannabis and related products to other legal retailers, utilizing a business-to-business focused sales strategy. Management believes its business model is the first of its type in Canada. The Hybrid Greenhouse combines the positive aspects of indoor cannabis cultivation with the cost savings and sustainability of a greenhouse. In addition, the full spectrum light of the sun provides a quality benefit compared to cannabis produced solely with artificial lighting and the naturally occurring UV-spectrum light provides anti-microbial properties. Management believes the Hybrid Greenhouse will allow 7 ACRES to produce a high volume of low cost, high quality medical cannabis.

To date, the Company has not yet generated significant revenues from its operations and has accumulated losses, and is considered to be in the development stage.

The Company's head office and registered records office is located at Suite 202, 20 De Boers Drive, Toronto, Ontario, M3J 0H1.

**2. Significant Accounting Policies:**

a) Statement of compliance

These condensed interim consolidated financial statements have been prepared in accordance and compliance with International Financial Reporting Standards ("**IFRS**") applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting.

These consolidated financial statements have been prepared on a historical cost basis except for financial instruments classified as fair value through profit or loss which have been measured at fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

b) Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, 8528934 Canada Ltd d/b/a 7 Acres. All significant intercompany balances and transactions were eliminated on consolidation.

c) Functional and presentation of foreign currency

The consolidated financial statements are presented in Canadian dollars unless otherwise noted. The presentation currency and functional currency of the Company and its subsidiary is the Canadian dollar.

d) Significant accounting judgments, estimates and assumptions

The preparation of these consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.



**SUPREME PHARMACEUTICALS INC.**  
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**2. Significant Accounting Policies (continued)**

e) New and revised IFRS in issue but not yet effective

IFRS 9, Financial Instruments was issued by the International Accounting Standards Board (“IASB”) in November 2009 and October 2010 and will replace IAS 39. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Two measurement categories continue to exist to account for financial liabilities in IFRS 9, fair value through profit or loss (“FVTPL”) and amortized cost. Financial liabilities held-for-trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied. The treatment of embedded derivatives under the new standard is consistent with IAS 39 and is applied to financial liabilities and non-derivative hosts not within the scope of the standard. The effective date of IFRS 9 is January 1, 2018. Management is currently evaluating the impact of IFRS 9 on its financial statements.

IFRS 15, *Revenue from Contracts and Customers* (“IFRS 15”) was issued by the IASB on May 2014, and will replace IAS 18, Revenue, IAS 11, Construction contracts, and related interpretations on revenue. IFRS 15 sets out the requirements for recognizing revenue that apply to all contracts with customers, except for contracts that are within the scope of the standards on leases, insurance contracts and financial instruments. IFRS 15 uses a control based approach to recognize revenue which is a change from the risk and reward approach under the current standard. Companies can elect to use either a full or modified retrospective approach when adopting this standard and it is effective for annual periods beginning on or after January 1, 2018.

In January 2016, the IASB issued IFRS 16, *Leases*, was issued in January 2016, and is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted for entities that have also adopted IFRS 15. IFRS 16 provides a comprehensive model for the measurement, presentation and disclosure of leases and supersedes IAS 17, Leases. The adoption of IFRS 16 will result in substantially all lessee leases being recorded on the balance sheet as an asset with a corresponding liability with both current and long-term portions.

The Company is currently assessing the impact of these standards.

**3. Intangible Assets**

The intangible asset represents the value attributed to an in process Health Canada application on acquisition of 7 ACRES. Subsequent to acquisition, the Company was granted a license to cultivate medical cannabis.

ACMPR licenses are issued by Health Canada for a 1-year term and to be renewed annually unless the Company has significantly breached compliance. Accordingly, the useful life of the License is considered indefinite and has not been amortized. At a minimum, the License is tested for impairment annually by comparing recoverable amount to its carrying value.

As the Company has not yet achieved commercial sales, management performed a value in use analysis based on the following key assumptions: a discount rate of 15%, sales price of \$3500/kg, and an average cost per gram of \$2.50 currently, decreasing to \$1 in 2020.

**4. Property, Plant and Equipment**

On May 23, 2014, Supreme purchased a 342,000 square foot green house facility including adjacent buildings situated on approximately sixteen acres of land located in the Bruce Energy Park, in Kincardine, Ontario, approximately 100 miles outside of Toronto (the “**Facility**”).

The Facility was acquired for the purpose of producing medical cannabis pursuant to the ACMPR (formerly the MMPR). On March 11, 2016, Supreme’s wholly owned subsidiary 7 ACRES, was issued the License to cultivate medical cannabis pursuant to the MMPR (now the ACMPR). Although major construction is still required to prepare the Facility for additional capacity of medical cannabis production, the area of the Facility currently completed and approved for medical cannabis production is being amortized.

**SUPREME PHARMACEUTICALS INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
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**(Unaudited)**

**4. Property, Plant and Equipment (continued)**

	<b>Facility – Kincardine Greenhouse</b>	<b>Land – Kincardine Greenhouse</b>	<b>Equipment</b>	<b>Total Property, Plant &amp; Equipment</b>
<b>Cost</b>				
Balance, June 30, 2015	\$ 7,646,560	\$ 1,203,319	\$ 102,626	\$ 8,952,505
Additions	1,134,284	-	49,666	1,183,950
Borrowing costs	360,265	-	-	360,265
Balance, June 30, 2016	9,141,109	1,203,319	152,292	10,496,720
Additions	2,478,645	-	73,404	2,552,049
Borrowing costs	336,593	-	-	336,593
<b>Balance, December 31, 2016</b>	<b>\$ 11,956,347</b>	<b>\$ 1,203,319</b>	<b>\$ 225,696</b>	<b>\$ 13,385,362</b>
<b>Accumulated Amortization</b>				
Balance, June 30, 2015	\$ -	\$ -	\$ 18,488	\$ 18,488
Amortization	173,191	-	30,138	203,329
Balance, June 30, 2016	173,191	-	48,626	221,817
Amortization	184,196	-	21,672	205,868
<b>Balance, December 31, 2016</b>	<b>\$ 357,387</b>	<b>\$ -</b>	<b>\$ 70,298</b>	<b>\$ 427,685</b>
Net carrying cost, June 30, 2016	\$ 8,967,918	\$ 1,203,319	\$ 103,666	\$ 10,274,903
<b>Net carrying cost, Dec 31, 2016</b>	<b>\$ 11,598,960</b>	<b>\$ 1,203,319</b>	<b>\$ 155,398</b>	<b>\$ 12,957,677</b>

As at December 31, 2016 the Company had \$2,815,236 of Facility under Development for the Phase 1 expansion. Each phase is considered under development until such time that it has been approved by Health Canada. Once Health Canada approval is granted the asset is amortized as it is available for use.

**5. Other Assets**

As at December 31, 2016, Supreme retains 7 mineral claims in the Copper Mountain area of British Columbia totaling approximately 556 hectares, which have a nominal value. The Company expects to dispose of the remaining claims by way of sale, spin out or abandonment although no formal steps have been taken in furtherance of same. The Company expects to dispose of this asset class due to (a) its change of business and focus on the medical marijuana operations, (b) negative change in resource and resource property prices and (c) due consideration regarding the return on additional investment in the resource claims. Nominal amounts have been spent on these assets during fiscal 2017 and 2016; they have not produced any revenue and are in the exploration stage. Accordingly, the Company does not anticipate a material impact on operations from the disposition.

As at December 31, 2016, total reclamation bonds of \$15,000 (2015: \$15,000) represent term deposits which have been pledged to the Province of British Columbia as security for reclamation obligations pursuant to the Mines Act of British Columbia. These deposits bear annual interest rates that range from 0.55% to prime rate less 2.00% with maturity dates from April 2017 to May 2017.

**SUPREME PHARMACEUTICALS INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
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**(Unaudited)**

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**6. Investments**

On April 22, 2016 Supreme closed an investment in CannSoft Inc. (“**CannSoft**”) a development stage software company focused on providing enterprise resource planning (“**ERP**”) solutions to the cannabis industry. The company purchased 285,714 common shares for \$100,000. The Company does not exercise significant influence or control. The investment has been classified as an available for sale financial instrument. As these financial instruments do not have a quoted market price, there may be significant variability in the range of reasonable fair values. Accordingly, the investment is therefore carried at cost, and management has determined there is no impairment in value. The Company considers this a strategic investment since ERP solutions are new for the cannabis industry. The Company intends to continue as a passive shareholder and dispose of this investment by way of a liquidity event such as an Acquisition or Public Listing, if possible. Disposition of this investment and a liquidity event is out of the Company’s control.

**7. Mortgage Payable**

During the six month period ended December 31, 2016 the Company refinanced its \$3,500,000 mortgage bearing interest at 7% per annum, with a new lender. The new mortgage payable is for principal \$4,000,000 with a 12 month term maturing on July 31, 2017. The mortgage bears interest at the rate of 12% per annum, compounded monthly. Interest is due monthly and principal is due on maturity. The Mortgage may be repaid at any time in the first six months of the term upon seven days written notice and a prepayment of three months bonus interest. After six months, the mortgage may be repaid with seven days’ notice without prepayment penalty. The mortgage is secured by first charge over the land and Facility as described including assignment of rents.

The effective rate of interest for the life of the loan is 12%. Interest is accrued during the life of the loan based on the effective rate of interest. As at December 31, 2016, all accrued interest has been paid (December 31, 2015: \$199,651).

As at December 31, 2016, \$336,593 of interest and fees were capitalized to the Facility.

Long-term debt is repayable as follows:

Year due:	Principal	Interest	Total payable
2017	\$ 4,000,000	\$ -	\$4,000,000

**8. Convertible Debentures**

**April 2015 Convertible Debenture:**

During the year ended June 30, 2015, the Company received proceeds of \$1,465,850 from a private placement issuance of 10% coupon, unsecured debentures, which are convertible into common shares at a rate of \$0.17 per share at any time and mature April 23, 2018. Concurrently, the lenders received 8,622,647 warrants exercisable at \$0.17 to April 23, 2020, subject to accelerated expiry in some circumstances.

The Company has prepaid the 10% coupon interest on the debentures by the issuance of 3,834,837 units, where each unit is comprised of a common share and a warrant exercisable at \$0.17 for a period of 5 years. The units were valued at the amount of interest obligation settled, \$439,755, and included in prepaid expenses. The amount will be expensed over the term of the debentures, and if converted or settled early any remaining balance will be expensed.

The convertible debentures were determined to be compound instruments, comprising liability, conversion feature, and warrants. As the debentures are convertible into common shares, the liability and equity components are presented separately. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal at a market interest rate of 19.9%. Using the residual method, the carrying amount of the conversion feature and the warrants issued is the difference between the principal amount and the initial carrying value of the financial liability. The equity component, and warrants are recorded in reserves on the statement of financial position.

**SUPREME PHARMACEUTICALS INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**June 30, 2016 and 2015**  
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**(Unaudited)**

**8. Convertible Debentures (continued)**

**April 2015 Convertible Debenture (continued):**

The debentures, net of the equity components and issue costs are accreted using the effective interest rate method over the term of the debentures, such that the carrying amount of the financial liability will equal the principal balance at maturity.

The Company incurred cash finders' fees of \$50,766 and issued 298,753 finders' warrants valued at \$41,021. These transaction costs have been allocated to the liability and equity components based on their pro-rata fair values.

On September 9, 2016 all outstanding convertible debt was converted to shares.

**December 2016 Convertible Debenture:**

During the six-month period ended December 31, 2016, the Company received gross proceeds of \$55,000,000 from a brokered private placement issuance of 10% coupon, unsecured debentures, which are convertible into common shares at a rate of \$1.30 per share at any time and mature December 31, 2019. Concurrently, the lenders received 42,350,000 warrants exercisable at \$1.70 to December 31, 2022, subject to accelerated expiry in some circumstances.

The convertible debentures were determined to be compound instruments, comprising liability, conversion feature, and warrants. As the debentures are convertible into common shares, the liability and equity components are presented separately. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal at a market interest rate of 19.9%. Using the residual method, the carrying amount of the conversion feature and the warrants issued is the difference between the principal amount and the initial carrying value of the financial liability. The equity component, and warrants are recorded in reserves on the statement of financial position. The debentures, net of the equity components and issue costs are accreted using the effective interest rate method over the term of the debentures, such that the carrying amount of the financial liability will equal the principal balance at maturity.

The Company incurred cash finders' fees of \$1,807,125, share issue fees of \$495,123 and issued 2,117,500 finders' warrants valued at \$1,425,560. These transaction costs have been allocated to the liability and equity components based on their pro-rata fair values.

Convertible debentures consist of the following:

	<b>Proceeds</b>	<b>Debt component</b>	<b>Equity component</b>
Balance June 30, 2015	\$ 1,347,063	\$ 809,555	\$ 576,896
Accretion (April 2015 Debentures)	-	55,184	-
Conversion (April 2015 Debentures)	(439,349)	(328,039)	(111,310)
Balance, June 30, 2016	\$ 934,714	\$ 536,700	\$ 465,586
Issue of convertible debt	55,000,000	41,302,525	13,697,475
Transaction costs	(3,727,808)	(2,799,416)	(928,392)
Accretion (April 2015 Debentures)	-	11,183	-
Accretion (Dec 2016 Debentures)	-	172,289	-
Conversion (April 2015 Debentures)	(934,714)	(547,883)	(465,586)
Balance, December 31, 2016	\$ 51,272,192	\$ 38,675,398	\$ 12,769,083

**SUPREME PHARMACEUTICALS INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**June 30, 2016 and 2015**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**

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**9. Share capital**

Authorized share capital:

Unlimited number of voting common shares.  
10,000,000 Class "A" preference shares.  
10,000,000 Class "B" preference shares.

**9a. Share Capital: Common shares issued and outstanding**

On July 15, 2016, the Company closed the second tranche of the private placement announced June 2016, for an aggregate of \$723,250. Pursuant to the private placement, the Company issued 1,808,125 units at a price of \$0.40 comprised of 1,808,125 common shares and 1,808,125 purchase warrants exercisable for one common share at a price of \$0.50 per share prior to July 15, 2019. All purchase warrants issued pursuant to this private placement are not subject to acceleration provisions. The Company paid finders' fees of \$12,750 and issued 24,375 finders warrants in the connection with the financing. As part of the private placement, \$430,000 was collected before year end and was included in shares to be issued in the consolidated statement of changes in shareholders' equity.

During July 2016 and August 2016, \$616,500 of the Company's outstanding convertible debt was converted to common shares. A total of 3,626,470 common shares were issued on conversion.

On September 1, 2016, the Company closed the third tranche of the private placement announced June 2016 for an aggregate of \$10,610,625. Pursuant to the private placement, the Company issued 26,526,564 units at a price of \$0.40 comprised of 26,526,564 common shares and 26,526,564 purchase warrants exercisable for one common share at a price of \$0.50 per share prior to August 30, 2019. All purchase warrants issued pursuant to this private placement are subject to certain acceleration provisions. The Company paid finders' fees of \$252,509 and issued 631,274 finders warrants in the connection with the financing.

On September 9, 2016 pursuant to the forced conversion of the remaining convertible debentures, \$410,000 of the Company's outstanding convertible debt was converted to common shares. A total of 2,411,764 common shares were issued on conversion.

In September 2016, 340,000 stock options were exercised generating proceeds of \$123,400, In October 2016, 1,925,000 stock options were exercised generating proceeds of \$856,550, In November 2016, 320,000 stock options were exercised generating proceeds of \$110,000 and In December 2016, 100,000 stock options were exercised generating proceeds of \$75,000.

On December 13, 2016, the Company closed a private placement of convertible debentures for an aggregate of \$55,000,000. Pursuant to the private placement, the Company issued: (a) \$55,000,000 in convertible debentures, at a conversion price of \$1.30; and (b) 42,350,000 purchase warrants exercisable for one common share at a price of \$1.70 per share prior to December 31, 2021. All purchase warrants issued pursuant to this private placement are subject to certain acceleration provisions. The Company paid finders' fees of \$1,807,125 in cash and issued 2,177,500 finders warrants in the connection with the financing. Finders' fees were allocated to the liability and equity portion of the convertible debt (Note 8).

During the six-month period ending December 31, 2016, a total of 430,000 stock options expired.

On December 31, 2016 the company had 170,446,603 common shares issued and outstanding.

**9b. Share Capital: Share purchase warrants**

On July 15, 2016, the Company issued 1,808,125 purchase warrants and 24,375 finders warrants.

On September 1, 2016, the Company issued 26,526,564 purchase warrants and 631,274 finders warrants. In July 2016 various warrant holders exercised 463,157 warrants generating proceeds of \$148,210, In August 2016 various warrant holders exercised 764,861 warrants generating proceeds of \$244,755, In September 2016 various warrant holders exercised 6,924,000 warrants generating proceeds of \$3,336,657, In October 2016 various warrant holders exercised 4,127,680 warrants generating proceeds of \$1,559,059, In November 2016 various warrant holders exercised 2,051,065 warrants generating proceeds of \$947,516 and In December 2016 various warrant holders exercised 1,025,352 warrants generating proceeds of \$406,349.

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**9b. Share Capital: Share purchase warrants (continued)**

On December 13, 2016, 42,350,000 warrants were issued as part of the convertible debenture financing, these were valued at \$28,511,202. In addition, 2,117,500 finders' warrants were issued in connection to the financing at a fair value of \$1,425,560.

During the six-month period ending December 31, 2016, a total of 897,448 share purchase warrants expired.

On December 31, 2016 the company had 95,279,694 share purchase warrants outstanding.

	Warrants Outstanding	Weighted Average Exercise Price
Outstanding, June 30, 2015	24,791,678	\$0.33
Granted	29,207,624	0.38
Exercised	(15,923,883)	(0.20)
Expired / Cancelled	-	-
Outstanding, June 30, 2016	38,075,419	\$ 0.44
Granted	73,457,838	1.23
Exercised	(15,356,115)	(0.43)
Expired / Cancelled	(897,448)	(0.50)
<b>Outstanding, December 31, 2016</b>	<b>95,279,694</b>	<b>\$ 1.05</b>

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

Exercise Price	Expiry Date	Number of Warrants	Weighted Average Remaining Life
\$ 0.50	July 2, 2017	3,200,000	0.57
\$ 0.50	June 20, 2019	8,682,057	2.47
\$ 0.50	January 23, 2017	163,317	0.06
\$ 0.32	April 23, 2020	6,494,839	3.31
\$ 0.32	July 27, 2017	862,822	0.57
\$ 0.55	July 28, 2018	2,858,821	1.57
\$ 0.50	July 15, 2019	1,495,000	2.50
\$ 0.50	August 30, 2019	27,055,338	2.66
\$ 1.70	December 31, 2022	44,467,500	6.00
		<b>95,279,694</b>	<b>4.12</b>

The warrants were valued using the Black-Scholes option pricing model using the following weighted average range assumptions. The Company has determined that its own historical volatility is not relevant to the current business activity. The company has estimated volatility for the warrants issued in the current year by using the historical volatility of other companies that the Company considers comparable to its current business activities:

	December 31, 2016
Share price	\$0.35 - \$1.82
Expected dividend yield	0.00%
Stock price volatility	89-91%
Expected life of warrants	1-3 years
Forfeiture rate	-
Risk free rate	0.56 - 0.75%

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**9c. Share Capital: Stock options**

As at December 31, 2016, the Company had outstanding and exercisable stock options as follows:

	Options Outstanding	Weighted Average Exercise Price
Outstanding, June 30, 2015	5,700,000	\$ 0.38
Granted	2,935,000	0.48
Exercised	(1,250,000)	0.31
<b>Outstanding and exercisable, June 30, 2016</b>	<b>7,385,000</b>	<b>\$ 0.47</b>
Granted	11,553,783	1.45
Exercised	(2,685,000)	0.43
Expired	(430,000)	(0.49)
<b>Outstanding and exercisable, December 31, 2016</b>	<b>15,823,783</b>	<b>\$ 1.19</b>

As at December 31, 2016, the Company had outstanding and exercisable stock options as follows:

Exercise Price	Expiry Date	Number of Options	Weighted Average Remaining Life (years)
\$ 0.25	May 5, 2019	150,000	2.34
\$ 0.41	October 14, 2019	1,875,000	2.79
\$ 0.50	January 10, 2021	1,645,000	4.03
\$ 0.75	April 25, 2021	800,000	4.32
\$ 0.75	August 29, 2021	3,923,783	4.67
\$ 0.77	September 14, 2021	130,000	4.71
\$ 2.00	December 15, 2026	7,300,000	9.96
		<b>15,823,783</b>	<b>8.66</b>

**9d. Share Capital: Share based payments**

On August 29, 2016 the Company issued 4,123,783 of incentive options to employees, officers, directors and consultants at a price of \$0.75 per share expiring on August 29, 2021. All options vest immediately. The Company recorded the fair value of the options as stock based compensation of \$1,849,771. The Company valued the options using the Black Scholes method using a risk free rate of 0.68%, expected life of 5 years, nil dividend yield, and 89% expected volatility.

On September 14, 2016 the Company issued 130,000 of incentive options to employees, officers, directors and consultants at a price of \$0.77 per share expiring on September 14, 2021. All options vest immediately. The Company recorded the fair value of the options as stock based compensation of \$74,813. The Company valued the options using the Black Scholes method using a risk free rate of 0.73%, expected life of 5 years, nil dividend yield, and 89% expected volatility.

On December 16, 2016 the Company issued 7,300,000 of incentive options to employees, officers, directors and consultants at a price of \$2.00 per share expiring on December 15, 2026. All options vest immediately. The Company recorded the fair value of the options as stock based compensation of \$10,283,980. The Company valued the options using the Black Scholes method using a risk free rate of 1.83%, expected life of 10 years, nil dividend yield, and 91% expected volatility.

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**9d. Share Capital: Share based payments (continued)**

The options were valued using the Black-Scholes option pricing model using the following weighted average assumptions. The Company has determined that its own historical volatility is not relevant to the current business activity. The company has estimated volatility for the options issued in the current year by using the historical volatility of other companies that the Company considers comparable to its current business activities:

	<b>December 31, 2016</b>
Share price	\$0.67 - \$1.66
Expected dividend yield	0.00%
Stock price volatility	89% - 91%
Expected life of options	5 years – 10 years
Forfeiture rate	-
Risk free rate	0.68% - 1.83%

**9e. Reserves:**

Reserves are comprised of share based payments, the equity component of convertible debt and initial fair value of warrants.

**10. Flow-through share liability**

The Company issued flow-through common shares to finance part of past exploration expenditures. The Company incurred a shortfall of qualifying expenditures of \$276,256 to 2012. Pursuant to the terms of the flow-through share agreements, the Company had agreed to indemnify subscribers for the amount of tax benefits lost in the event the amount of qualifying expenditures renounced to subscribers was reduced. Accordingly, at June 30, 2014, the Company recorded a commitment of \$120,000 related to the flow-through shares, representing the estimated amount payable to indemnify the subscribers for the reduced renouncements. The Company also made a provision of \$ 4,372 (2015 - \$4,482) in additional Part XII.6 tax, penalties and interest relating to the shortfall. The total liability for flow-through share commitments as at December 31, 2016 is \$178,164 (2015 - \$169,527).

**11. Related party transactions**

The aggregate value of transactions and outstanding balances to related parties for the six month period ended December 31, were as follows:

<b>Related party transactions</b>	<b>2016</b>	<b>2015</b>
Management and consulting fees	\$ -	\$ 39,515
Share based payments	10,395,242	26,875
Salaries and wages	278,120	-
	<b>\$ 10,673,362</b>	<b>\$ 66,390</b>

<b>Payable at December 31,</b>	<b>2016</b>	<b>2015</b>
Management and consulting fees	\$ -	\$ -
	<b>\$ -</b>	<b>\$ -</b>



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## **12. Capital management**

Capital is comprised of the Company's shareholder's equity and any debt it may issue, other than trade payables in the normal course of operations. As at December 31, 2016, the Company's shareholders' equity was \$49,385,619 (June 30, 2016- \$19,364,554) and liabilities were \$44,068,094 (June 30, 2016 - \$4,847,510). The Company's objective when managing capital is to safeguard its accumulated capital in order to provide adequate return to shareholders by maintaining a sufficient level of funds, in order to support its ongoing activities. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

The Company is dependent on external financing to fund its activities. The Company will spend its existing working capital on operations, development of the Facility and raise additional amounts as needed. The Company is not subject to any externally imposed capital requirements, except as noted in Note 10. There have been no changes in the Company's approach to capital management during the six month period ended December 31, 2016.

## **13. Financial risk management**

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

At December 31, 2016, the Company's financial instruments consist of cash, short term investments, reclamation bonds, investment, accounts payable and accrued liabilities, mortgage payable, and convertible debt. The fair values of cash, reclamation bonds, accounts payable and accrued liabilities, mortgage payable and due to related parties approximate their carrying values due to the relatively short-term to maturity. The Company classifies its cash as FVTPL, reclamation bonds as loans and receivables, investments as available for sale and accounts payable and accrued liabilities, mortgage payable, and convertible debt as other financial liabilities. The fair value of cash is based on level 1 inputs of the fair value hierarchy. The Company is exposed to a variety of financial instrument related risks.

The investment is considered available for sale, and is considered Level 3. As it is a security without a quoted value, cost is currently the best estimate of fair value available to the company. The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

### **Credit risk**

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. Financial instruments that potentially subject the Company to concentrations of credit risks consist principally of cash and reclamation bonds. To minimize the credit risk the Company places these instruments with a high credit quality financial institution of Canada.

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company typically settles its financial obligations out of cash and occasionally will settle liabilities with the issuance of common shares. The ability to settle obligations with cash relies on the Company raising financing in a timely manner and by maintaining sufficient cash in excess of anticipated needs. As at December 31, 2016 the Company had a combined cash and short term investments balance of \$71,726,751 and current liabilities of \$5,392,696. The Company's current resources are sufficient to settle its current liabilities. Management believes the current resources available should be sufficient to complete the sales licensing process, barring any unforeseen delays or complications. All of the Company's liabilities are due within the next twelve months.

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**13. Financial risk management (continued)**

Interest rate risk

The Company is not subject to interest rate risk on future cash flows, as all of its instruments bear fixed rates of interest, other than its flow-through share commitments which bear interest at the Canada Revenue Agency's prescribed rates.

**14. Commitments**

The Company has rental leases under which it is committed to pay the following amounts:

Fiscal 2017	\$22,109
Fiscal 2018	\$23,247

**15. Subsequent events**

Subsequent to December 31, 2016, 100,000 stock options were exercised generating proceeds of \$25,000.

Subsequent to December 31, 2016, 3,911,924 warrants were exercised generating proceeds of \$1,879,680.