# Acerus Pharmaceuticals Corporation

Unaudited Condensed Interim Consolidated Financial Statements

September 30, 2019

(expressed in thousands of U.S. dollars except per share amounts and unless otherwise stated)

**Acerus Pharmaceuticals Corporation**
Condensed Interim Consolidated Statement of Financial Position
As at September 30, 2019 and December 31, 2018
Unaudited
(expressed in thousands of U.S. dollars)

| | Notes | | September 30, 2019 | | December 31, 2018 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current assets** | | | | | |
| Cash | | $ | 4,094 | $ | 3,829 |
| Trade and other receivables | | | 308 | | 1,113 |
| Contract asset | 3(b) | | 536 | | - |
| Inventory | | | 1,574 | | 2,506 |
| Prepaid and other assets | | | 988 | | 176 |
| **Total current assets** | | | 7,500 | | 7,624 |
| Property and equipment, net | | | 1,106 | | 1,267 |
| Right of use asset | 3(c) | | 270 | | - |
| Intangible assets, net | 6 | | 5,009 | | 7,933 |
| **Total assets** | | $ | 13,885 | $ | 16,824 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable and accrued liabilities | 7 | $ | 8,302 | $ | 5,619 |
| Current portion of deferred lease inducement | | | - | | 46 |
| Current portion of lease liability | 3(c) | | 94 | | - |
| **Total current liabilities** | | | 8,396 | | 5,665 |
| Accrued liabilities | 7 | | - | | 2,462 |
| Deferred lease inducement | | | - | | 254 |
| Lease liability | 3(c) | | 525 | | - |
| Long-term debt | 8 | | 13,417 | | 8,287 |
| Derivative financial instruments | | | 355 | | 227 |
| **Total liabilities** | | | 22,693 | | 16,895 |
| **Shareholders' (deficit)** | | | | | |
| Share capital | 9 | $ | 158,402 | $ | 154,737 |
| Warrants | 9 | | 1,420 | | 1,420 |
| Contributed surplus | | | 11,348 | | 11,500 |
| Accumulated other comprehensive loss | | | (13,796) | | (13,851) |
| Deficit | | | (166,182) | | (153,877) |
| **Total shareholders'(deficit)** | | | (8,808) | | (71) |
| **Total liabilities & shareholders' (deficit)** | | $ | 13,885 | $ | 16,824 |

The accompanying notes are an integral part of these unaudited condensed interim consolidated financial statements.
Going concern (note 1)
These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on November 13, 2019.

**Acerus Pharmaceuticals Corporation**

Condensed Interim Consolidated Statement of Loss and Comprehensive Loss
For the three and nine months ended September 30, 2019 and 2018
Unaudited
(expressed in thousands of U.S. dollars, except per share and share data)

| | | For the three months ended, September 30, | | For the nine months ended, September 30, | |
|---|---|---|---|---|---|
| | **Notes** | **2019** | **2018** | **2019** | **2018** |
| **Revenue** | | | | | |
| Product revenue | | $ (167) | $ 1,583 | $ 3,254 | $ 5,159 |
| Licensing and other revenue | | - | - | - | 150 |
| | | (167) | 1,583 | 3,254 | 5,309 |
| Cost of goods sold | 10 | (124) | 777 | 1,847 | 2,833 |
| Royalty buyout | | - | - | - | 6,680 |
| **Gross margin** | | (43) | 806 | 1,407 | (4,204) |
| **Expenses** | | | | | |
| Research and development | 10 | 622 | 751 | 2,307 | 1,827 |
| Selling, general and administrative | 10 | 3,184 | 2,159 | 9,642 | 6,173 |
| **Total operating expenses** | | 3,806 | 2,910 | 11,949 | 8,000 |
| Operating loss | | (3,849) | (2,104) | (10,542) | (12,204) |
| **Other expenses/(income)** | | | | | |
| Interest on long-term debt and other financing costs | 8 | 702 | 718 | 1,868 | 1,276 |
| Interest income | | (5) | (3) | (6) | (12) |
| Foreign exchange (gain)/loss | | 91 | 48 | (94) | 353 |
| Change in fair value of derivative financial instruments | | (25) | 2 | (64) | (88) |
| **Total other expenses** | | 763 | 765 | 1,704 | 1,529 |
| Loss for the period before income taxes | | (4,612) | (2,869) | (12,246) | (13,733) |
| Income tax expense | | - | 2 | - | 2 |
| **Net loss for the period** | | (4,612) | (2,871) | $ (12,246) | $ (13,735) |
| Other comprehensive income, net of income tax | | | | | |
| Foreign currency translation adjustment | | 11 | 8 | 55 | 99 |
| **Total comprehensive loss for the period** | | (4,601) | (2,863) | $ (12,191) | $ (13,636) |
| Loss per common share | | | | | |
| Basic and diluted net loss per common share | 11 | $ (0.02) | $ (0.01) | $ (0.05) | $ (0.06) |
| Weighted average common shares outstanding | | | | | |
| Basic and diluted | 11 | 261,225,290 | 235,262,972 | 252,905,143 | 220,798,110 |

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

**Acerus Pharmaceuticals Corporation**
Condensed Interim Consolidated Statement of Changes in Shareholders' Equity (Deficit)
For the nine months ended September 30, 2019 and 2018
Unaudited
(expressed in thousands of U.S. dollars )

| | Note | Share capital | Warrants | Contributed surplus | Accumulated other comprehensive loss | Deficit | Total |
|---|---|---|---|---|---|---|---|
| **Balance, January 1, 2018** | | $ 151,766 | $ - | $ 11,066 | $ (14,052) | $ (135,091) | $ 13,689 |
| Net loss for the period | | - | - | - | - | (13,735) | (13,735) |
| Foreign currency translation adjustment | | - | - | - | 99 | - | 99 |
| Total comprehensive loss for the period | | - | - | - | 99 | (13,735) | (13,636) |
| Issuance of common shares, net of costs | | 2,943 | - | - | - | - | 2,943 |
| Issuance of warrants, net of costs | | - | 1,420 | - | - | - | 1,420 |
| Exercise of stock options | | 11 | - | - | - | - | 11 |
| Share based compensation | 12 | - | - | 337 | - | - | 337 |
| **Balance as at September 30, 2018** | | $ 154,720 | $ 1,420 | $ 11,403 | $ (13,953) | $ (148,826) | $ 4,764 |
| **Balance as at January 1, 2019** | | $ 154,737 | $ 1,420 | $ 11,500 | $ (13,851) | $ (153,877) | $ (71) |
| *Adjustment for IFRS 16: Leases* | 3(c) | - | | | - | (59) | (59) |
| **Adjusted Balance as at January 1, 2019** | | 154,737 | 1,420 | 11,500 | (13,851) | (153,936) | (130) |
| Net loss for the period | | - | - | - | - | (12,246) | (12,246) |
| Foreign currency translation adjustment | | - | - | - | 55 | - | 55 |
| Total comprehensive loss for the period | | - | - | - | 55 | (12,246) | (12,191) |
| Issuance of common shares, net of costs | 9 | 3,350 | | | | | 3,350 |
| Exercise of stock options | 9 | 315 | | (315) | | | - |
| Share based compensation | 12 | - | - | 163 | - | - | 163 |
| **Balance as at September 30, 2019** | | $ 158,402 | $ 1,420 | $ 11,348 | $ (13,796) | $ (166,182) | $ (8,808) |

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

## Acerus Pharmaceuticals Corporation

Condensed Interim Consolidated Statement of Cash Flows
For the nine months ended September 30, 2019 and 2018
Unaudited
(expressed in thousands of U.S. dollars)

| | Note | September 30, 2019 | September 30, 2018 |
|---|---|---|---|
| **Operating activities:** | | | |
| Net loss for the period | | $ (12,246) | $ (13,735) |
| Items not affecting cash: | | | |
| Adjustment for unrealized foreign exchange (gain)/loss | | (190) | 361 |
| Amortization of intangible assets | 6 | 642 | 1,300 |
| Depreciation of property and equipment | 10 | 191 | 193 |
| Depreciation of right of use asset | 10 | 35 | - |
| Amortization of deferred leasehold inducement | | - | (37) |
| Interest on long-term debt and other financing costs | 8 | 1,868 | 1,276 |
| Change in fair value of derivative financial instruments | | (64) | (88) |
| Share based compensation | 10, 12 | 163 | 337 |
| Gain on disposal of property and equipment | | (5) | - |
| Impairment on intangible asset | 6 | 2,536 | - |
| Inventory impairment | 10 | 316 | - |
| Net changes in non-cash working capital items related to operating activities: | | | |
| Trade and other receivables | | 994 | 476 |
| Contract asset | 3(b) | (694) | - |
| Inventory | | 638 | 45 |
| Prepaids and other assets | | (611) | (113) |
| Accounts payable and accrued liabilities | | (478) | 4,203 |
| Licensing fee receivable | | - | 300 |
| **Net cash used in operating activities** | | (6,905) | (5,482) |
| | | | |
| **Financing activities** | | | |
| Interest and financing fees paid | 8 | (1,127) | (557) |
| Proceeds from issuance of common shares, net of financing costs | 9 | 3,350 | 4,374 |
| Payment of long-term debt | | - | (1,500) |
| Principal elements of lease payments | 3(c) | (59) | - |
| Proceeds from issuance of long-term debt | 8 | 5,000 | 1,571 |
| **Net cash from/(used in) financing activities** | | 7,164 | 3,888 |
| | | | |
| **Investing activities** | | | |
| Proceeds from disposition of property and equipment | | 5 | - |
| Acquisition of property and equipment, net of deposits | | (13) | (88) |
| Acquisition of product rights | 6 | (100) | (156) |
| **Net cash used in investing activities** | | (108) | (244) |
| | | | |
| **Net increase/(decrease) in cash for the period** | | 151 | (1,838) |
| Exchange gain/(loss) on cash | | 114 | (87) |
| Cash, beginning of period | | 3,829 | 3,156 |
| Cash, end of period | | $ 4,094 | $ 1,231 |

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

## 1. GOING CONCERN

These unaudited condensed interim consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due for the foreseeable future.

The ability of Acerus Pharmaceuticals Corporation ("Acerus") and its subsidiaries (together, the "Company") to realize its assets and meet its obligations as they come due is dependent on successfully commercializing its existing products, bringing new products and technologies to market and achieving future profitable operations, the outcome of which cannot be predicted at this time. Furthermore, the Company will require additional funding, either from commercial sales of its existing products or commercial transactions with lenders or investors, to continue the development and commercialization of additional products. These circumstances lend significant doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the ultimate appropriateness of the use of accounting principles applicable to a going concern.

Management has assessed the Company's ability to continue as a going concern and concluded that in order to complete its planned product development and commercialization programs, and meet the amended minimum threshold for consolidated unencumbered liquid assets required to be maintained by the Company in December 2019 and January 2020 (note 8) additional capital will be required. In addition, the anticipated shortage of certain strengths of Estrace® in 2019 and the manufacturing process change in Natesto® that resulted in Health Canada requiring the submission of a Supplemental New Drug Submission ("SNDS") before the product can be re-introduced to the Canadian market could result in the Company failing to meet projected revenues or other budgeted targets, which could result in the Company violating its debt financial covenants within the next twelve months. The Company's ability to accomplish its strategic plans is dependent upon earning sufficient revenues from existing products, bringing new products and technologies to market, achieving future profitable operations and obtaining additional financing, and executing other strategic initiatives that could provide cash flows, or alternatively curtailing expenditures. There are no assurances that any of these initiatives will be successful. Factors within and outside the Company's control could have a significant bearing on its ability to obtain additional financing.

These unaudited condensed interim consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and statement of financial position classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

## 2. DESCRIPTION OF BUSINESS

These unaudited condensed interim consolidated financial statements represent the consolidated accounts of Acerus (incorporated in Ontario, Canada) and its wholly-owned subsidiaries, Acerus Labs Inc. ("ALI") (incorporated in Ontario), Acerus Biopharma Inc. ("ABI") (incorporated in Ontario), and Acerus Pharmaceuticals (Barbados) Inc. ("APBI") (incorporated in Barbados). APBI was dissolved on February 26, 2018. The head office, principal address and records office of the Company are located in Mississauga, Ontario, Canada. The Company's registered address is 2486 Dunwin Drive, Mississauga, Ontario, L5L 1J9.

Acerus is a Canadian-based specialty pharmaceutical company focused on the development, manufacture, marketing and distribution of branded products that improve patient experience, with a primary focus in the field of men's and women's health. The Company commercializes its products via its own salesforce in Canada, and through a global network of licensed distributors in the U.S. and other territories.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies applied in these unaudited condensed interim consolidated financial statements are consistent with the significant accounting policies used in the preparation of the annual audited consolidated financial statements for the year ended December 31, 2018 except for the adoption of IFRS 16 *Leases* starting January 1, 2019.

### (a) Basis of presentation

These unaudited condensed interim consolidated financial statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34, Interim Financial Reporting. The unaudited condensed interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2018, which have been prepared in accordance with IFRS as issued by the IASB.

### (b) Revenue estimate

Historically, the Company recognized revenue for certain partners in two steps: 1) at a contractual supply price when the product is delivered to the marketing partner; and 2) an additional top-up amount is earned based on a pricing schedule when the marketing partner recognizes sales of the product. Variable additional top-up amounts were estimated based on the partners' reported net sales for the period. The Company previously only recognized the top-up revenue when the partner sold the product as it was unable to reliably estimate its portion of revenue. While the Company still does this for its South Korean partner, the Company now believes there are sufficient stable historical results to estimate the top-up revenue earned per unit that is highly probable of not resulting in a significant reversal of cumulative revenue in the future for its U.S. partner. As of January 1, 2019, the Company commenced recognizing revenue for this partner on delivery of the product as the sum of two items: 1) the contractual supply price when the product is delivered; 2) an estimate of the top-up revenue that is highly probable will be earned when the marketing partner recognizes sale of the product. An adjustment is made, if required, to the actual top-up revenue earned when the marketing partner recognizes sale of the product. As this change was done in 2019 the Company made a one-time adjustment to revenue of $694 in March 2019 to recognize top-up revenue for the units the marketing partner currently had on hand. For the three and nine months ending September 30, 2019, Acerus earned a total of $145 and $609 in Tier 2 revenue from its marketing partner. Of this amount, $65 and $158 for the three and nine months revenue respectively, was previously recognized as part of the one-time adjustment made in Q1 2019 for inventory units held by the marketing partner. The remaining $80 and $451 was recognized in revenue for the three and nine months ending September 30, 2019.

### (c) New and amended standards

A number of new or amended standards became applicable for the current reporting period, and the Company had to change its accounting policies and make adjustments as a result of adopting IFRS 16 *Leases.* The impact of the adoption of the leasing standard and the new accounting policies are disclosed below. The other standards did not have any impact on the Company's accounting policies and did not require retrospective adjustments.

<u>IFRS 16 *Leases*</u>

The Company has adopted IFRS 16 on a modified retrospective basis from January 1, 2019, with no restatement of comparatives, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on January 1, 2019.

On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17 *Leases*. These liabilities were measured at the present value of the remaining lease payments excluding renewal options as they are not reasonably certain that the options will be exercised, discounted using the Company's incremental borrowing rate as of January 1, 2019. The weighted average incremental borrowing rate applied to the lease liabilities on January 1, 2019 was 6.25%.

## 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) New and amended standards (continued)

The following is a reconciliation of total operating lease commitments at December 31, 2018 to the lease liabilities recognized at January 1, 2019:

| | | |
|---|---|---|
| Total operating lease commitments disclosed at December 31, 2018 | $ | 1,152 |
| Variable lease payments not recognized in lease liability | | (357) |
| Operating lease liabilities before discounting | | 795 |
| Discounted using incremental borrowing rate | | (135) |
| Total lease liabilities recognized under IFRS 16 at January 1, 2019 | $ | 660 |
| | | |
| Of which are: | | |
| Current lease liabilities | | 78 |
| Non-current lease liabilities | | 582 |

The associated right-of-use asset for the property lease was measured on a retrospective basis as if the new rules had always been applied adjusted by the amount of any prepaid or accrued lease payments and deferred lease inducement relating to that lease recognized in the statement of financial position as at December 31, 2018. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets to the date of initial application.

The recognized right-of-use asset relates to the lease on the Canadian facilities. The change in accounting policy affected the following items in the statement of financial position on January 1, 2019:

- Right-of-use assets – increased by $296
- Prepaid and other assets – decreased by $26
- Lease liabilities - increased by $660
- Accrued lease rentals – decreased by $31
- Deferred lease inducement – decreased by $300

The net impact on deficit on January 1, 2019 was an increase of $59. Segment assets for September 30, 2019 increased by $244 as a result of the change in accounting policy.

In applying IFRS 16 for the first time, the Company used the following practical expedients permitted by the standard:

- reliance on previous assessments on whether leases are onerous
- elected to account for the payments for short-term leases and leases of low-value assets as an expense in the statement of loss on a straight-line basis over the lease term
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

For the three and nine months ended September 30, 2019 depreciation of the right of use asset was $12 and $35 respectively. The right of use asset is depreciated on a straight-line basis over the term of the lease.

| | | |
|---|---|---|
| Right of use asset, January 1, 2019 | $ | 296 |
| Depreciation of right of use asset | | (35) |
| Foreign exchange effect | | 9 |
| Right of use asset, September 30, 2019 | $ | 270 |

## 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) New and amended standards (continued)

For the three and nine months ended September 30, 2019 finance charges on the lease liability were $9 and $28 respectively (included in Interest on long-term debt and other financing costs in the consolidated statement of loss and comprehensive loss) and the expense related to variable lease payments not included in the measurement of lease liabilities was $13 and $47 respectively (included in selling, general & administrative expenses in the consolidated statement of loss and comprehensive loss). The lease term matures on June 30, 2025.

| | | |
|---|---|---|
| Lease liabilities, January 1, 2019 | $ | 660 |
| Payments | | (59) |
| Foreign exchange effect | | 18 |
| Lease liabilities, September 30, 2019 | | 619 |
| Current lease liabilities | | 94 |
| Non-current lease liabilities | $ | 525 |

As at September 30, 2019, the Company has the following obligations to make future payments related to the lease liabilities:

| | | September 30, 2019 |
|---|---|---|
| No later than 1 year | $ | 128 |
| Later than 1 year and no later than 5 years | | 529 |
| Later than 5 years | | 72 |
| | | 729 |
| Finance charges | | (110) |
| Total lease liabilities | $ | 619 |

Until December 31, 2018, leases of property and equipment were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

From January 1, 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Company. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to comprehensive loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of fixed lease payments.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. Subsequent to initial measurement, the liability will be reduced for payments made and increased for interest. It is remeasured to reflect any reassessment or modification, or if there are changes in in-substance fixed payments. When the lease liability is remeasured, the corresponding adjustment is reflected in the right-of-use asset, or comprehensive loss if the right-of-use asset is already reduced to zero.

## 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) New and amended standards (continued)

Right-of-use assets are measured at cost comprising the following:

- The amount of the initial measurement of lease liability
- Any lease payments made at or before the commencement date less any lease incentives received
- Any initial direct costs, and
- Any restoration costs

Payments associated with short-term leases and leases of low-value assets are recognized on a straight-line basis as an expense in comprehensive loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT-equipment.

*Other pronouncements*

IFRIC 23 *Uncertainty over Income Tax Treatments,* became effective on January 1, 2019. It did not have a significant impact on the Company's financial results or position on adoption.

## 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In preparing the Company's unaudited condensed interim consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the unaudited condensed interim consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results may differ from these estimates. In preparing the unaudited condensed interim consolidated financial statements, the significant estimates made by management include those that applied to and are disclosed in the Company's annual audited consolidated financial statements for the year ended December 31, 2018 and the items listed below:

*Lease liability*

In determining the lease term, management considers all the facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. The extension option is only included in the lease term if the lease is reasonably certain to be extended. The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within management's control.

The lease payments are discounted using the interest rate implicit in the lease. As that rate could not be determined, management estimated the Company's incremental borrowing rate, being the rate it would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

## 5. PRODUCTS

### (a) Bio-adhesive gel technology

In May 2009 (and in accordance with certain subsequent contractual amendments), ABI acquired certain rights from M&P Patent AG (since renamed Mattern Pharma) to use certain technology to develop, apply for and obtain regulatory approval, and to manufacture and sell four product candidates pursuant to an Intellectual Property Rights and Product Development Agreement ("IP Agreement") in exchange for milestones, royalties based on the Company's gross margin, and other payments depending on the achievement of specified goals for Natesto® and Tefina™.

On May 17, 2018, the Company entered into an agreement with Mattern Pharma AG (Mattern) to buy out all of its obligations (the "Buyout") under the Amended and Restated Intellectual Property Rights and Product Development Agreement, dated December 21, 2013 (as amended) ("License Agreement"), including all of its future royalty payment obligations.

**5. PRODUCTS (continued)**

**(a) Bio-adhesive gel technology (continued)**

Under the License Agreement, Acerus owed royalties on upfronts, milestones and revenues from products, including Natesto®, covered by the License Agreement, including minimum annual royalties of $5,000 if gross product sales are $75,000 or greater or $2,500 if gross product sales are below $75,000 starting in fiscal 2018 and ending in 2024. Pursuant to the Buyout, with the payment of $7,500, all of Acerus' material obligations owed to Mattern are suspended, but Mattern's obligations to Acerus remain in force. Under the Buyout, among other rights, Acerus receives a perpetual, fully-paid, irrevocable license to all of Mattern's patents and know-how for the products covered by the License Agreement.

Acerus will pay the $7,500 in the following instalments: $750 was paid in July 2018, $1,750 was paid in September 2018, $625 was paid in January 2019, $2,025 was paid in April 2019 which includes a deferral fee of $150, and $2,500 by January 20, 2020 (subject to deferral rights). The Company recorded an expense of $6,680 in the year ended December 31, 2018, representing the fair value of the $7,500 obligation under the Buyout. The fair value was estimated by discounting the payments using a rate of 14.75%.

The Buyout also includes a covenant not to sue and a waiver from Mattern, which will become irrevocable upon payment of the last instalment to Mattern. The Buyout will remain in full force and effect as long as the License Agreement is in force. In the event of a payment default, following a grace period, the Buyout automatically terminates and the License Agreement's obligations become binding on Acerus again. In such an eventuality, all monies paid by Acerus pursuant to the Buyout, with the exception of the first instalment, can be offset against monies that would otherwise be owed to Mattern under the License Agreement.

**(b) Pulmonary and nasal dry powder delivery technology**

On November 30, 2009, ABI entered into an asset purchase agreement with Keldmann Healthcare A/S ("Keldmann"), a privately-held Denmark-based technology company.

Pursuant to the terms of the asset purchase agreement, ABI paid $4,500 to Keldmann to acquire the Direct Haler technology platform (TriVair) for pulmonary and nasal delivery of pharmaceutical medications. This acquisition was accounted for as a purchase of identifiable intangible and tangible assets.

As part of this transaction with Keldmann, and pursuant to an Amended Product Development Agreement dated December 30, 2009, ABI may collaborate with Keldmann on the development of certain product candidates in exchange for consulting fees and will make milestone, royalty and other payments depending on achievement of specified development and other goals.

There is a milestone payment of $2,000 due upon Food and Drug Administration ("FDA") approval for each product to a maximum of $8,000 for products ABI files itself. As well, there is a cap on royalty payments of $25,000 per product.

**(c) Estrace®**

The Company acquired the Canadian rights to Estrace® from affiliates of Shire plc in July 2014. The acquisition was accounted for as a business combination. On January 11, 2019, the Corporation reported an anticipated shortage of certain doses of Estrace® on the Drug Shortages Canada website in relation to supply issues arising from the Corporation's contract manufacturer. A shortage of Estrace® may accelerate erosion of Estrace® sales due to the presence of the third-party generic.

**(d) Gynoflor™**

The Company entered into a license and supply agreement with Medinova AG ("Medinova"), a Swiss pharmaceutical company, granting the Company the exclusive rights to commercialize Gynoflor™ in Canada. On January 24, 2019 the Company received a Notice of Deficiency-Withdrawal Letter ("Notice") for its Gynoflor™ New Drug Submission.

On June 17, 2019, the Company terminated the license and supply agreement with Medinova.

**5. PRODUCTS (continued)**

**(e) Elegant™ franchise**

On December 20, 2017, the Company entered into a license, development and supply agreement with Viramal Limited (“Viramal”), a London-based specialty pharmaceutical company, granting the Company exclusive rights to commercialize the Elegant™ franchise in Canada. Under the terms of the license, development and supply agreement, the Company will pay Viramal a regulatory milestone payment upon the Company receiving marketing approval in Canada, as well as milestone payments based on achieving sales targets. Viramal will oversee the manufacturing of Elegant™ and will receive a supply price for the product.

**(f) UriVarx®**

On January 8, 2018 the Company entered into an exclusive distributor and license agreement with Innovus Pharmaceuticals, Inc. (“Innovus”), granting Acerus the exclusive rights to commercialize UriVarx® in Canada. Under the terms of the exclusive distributor and license agreement, the Company paid an upfront payment at signing and will pay milestone payments based on the Company achieving certain sales targets. Innovus will oversee the manufacturing of UriVarx® and will receive a supply price for the product.

The Company reached a mutual agreement with Innovus to terminate the exclusive distributor and license agreement effective June 1, 2019.

**(f) avanafil (formerly identified as Stendra®)**

On March 27, 2018 the Company entered into an exclusive distributor and license agreement with Metuchen Pharmaceuticals LLC (“Metuchen”), a privately-held specialty pharmaceutical company, granting Acerus the exclusive rights to commercialize avanafil in Canada. Avanfil is a new chemical entity targeting the large and growing Erectile Dysfunction (“ED”) market and is available in the U.S. under the brand name Stendra®. Under the terms of the sublicense agreement, Metuchen will receive regulatory milestone payments upon Acerus filing a New Drug Submission (“NDS”) with Health Canada and upon Acerus receiving marketing approval in Canada. Metuchen will also receive milestone payments based on Acerus achieving sales targets. Metuchen will oversee the manufacturing of avanafil and will receive a supply price for the product comprised of a transfer price and royalties on net sales of the product. On March 4, 2019, the Company announced it filed a NDS for avanafil with Health Canada. The initial screening process by Health Canada was completed in June 2019. The dossier is now in active review by Health Canada.

**(g) Lidbree™**

On May 29, 2018 the Company entered into an exclusive agreement with Pharmanest AB (“Pharmanest”) to commercialize Short Acting Lidocaine Product (“Lidbree™” formerly referred to as “Shact™”), a pain relief drug device combination in Canada. Under the terms of the license agreement, Pharmanest will receive an upfront and regulatory milestone payments upon the Company receiving marketing approval in Canada. Pharmanest will also receive milestone payments based on the Company achieving sales targets. Pharmanest will oversee the manufacturing of Lidbree™ and will receive a tiered supply price for the product comprised of a percentage on net sales of the product.

## 6. INTANGIBLE ASSETS

| | Technology and patents | Product rights | Total |
|---|---|---|---|
| **Costs** | | | |
| Balance, January 1, 2019 | $ 4,400 | $ 29,382 | $ 33,782 |
| Addition | - | 100 | 100 |
| Disposal | - | (73) | (73) |
| Effect of foreign currency exchange difference | - | 883 | 883 |
| Balance, September 30, 2019 | $ 4,400 | $ 30,292 | $ 34,692 |
| | | | |
| **Accumulated depreciation** | | | |
| Balance, January 1, 2019 | $ 2,415 | $ 23,434 | $ 25,849 |
| Amortization | 82 | 560 | 642 |
| Disposal | - | (73) | (73) |
| Impairment charges | - | 2,536 | 2,536 |
| Effect of foreign currency exchange difference | - | 729 | 729 |
| Balance, September 30, 2019 | $ 2,497 | $ 27,186 | $ 29,683 |
| | | | |
| **Net book value** | | | |
| September 30, 2019 | $ 1,903 | $ 3,106 | $ 5,009 |

| | Technology and patents | Product rights | Total |
|---|---|---|---|
| **Costs** | | | |
| Balance, January 1, 2018 | $ 4,400 | $ 31,484 | $ 35,884 |
| Addition | - | 458 | 458 |
| Effect of foreign currency exchange difference | - | (2,560) | (2,560) |
| Balance, December 31, 2018 | $ 4,400 | $ 29,382 | $ 33,782 |
| | | | |
| **Accumulated depreciation** | | | |
| Balance, January 1, 2018 | $ 2,305 | $ 21,018 | $ 23,323 |
| Amortization | 110 | 1,584 | 1,694 |
| Impairment charge | - | 2,641 | 2,641 |
| Effect of foreign currency exchange difference | - | (1,809) | (1,809) |
| Balance, December 31, 2018 | $ 2,415 | $ 23,434 | $ 25,849 |
| | | | |
| **Net book value** | | | |
| December 31, 2018 | $ 1,985 | $ 5,948 | $ 7,933 |

Amortization expense related to the technology and patents is computed based on the life of the existing patents and is included in the research and development expense on the interim consolidated statement of loss and comprehensive loss. The remaining life of the Direct Haler patents and patent applications (if issued) is 17 years and 4 months. Amortization of $27 and $82 has been recorded for the three and nine months ended September 30, 2019 ($27 and $82 for the three and nine months ended September 30, 2018).

Product rights includes rights for Estrace®, Lidbree™, UriVarx® and avanafil. Of the product acquisition costs, $300 was accrued but not payable as of September 30, 2019. Amortization of $139 and $530 has been recorded in cost of goods sold and $11 and $30 in research and development costs for the three and nine months ended September 30, 2019 ($396 and $1,194 in cost of goods sold and $24 and $24 in research and development costs for the three and nine months ended September 30, 2018).

The Company reached a mutual agreement with Innovus to terminate the exclusive distributor and license agreement for UriVarx effective June 1, 2019. As such the Company wrote off a net of $65 ($73 of cost and $8 of accumulated depreciation) representing the remaining balance of the UriVarx intangible asset.

## 6. INTANGIBLE ASSETS (continued)

On January 11, 2019, the Company reported an anticipated shortage of certain doses of Estrace® on the Drug Shortages Canada website in relation to supply issues arising from the Company's contract manufacturer. The Company was notified by its contract manufacturer of a partial manufacturing license suspension at the facility where Estrace® is being produced as a result of an audit by U.K. health authorities. Anticipating a potential shortage of certain strengths of Estrace® over the next six months, the Company impaired the related intangible asset by $2,641 at December 31, 2018. In 2019, the Company was informed of further delays in lifting the license suspension and as a result, the Company impaired the asset by a further $2,471 at March 31, 2019. An alternative manufacturer has been identified and the Company is working towards supply of product in the first half of fiscal 2020.

A shortage of Estrace® may accelerate erosion of Estrace® sales due to the presence of the third-party generic. The intangible asset was written down to its recoverable amount in both 2018 and 2019 using a value-in-use discounted cash flow model. Key assumptions included a pre-tax discount rate of 16.9%, estimated cash flows, projected declines in revenue and for the 2019 model an increased cost of goods related to transferring the product to a different contract manufacturer. In the model, the Company assumed it would receive product by the second quarter in fiscal 2020 (versus by September 2019 in the 2018 impairment model). Assuming all variables remain constant, an increase or decrease in discount rate used in the 2019 impairment model by 1% would have resulted in a $114 increase and $123 decrease in net loss respectively. Assuming all variables remain constant, an increase or decrease in estimated revenues used by 10% would have resulted in a $415 decrease and $419 increase in net loss respectively.

## 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | September 30, 2019 | December 31, 2018 |
|---|---|---|
| Accounts payable | $ 1,049 | $ 1,378 |
| Employee salaries and benefits payable | 468 | 925 |
| Buyout payable (note 5a) | 2,419 | 2,488 |
| Interest and financing fees payable | 276 | 317 |
| Accrued liabilities | 1,007 | 300 |
| Payables related to Natesto® US co-promote | 2,088 | - |
| Provision for returns and discounts | 995 | 211 |
| Total current accounts payable and accrued liabilities | $ 8,302 | $ 5,619 |
| Other long-term accruals | - | 300 |
| Buyout payable (note 5a) | - | 2,162 |
| Total accounts payable and accrued liabilities | $ 8,302 | $ 8,081 |

On August 2, 2019, the Company announced that it will voluntarily replace certain Natesto® lots released in the Canadian and South Korean markets, which is expected to cause temporary shortages in those markets. Acerus has identified four commercial lots of Natesto® released in the Canadian and South Korean markets that were found to be non-conforming during long-term stability studies, even though such lots were fully in-specification at the time of release. This post-release non-conformity is not harmful to the patient, but may result in difficulties in dispensing.

Acerus made minor modifications to the manufacturing process that appear to have resolved the previously identified issues and has produced a batch of Natesto® (the "Revised Batch"). While Acerus believed the changes would have been classified by Health Canada as level III, thereby requiring only an annual notification update to Health Canada and allowing for product to be released in Q4-2019, Health Canada, after much deliberation, classified the modifications as level I, requiring the submission of a SNDS prior to the release of the Revised Batch in the Canadian market. In the event that Health Canada utilizes the full regulatory allotted time for reviewing a SNDS, Acerus would expect the Revised Batch to be released in the Canadian Market in Q1-2021. Acerus continues to work with Health Canada to facilitate an expeditious review of the SNDS and minimize market disruptions.

## 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES (continued)

At this time, the current supply of Natesto® to the United States is not affected by this situation. Acerus is working with its South Korean partner to determine whether the Revised Batch can be released in the South Korean market and, if so, under what timeframes.

The Company had previously impaired inventory by $339 and accrued $453 related to replacing products, discounts and potential returns due to the issue described above. However, due to the additional delays, the Company reversed the previous accruals related to discounts and replacement of product and has accrued $660 for returns in the current quarter.

## 8. LONG-TERM DEBT

| | Promissory Note | Quantius Debt | SWK Facility | First Generation Loan | Total |
|---|---|---|---|---|---|
| Balance, January 1, 2018 | $ 2,357 | $ 2,212 | $ - | $ - | $ 4,569 |
| Accrued royalty payable | - | 306 | - | - | 306 |
| Amortization of deferred financing costs | - | 180 | 60 | - | 240 |
| Transaction costs | - | - | (773) | - | (773) |
| Debt issuance | - | 1,571 | 9,000 | - | 10,571 |
| Repayment of principal and royalty payable | (2,357) | (4,207) | - | - | (6,564) |
| Effect of foreign currency exchange difference | - | (62) | - | - | (62) |
| Balance, December 31, 2018 | $ - | $ - | $ 8,287 | $ - | $ 8,287 |
| Current portion at December 31, 2018 | - | - | - | - | - |
| Long-term portion at December 31, 2018 | $ - | $ - | $ 8,287 | $ - | $ 8,287 |
| | | | | | |
| Balance, January 1, 2019 | $ - | $ - | $ 8,287 | $ - | $ 8,287 |
| Amortization of deferred financing costs | - | - | 260 | - | 260 |
| Transaction costs | - | - | 14 | - | 14 |
| Warrant modification/issuance | - | - | (107) | | (107) |
| Debt issuance | - | - | - | 5,000 | 5,000 |
| Repayment of principal and royalty payable | - | - | - | - | - |
| Effect of foreign currency exchange difference | - | - | (37) | - | (37) |
| Balance, September 30, 2019 | $ - | $ - | $ 8,417 | $ 5,000 | $ 13,417 |
| Current portion at September 30, 2019 | - | - | - | - | - |
| Long-term portion at September 30, 2019 | $ - | $ - | $ 8,417 | $ 5,000 | $ 13,417 |

*Endo – Promissory note*

Pursuant to the transition agreement between Acerus and an affiliate of Endo International plc ("Endo"), the parties entered into an agreement related to the unused customer deposit (pre-paid inventory) owed to Endo following the termination of the Natesto® license agreement in 2016. A $500 cash payment was paid to Endo in July 2016 and $3,800 of the remaining principal amount were subject to a promissory note, of which $500 was paid in December 2016 and the remaining amounts were payable in equal quarterly installments of $236 with the final payment and maturity date of June 30, 2020. The promissory note was unsecured and bore interest at a rate of LIBOR + 9.5% per annum with a LIBOR floor rate of 1%.

On March 15, 2018, the promissory note was amended such that principal repayments under the promissory note would now be made annually on the last business day of December of each year instead of quarterly. Payments of interest were to continue to be made quarterly.

On July 5, 2018, the promissory note was amended such that Endo accepted a prepayment of $1,500 in full satisfaction of the Company's obligation to prepay a portion of the promissory note from 50% of the net proceeds of the equity financing closed on June 28, 2018. Under the amended promissory note, the remaining balance and all interest accrued and unpaid would be paid the earlier of (i) the next equity financing completed by the Company; and (ii) June 30, 2019 unless another pre-payment obligation under the promissory note is triggered.

On October 11, 2018, the promissory note and outstanding accrued interest was repaid in full and the note was extinguished.

## 8. LONG-TERM DEBT (continued)

*Quantius Inc. credit facility*

On December 6, 2017, Acerus entered into a senior secured term credit facility with Quantius Inc. ("Quantius") for up to CDN$5,000 of which CDN$3,000 was available at closing, with the remaining CDN$2,000 received on April 20, 2018 following the satisfaction of certain conditions, including 1) Aytu achieving a pre-determined number of prescriptions per month for Natesto® in the U.S., and 2) maintaining Estrace® sales at a pre-determined minimum level. For the year ended December 31, 2018, the proceeds from the Quantius credit facility, net of financing costs paid amounted to $1,571.

The credit facility bore interest at a rate equivalent to the Bank of Canada prime plus 11.05% and was due to mature on December 1, 2019. The credit facility was repayable in monthly instalments of 1/48 of the balance owing commencing December 1, 2018 with the remaining balance due at maturity. As part of the transaction, Quantius received an underwriting fee representing low single digit percentage of the maximum facility amount and received a royalty fee representing low single digit percentage of revenues over the term of the facility, capped at a high single digit percentage of the borrowed amount. Under terms of the agreement, the Company had the option to prepay the credit facility with the payment of low single digit prepayment penalties depending on the timing of pre-payment. The prepayment penalties could be fully offset against the royalty fee payable at maturity. The terms of the agreement also contained customary financial covenants.

The credit facility was subsequently extinguished on October 12, 2018 with payment of principal, accrued interest pre-payment penalty and royalty retirement fee.

*SWK credit facility*

On October 12, 2018, the Company entered into a senior secured term loan credit facility with SWK Funding LLC ("SWK") for up to $11,000 ("New Facility"). An initial tranche of $9,000 of the New Facility was received at closing, with the remaining $2,000 of the New Facility becoming available on or before March 31, 2019, upon satisfaction of certain future conditions. As the conditions were not satisfied, the Company was not able to draw on the additional $2,000 on March 31, 2019.

The New Facility bears interest at a rate per annum equal to the greater of (a) the three-month London Inter-Bank Offered Rate ("LIBOR"), or (b) 1.50%, with such base rate being capped at no greater than 4.25%, plus an applicable margin of 10.50%. The New Facility matures on October 11, 2023 and is interest-only for the first two years of the term. Principal payments thereafter will be based on a tiered percentage of net revenue with a cap of $600 per quarter.

As part of the transaction, SWK received an origination fee representing a low single digit percentage of the maximum facility amount, and will receive a final payment on maturity representing a single digit percentage of the principal amount actually advanced under the facility. Acerus has also issued 5,331,563 common share purchase warrants (the "Original Warrants") to SWK as partial consideration for the New Facility. Each Warrant entitles SWK to purchase one common share of Acerus at an exercise price of CDN$0.40 per common share, expires on October 11, 2023 and has a cashless exercise feature. Following the second anniversary of the issuance of the Warrants, the Company can cause SWK to exercise the Warrants prior to their expiry date if the closing price of the Company's common shares on the TSX trades at or above CDN$0.80 per share for a period of at least 21 consecutive trading days.

The proceeds from the New Facility was used primarily to (i) repay the amount outstanding under the Quantius Facility, including a prepayment penalty and royalty retirement fee; (ii) retire the Endo promissory note; and (iii) for ongoing general working capital.

Under the terms of the agreement, the Company will have the option to prepay the loan prior to the maturity date subject to the payment of certain prepayment fees. The terms of the agreement also contain customary financial covenants some of which were amended on June 28, 2019.

**8. LONG-TERM DEBT (continued)**

On September 30, 2019 the Company received a waiver letter from SWK waiving the requirement to comply with the Adjusted EBITDA and Aggregate Revenue covenants as at September 30, 2019 contained in the credit agreement.

The Company also amended the debt agreement to set the minimum threshold for Consolidated Unencumbered Liquid Assets required to be maintained by the Company. This amount is defined in the agreement as cash adjusted for a certain portion of accounts receivable and payable. This level will be set at (i) $1,000 at September 30, 2019; (ii) $5,000 at December 15, 2019; (iii) $4,000 at December 31, 2019; (iv) $2,000 at January 31, 2020, and (v) $1,000 at all times after January 31, 2020. In connection with the amendment, the Company agreed to reprice the 5,331,563 Original Warrants from CDN$0.40 to CDN$0.11. In addition, the Original Warrants' expiry date was extended from October 11, 2023 to September 30, 2024. No other changes were made to the term of the Original Warrants. On October 3, 2019, the Company issued 1,361,544 common share purchase warrants (the "new Warrants") to SWK in connection with the amendment. Each New Warrant will entitle SWK to purchase one common share of Acerus at an exercise price of CDN$0.11 per common share and will expire on September 30, 2024. The terms of the New Warrants will otherwise be identical to those of the Original Warrants. As such, in certain circumstances, the Company may cause SWK to exercise the New Warrants prior to their expiry date if the closing price of the Company's common shares on the TSX exceeds CDN$0.80 per share for a period of at least 21 consecutive trading days. The obligation to issues these share purchase warrants are recorded as a warrant derivative liability on the balance sheet as of September 30, 2019 with a value of $71.

As of September 30, 2019, the Company had $9,000 outstanding on the credit facility.

*First Generation Loan*

On July 18, 2019, the Company entered into a $5,000 subordinated secured term loan facility ("the Loan") with First Generation Capital Inc. ("First Generation"), a company affiliated with the Chairman of the Board of Directors of Acerus.

The Loan is subordinated to the existing $9,000 facility with SWK and bears interest at a rate per annum equal to the three-month LIBOR, plus an applicable margin of 10.50%. Subject to the terms of the subordination and intercreditor agreement between First Generation and SWK, the Loan is repayable in full on December 31, 2020, is interest-only until maturity with regularly scheduled payments of interest to First Generation being permitted subject to certain conditions related to Acerus' market capitalization and aggregate annual revenue, and can be prepaid in full or in part without penalty following repayment in full of indebtedness owing to SWK.

As of September 30, 2019, the Company had $5,000 outstanding on the credit facility.

*Interest and financing costs*

Interest expense on long-term debt was $462 and $1,081 for the three and nine months ended September 30, 2019 ($378 and $791 for the three and nine months ended September 30, 2018).

## 8. LONG-TERM DEBT (continued)

| **Accrued interest & financing costs** | | |
|---|---|---|
| Balance, January 1, 2018 | $ | 99 |
| Interest and financing fees | | 1,773 |
| Transaction costs | | 505 |
| Amortization of deferred financing fees | | (240) |
| Prepayment penalty and royalty retirement fee | | (312) |
| Accretion of Buyout payable | | (470) |
| Transaction costs paid | | (341) |
| Interest and financing fees paid | | (692) |
| Effect of foreign currency exchange difference | | (5) |
| Balance, December 31, 2018 | $ | 317 |
| | | |
| Balance, January 1, 2019 | $ | 317 |
| Interest and financing fees | | 1,868 |
| Transaction costs | | (17) |
| Amortization of deferred financing fees | | (260) |
| Accretion of Buyout payable | | (419) |
| Interest and financing fees paid | | (1,127) |
| SWK warrant modification and issuance | | (79) |
| Effect of foreign currency exchange difference | | (7) |
| Balance, September 30, 2019 | $ | 276 |

## 9. SHARE CAPITAL AND WARRANTS

### Shares Issued and Outstanding

| | Number of Common shares | Number of Warrants | | Common shares | | Warrants | | Total |
|---|---|---|---|---|---|---|---|---|
| Balance as at January 1, 2018 | 213,118,645 | - | $ | 151,766 | $ | - | $ | 151,766 |
| Issuance of units, June 2018 | 22,041,705 | 23,584,624 | | 2,937 | | 1,420 | | 4,357 |
| Exercise of options | 223,912 | - | | 34 | | - | | 34 |
| Balance as at December 31, 2018 | 235,384,262 | 23,584,624 | $ | 154,737 | $ | 1,420 | $ | 156,157 |
| Balance as at January 1, 2019 | 235,384,262 | 23,584,624 | $ | 154,737 | $ | 1,420 | $ | 156,157 |
| Issuance of shares, March 2019 | 23,230,772 | - | | 3,350 | | - | | 3,350 |
| Exercise of options | 2,610,256 | - | | 315 | | - | | 315 |
| Balance as at September 30, 2019 | 261,225,290 | 23,584,624 | $ | 158,402 | $ | 1,420 | $ | 159,822 |

The Company is authorized to issue an unlimited number of common shares.

On June 28, 2018, the Company closed an offering, under which 22,041,705 units were issued at a price of CDN$0.30 per unit which included 2,875,005 units in connection with the exercise in full of the over-allotment option granted to the Underwriter of the offering. Each unit was comprised of one common share of the Company and one common share purchase warrant of the Company. Each warrant entitles the holder thereof to purchase one additional common share of the Company at an exercise price of CDN$0.40 at any time up to 24 months following closing of the offering. On closing, the Underwriter received cash commission equal to 7% of the gross proceeds from the sale of Units and compensation warrants entitling it to purchase 1,542,919 common shares at a price of CDN$0.30 within 24 months of closing.

The gross proceeds were segregated into their common share and warrant components based on their relative fair values of CDN$4,597 and CDN$2,016 respectively. The common share and warrant components are shown net of transaction costs of CDN$693 and CDN$304 respectively. The fair value of the warrants was based on a Black-Scholes model, with the residual amounts of the net proceeds being allocated to the value of the common shares. The fair value of the warrants, CDN$0.09 per warrant, was based on a Black-Scholes model using the following variables: an expected life of 2 years; a risk-free rate of 1.95%; a volatility rate of 86%; and an exercise price of CDN$0.40. The fair value of the broker warrants, CDN$0.11 per warrant, was based on a Black-Scholes model using the following variables: an expected life of 2 years; a risk-free rate of 1.95%; a volatility rate of 86%; and an exercise price of CDN$0.30.

## 9. SHARE CAPITAL AND WARRANTS (continued)

On March 29, 2019 the Company closed a non-brokered private placement of 23,230,772 common shares to certain directors and officers at a price of CDN$0.195 per common share for gross proceeds of CDN$4,530.

In addition to the warrants in the table above, there are 8,366,377 (December 31, 2018 – 8,366,377) warrants issued that have been classified as a derivative financial instrument and classified under long-term liabilities. This figure excludes the new warrants issued on October 3, 2019.

## 10. NATURE OF EXPENSES

| | For the three months ended September 30, 2019 | | | |
|---|---|---|---|---|
| | Cost of sales | R&D | SG&A | Total |
| Cost of finished goods | $ (300) | $ - | $ - | $ (300) |
| Salaries and benefits | - | 157 | 363 | 520 |
| Amortization of intangible assets | 139 | 38 | - | 177 |
| Depreciation of property and equipment | 33 | 20 | 11 | 64 |
| Depreciation of right of use asset | - | - | 12 | 12 |
| Inventory impairment | (23) | - | - | (23) |
| Share-based compensation | - | 7 | 50 | 57 |
| Research & development | - | 400 | - | 400 |
| Selling and marketing | - | - | 2,000 | 2,000 |
| General and administrative | - | - | 748 | 748 |
| Other | 27 | - | - | 27 |
| | $ (124) | $ 622 | $ 3,184 | $ 3,682 |

| | For the three months ended September 30, 2018 | | | |
|---|---|---|---|---|
| Cost of finished goods | $ 269 | $ - | $ - | $ 269 |
| Salaries and benefits | - | 230 | 735 | 965 |
| Amortization of intangible assets | 396 | 51 | - | 447 |
| Depreciation of property and equipment | 34 | 7 | 23 | 64 |
| Share-based compensation | - | 15 | 96 | 111 |
| Research & development | - | 448 | - | 448 |
| Selling and marketing | - | - | 674 | 674 |
| General and administrative | - | - | 631 | 631 |
| Other | 78 | - | - | 78 |
| | $ 777 | $ 751 | $ 2,159 | $ 3,687 |

| | For the nine months ended September 30, 2019 | | | |
|---|---|---|---|---|
| | Cost of sales | R&D | SG&A | Total |
| Cost of finished goods | $ 726 | $ - | $ - | $ 726 |
| Salaries and benefits | - | 592 | 2,062 | 2,654 |
| Amortization of intangible assets | 530 | 112 | - | 642 |
| Depreciation of property and equipment | 101 | 40 | 50 | 191 |
| Depreciation of right of use asset | - | - | 35 | 35 |
| Inventory impairment | 316 | - | - | 316 |
| Share-based compensation | - | 24 | 139 | 163 |
| Research & development | - | 1,539 | - | 1,539 |
| Selling and marketing | - | - | 2,910 | 2,910 |
| General and administrative | - | - | 1,910 | 1,910 |
| Impairment of intangible asset | - | - | 2,536 | 2,536 |
| Other | 174 | - | - | 174 |
| | $ 1,847 | $ 2,307 | $ 9,642 | $ 13,796 |

## 10. NATURE OF EXPENSES (continued)

| | For the nine months ended September 30, 2018 | | | |
|---|---|---|---|---|
| | Cost of sales | R&D | SG&A | Total |
| Cost of finished goods | $ 1,231 | $ - | $ - | $ 1,231 |
| Royalty expense | 6,680 | - | - | 6,680 |
| Salaries and benefits | - | 749 | 1,935 | 2,684 |
| Amortization of intangible assets | 1,194 | 106 | - | 1,300 |
| Depreciation of property and equipment | 101 | 19 | 73 | 193 |
| Share-based compensation | - | 60 | 277 | 337 |
| Research & development | - | 893 | - | 893 |
| Selling and marketing | - | - | 1,781 | 1,781 |
| General and administrative | - | - | 2,107 | 2,107 |
| Other | 307 | - | - | 307 |
| | $ 9,513 | $ 1,827 | $ 6,173 | $ 17,513 |

## 11. LOSS PER SHARE

The following table sets forth the computing of basic and diluted loss per share (share and per share amounts below are not in thousands):

| | For the three months ended September 30, | |
|---|---|---|
| | 2019 | 2018 |
| Numerator for basic and diluted (loss) per share available to common shareholders | $ (4,612) | $ (2,871) |
| Denominator for basic and diluted (loss) per share | 261,225,290 | 235,262,972 |
| Basic and diluted (loss) per share | $ (0.02) | $ (0.01) |

| | For the nine months ended September 30, | |
|---|---|---|
| | 2019 | 2018 |
| Numerator for basic and diluted (loss) per share available to common shareholders | $ (12,246) | $ (13,735) |
| Denominator for basic and diluted (loss) per share | 252,905,143 | 220,798,110 |
| Basic and diluted (loss) per share | $ (0.05) | $ (0.06) |

For the three and nine months ended September 30, 2019, the computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect on the stock options and warrants.

For the three months ended September 30, 2019:

| | | Weighted Average Shares | |
|---|---|---|---|
| | Total issued | Basic | Diluted |
| Balance, July 1, 2018 | 235,235,347 | 235,235,347 | 235,235,347 |
| Exercise of options, August 2018 | 55,250 | 27,625 | 27,625 |
| Balance, September 30, 2018 | 235,290,597 | 235,262,972 | 235,262,972 |
| | | | |
| Balance, July 1, 2019 | 261,225,290 | 261,225,290 | 261,225,290 |
| Balance, September 30, 2019 | 261,225,290 | 261,225,290 | 261,225,290 |

**11. (LOSS) PER SHARE (continued)**

For the nine months ended September 30, 2019:

| | | Weighted Average Shares | |
|---|---|---|---|
| | Total issued | Basic | Diluted |
| Balance, January 1, 2018 | 213,118,645 | 213,118,645 | 213,118,645 |
| Exercise of options, March 2018 | 74,997 | 52,768 | 52,768 |
| Issuance of common shares, June 2018 | 22,041,705 | 7,617,354 | 7,617,354 |
| Exercise of options, August 2018 | 55,250 | 9,344 | 9,344 |
| Balance, September 30, 2018 | 235,290,597 | 220,798,111 | 220,798,111 |
| | | | |
| Balance, January 1, 2019 | 235,384,262 | 235,384,262 | 235,384,262 |
| Private Placement, March 2019 | 23,230,772 | 15,742,465 | 15,742,465 |
| Exercise of stock options | 2,610,256 | 1,778,416 | 1,778,416 |
| Balance, September 30, 2019 | 261,225,290 | 252,905,143 | 252,905,143 |

**12. SHARE BASED COMPENSATION**

The Company has an incentive stock option plan that permits it to, from time to time, grant options to acquire common shares to its directors, officers, employees, consultants, and others, up to the maximum number of a "rolling" amount equal to 10% of the total shares issued and outstanding (26,122,529 options available as at September 30, 2019). The option exercise price must be equal to or greater than the market price of the Company's common shares at the date of grant.

The stock option plan also provides that:

- upon the surrender, termination, expiry or exercise of any options granted under the stock option plan, common shares subject to such options shall become available to satisfy future grants of options under the stock option plan; and

- a holder of an option may, rather than exercise such option, elect a cashless exercise of such option payable in common shares equaling the amount by which the value of an underlying share at that time exceeds the exercise price of such option or warrant to acquire such common share.

The Company uses the Black-Scholes option pricing model to price its options, which requires certain assumptions including the stock price volatility for a publicly held corporation.

## 12. SHARE BASED COMPENSATION (continued)

The following table presents the Black-Scholes variables used to calculate the fair value of the options granted in fiscal 2019 and 2018:

| | | | | | | Black-scholes model variables | | | |
|---|---|---|---|---|---|---|---|---|---|
| Grant date | Number granted | Granted to | Exercise price (CDN$) | Life (Years) | Vesting periods (Years) | Risk free rate | Expected volatility | Expected dividend rate | Fair value per options (CDN$) |
| Mar 23, 2018 | 1,948,331 | Employees & directors | $0.27 | 5 | 1-3 | 2.1% | 90.0% | nil | $0.20 |
| Mar 23, 2018 | 100,000 | Director | $0.27 | 3 | 0 | 2.0% | 95.6% | nil | $0.17 |
| Aug 15, 2018 | 1,050,000 | Employees | $0.21 | 5 | 3 | 2.2% | 89.8% | nil | $0.14 |
| Aug 29, 2018 | 214,286 | Consultant | $0.28 | 3 | 1 | 2.2% | 98.0% | nil | $0.18 |
| Nov 19, 2018 | 750,000 | Employee | $0.17 | 5 | 3 | 2.4% | 86.5% | nil | $0.10 |
| Mar 06, 2019 | 1,050,000 | Directors | $0.13 | 5 | 1-3 | 1.8% | 86.4% | nil | $0.09 |
| Aug 08, 2019 | 1,965,686 | Employees | $0.13 | 5 | 3 | 1.5% | 86.9% | nil | $0.08 |

A forfeiture rate of 3% was used to estimate option expenses during the period. The Company recognized total share-based compensation expense of $57 and $163 for the three and nine months ended September 30, 2019 ($111 and $337 for the three and nine months ended September 30, 2018).

The following table summarizes the activity under the Company's stock option plan (amounts in chart below are not in thousands):

| | September 30, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Number | Weighted average exercise price (CDN) | Number | Weighted average exercise price (CDN) |
| Balance at January 1, | 17,763,346 | $ 0.18 | 17,316,200 | $ 0.23 |
| Granted | 3,015,686 | 0.13 | 3,312,617 | 0.25 |
| Exercised | (5,225,000) | 0.11 | (130,247) | 0.11 |
| Cancelled | - | - | (861,875) | 0.12 |
| Forfeited | (1,764,817) | 0.17 | (172,500) | 0.12 |
| Expired | (435,000) | 0.82 | (1,876,200) | 0.81 |
| Balance at September 30, | 13,354,215 | $ 0.18 | 17,587,995 | $ 0.18 |
| Options exercisable at September 30, | 8,173,889 | $ 0.18 | 9,203,032 | $ 0.18 |

| | Canadian Dollar Options outstanding as at September 30, 2019 | | |
|---|---|---|---|
| Exercise prices | Number outstanding | Weighted average remaining life in years | Number excercisable |
| $0.09 to $0.11 | 2,668,334 | 1.8 | 2,599,995 |
| $0.12 to $0.18 | 8,349,193 | 3.6 | 3,808,456 |
| $0.21 to $0.36 | 1,951,688 | 3.1 | 1,380,438 |
| $0.41 to $0.75 | 385,000 | 0.4 | 385,000 |
| | 13,354,215 | 3.1 | 8,173,889 |

## 13. RELATED PARTY TRANSACTIONS

Details of the transactions between the Company, key management and other related parties are disclosed below:

Key management includes the Company's directors and executive officers. The remuneration of directors and key members of management and professional fees paid or payable to firms affiliated with the current directors for the three and nine months ended September 30, 2019 and 2018 were as follows:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Short-term compensation of key management and directors | $ 208 | $ 572 | $ 768 | $ 1,184 |
| Termination benefits | - | - | 363 | $ - |
| Share-based compensation | 51 | 110 | 141 | 280 |
| Interest accrued | 128 | - | 128 | - |
| Professional fees paid or payable to firms affiliated with directors & officers | - | - | - | 189 |
| | $ 387 | $ 682 | $ 1,400 | $ 1,653 |

These transactions are in the normal course of operations.

Executive employment agreements allow for total additional payments of approximately $1,260 if a change in control occurs, $1,234 if all are terminated without cause, and $nil if all are terminated with cause.

As at September 30, 2019, Acerus had a $6,027 receivable ($2,073 receivable as at December 31, 2018) to its wholly owned subsidiary ABI. The receivable is non-interest bearing, due on demand and eliminates upon consolidation except for the foreign exchange loss of $71 and $107 for the three and nine months ended September 30, 2019 (gain of $55 and loss of $264 for the three and nine months ended September 30, 2018) that has been recorded in the consolidated statement of loss.

As of September 30, 2019, the Company had $5,000 outstanding on a subordinated secured term loan facility with First Generation, a company affiliated with the Chairman of the Board of Directors of Acerus. At September 30, 2019 the Company had $128 in interest payable included in accounts payable related to the loan.

## 14. LITIGATION

*Schenk Litigation*

Valeant Pharmaceuticals International, Inc. and Valeant International Bermuda ("Valeant") are defendants in Ontario Superior Court of Justice Action No. CV-11-438382, which claims a declaration that Valeant is contractually obligated to compensate the plaintiff, Reiner Schenk ("Schenk") pursuant to the terms of a contract between Schenk and Biovail Corporation. The main action was commenced by Notice of Action issued on October 31, 2011 and a Statement of Claim was issued on December 14, 2011. Acerus Pharmaceuticals Corporation was named as one of the defendants in the main action, but the action was discontinued as against Acerus on December 14, 2011. On October 29, 2013, Valeant commenced a third party claim against Acerus (among others) claiming contribution, indemnity and other relief over to the full extent that Valeant may be held liable to Schenk, and damages for breach of fiduciary duty, breach of contract and intentional interference with economic relations in any amount for which Valeant is found liable to Schenk. Acerus has defended the third-party claim, denying any liability to Valeant. The parties have concluded examinations for discovery and are scheduled to attend a pre-trial conference in February 2020. The trial is scheduled to commence in April 2020 and is anticipated to be two weeks long. As of September 30, 2019, the Company has not accrued for any potential claims.

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

## 15. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

At September 30, 2019 and December 31, 2018, the Company's financial instruments consisted of cash, trade and other receivables, accounts payable and accrued liabilities, long-term debt, and derivative financial instruments. Cash, trade and other receivables and accounts payable and accrued liabilities are measured at amortized cost and their fair values approximate carrying values due to their short-term nature. The derivative financial instruments are measured at fair value with any changes recognized through the consolidated statement of loss and comprehensive loss and are classified as Level 2. The fair value of the derivative financial instrument is estimated using a Black-Scholes pricing model.

The long-term debt is measured at amortized cost. At September 30, 2019, the fair value of the long-term debt approximates its face value of $14,000. The fair values are based on cash flows discounted using a rate based on the borrowing rate and are within Level 3 of the fair value hierarchy.

## 16. SEGMENT REPORTING

The Chief Executive Officer and Chief Financial Officer are the Company's chief operating decision-makers (CODM). Management has determined that there is one operating segment based on the information reviewed by the CODM for the purposes of allocating resources and assessing performance.

At September 30, 2019, the Company had inventory in Canada and Germany in the amounts of $38 and $1,536 respectively ($818 and $1,688 respectively in Canada and Germany at December 31, 2018). At September 30, 2019, the Company has total long-term assets in Canada and Germany in the amounts of $5,781 and $604 respectively ($8,492 and $708 respectively in Canada and Germany at December 31, 2018). The remaining current assets and liabilities are held in Canada.

For the three months ended September 30, 2019 the Company had revenues of $49, $80 and ($296) from customers located in Canada, U.S. and rest of world respectively ($1,411, $172 and $nil from customers in Canada, U.S. and rest of world respectively for the three months ended September 30, 2018). For the nine months ended September 30, 2019 the Company had revenues of $2,108, $1,146 and $nil from customers located in Canada, U.S. and rest of world respectively ($4,101, $1,058 and $150 from customers in Canada, U.S. and rest of world respectively for the nine months ended September 30, 2018). The Canadian and rest of world revenue figures for 2019 were impacted by the return provisions related to the voluntarily recall of certain Natesto® lots released in the Canadian and South Korean markets. The Company had previously accrued $453 related to replacing products, discounts and potential returns due to the issue described above. However, due to the additional delays, the Company reversed the previous accruals related to discounts and replacement of product and has accrued $660 for returns in the current quarter.