cipher™ PHARMACEUTICALS

2020

Second Quarter Report

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. and its subsidiaries ["Cipher" or "the Company"] as at and for the three and six months ended June 30, 2020. This document should be read in conjunction with the unaudited interim condensed consolidated financial statements of Cipher for the three and six months ended June 30, 2020 and the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*. Additional information about the Company, including the Audited Annual Financial Statements and Annual Information Form for the year ended December 31, 2019, is available on SEDAR at www.sedar.com.

The discussion and analysis within this Management Discussion and Analysis ["MD&A"] are as at August 12, 2020. All dollar figures are stated in U.S. dollars unless otherwise indicated.

Caution Regarding Forward-Looking Statements

This document includes forward-looking statements within the meaning of applicable securities laws. These forward-looking statements include, among others, statements with respect to our objectives and goals and strategies to achieve those objectives and goals, as well as statements with respect to our beliefs, plans, expectations, anticipations, estimates and intentions and statements relating to the Special Committee's review of the strategic direction of the Company and its strategic priorities including the anticipated benefits thereof. The words "may", "will", "could", "should", "would", "suspect", "outlook", "believe", "plan", "anticipate", "estimate", "expect", "intend", "forecast", "objective", "hope" and "continue" [or the negative thereof], and words and expressions of similar import, are intended to identify forward-looking statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, which give rise to the possibility that predictions, forecasts, projections and other forward-looking statements will not be achieved. Certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from those expressed or implied in such statements. We caution readers not to place undue reliance on these statements as a number of important factors, many of which are beyond our control, could cause our actual results to differ materially from the beliefs, plans, objectives, expectations, anticipations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the extent and impact of the coronavirus [COVID-19] outbreak on our business including any impact on our contract manufacturers and other third party service providers, our ability to enter into development, manufacturing and marketing and distribution agreements with other pharmaceutical companies and keep such agreements in effect; our dependency on a limited number of products; our dependency on protection from patents that will expire; integration difficulties and other risks if we acquire or in-license technologies or product candidates; reliance on third parties for the marketing of certain products; the product approval process is highly unpredictable; the timing of completion of clinical trials, regulatory submissions and regulatory approvals; reliance on third parties to manufacture our products and events outside of our control that could adversely impact the ability of our manufacturing partners to supply products to meet our demands; we may be subject to future product liability claims; unexpected product safety or efficacy concerns may arise; we generate license revenue from a limited number of distribution and supply agreements; the pharmaceutical industry is highly competitive; requirements for additional capital to fund future operations; products in Canada may be subject to pricing regulation; dependence on key managerial personnel and external collaborators; no assurance that we will receive regulatory approvals in the U.S., Canada or any other jurisdictions and current uncertainty surrounding health care regulation in the U.S.; certain of our products are subject to regulation as controlled substances; limitations on reimbursement in the healthcare industry; limited reimbursement for products by government authorities and third-party payor policies; products may not be included on list of drugs approved for use in hospitals; hospital customers may make late payments or not make any payments; various laws pertaining to health care fraud and abuse; reliance on the success of strategic investments and partnerships; the publication of negative results of clinical trials; unpredictable development goals and projected time frames; rising insurance costs; ability to enforce covenants not to compete; risks associated with the industry in which we operate; we may be unsuccessful in evaluating material risks involved in completed and future acquisitions; we may be unable to identify, acquire or integrate acquisition targets successfully; legacy risks from operations conducted in the U.S.; inability to meet covenants under our long term debt arrangement; compliance with privacy and security regulation; our policies regarding returns, allowances and chargebacks may reduce revenues; certain current and future regulations could restrict our activities; additional regulatory burden and controls over financial reporting; reliance on third parties to perform certain services; general commercial litigation, class actions, other litigation claims and regulatory actions; the difficulty for shareholders to realize in the United States upon judgments of U.S. courts predicated upon civil liability of the Company and its directors and officers who are not residents of the United States; the potential violation of intellectual property rights of third parties; our efforts to obtain, protect or enforce our patents and other intellectual property rights related to our products; changes in U.S., Canadian or foreign patent laws; litigation in the pharmaceutical industry

concerning the manufacture and supply of novel and generic versions of existing drugs; inability to protect our trademarks from infringement; shareholders may be further diluted if we issue securities to raise capital; volatility of our share price; the fact that we have a significant shareholder; we do not currently intend to pay dividends; our operating results may fluctuate significantly; and our debt obligations will have priority over the common shares of the Company in the event of a liquidation, dissolution or winding up.

We caution that the foregoing list of important factors that may affect future results is not exhaustive. When reviewing our forward-looking statements, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Additional information about factors that may cause actual results to differ materially from expectations, and about material factors or assumptions applied in making forward-looking statements, may be found in the "Risk Factors" section of this MD&A and the Annual Information Form for the year ended December 31, 2019, and elsewhere in our filings with Canadian securities regulators. Except as required by Canadian securities law, we do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by us or on our behalf; such statements speak only as of the date made. The forward-looking statements included herein are expressly qualified in their entirety by this cautionary language.

Market Industry Data

The market and industry data contained in this MD&A is based upon information from independent industry and other publications and our knowledge of, and experience in, the industry in which the Company operates. Market and industry data are subject to variations and cannot be verified with complete certainty due to limits on the availability and reliability of raw data at any particular point in time, the voluntary nature of the data gathering process or other limitations and uncertainties inherent in any statistical survey. Accordingly, the accuracy and completeness of this data are not guaranteed. Cipher has not independently verified any of the data from third party sources referred to in this MD&A or ascertained the underlying assumptions relied upon by such sources**.**

Overview

Cipher [TSX: CPH] is a specialty pharmaceutical company with a diversified portfolio of commercial and early to late-stage products. Cipher acquires products that fulfill unmet medical needs, manages the required clinical development and regulatory approval process, and markets these products directly in Canada or indirectly through partners in the U.S., Canada and Latin America.

Corporate Strategy

Cipher's corporate strategy is to build a portfolio of prescription products across a broad range of therapeutic areas that meet an unmet medical need. The focus of the Company's strategy is to:

- strategically market and distribute its Canadian commercial assets directly or indirectly, by way of partnerships;
- out-license products in markets where Cipher does not have a commercial presence;
- selectively invest in drug development programs where we see a favourable risk/return profile;
- distribute products through established sales organizations using a royalty based model; and
- conserve capital, maximize cashflow and eliminate debt.

The Company is actively assessing and sourcing opportunities that would build on the strengths of the organization, including a scalable commercial infrastructure in Canada. The execution of any transaction is contingent on the Company being able to negotiate acceptable terms and securing the necessary financing.

Significant Transactions and Developments

2020

TRULANCE® NOTICE OF TERMINATION

On January 13, 2020, the Company received a notice of termination from Bausch Health for alleged breach of contract in respect of its licensing agreement for Trulance. The Company is currently in arbitration with Bausch to resolve the matters contained within.

COVID-19

The Company is closely monitoring the developments of the Coronavirus-19 ["COVID-19"] situation. It is too soon to assess the impacts of the current outbreak, given the many unknowns related to COVID-19. The global response to the COVID-19 outbreak has resulted in, among other things, border closures, severe travel restrictions and extreme fluctuations in financial and commodity markets. Additional measures may be implemented by one or more governments in jurisdictions where the Company operates. Labour shortages

due to illness, Company or government imposed isolation programs, or restrictions on the movement of personnel or possible supply chain disruptions could result in a reduction or cessation of all or a portion of the Company's operations. The extent to which COVID-19 and any other pandemic or public health crisis impacts the Company's business, affairs, operations, financial condition, liquidity, availability of credit and results of operations will depend on future developments that are highly uncertain and cannot be predicted with any meaningful precision, including new information which may emerge concerning the severity of COVID-19 and the actions required to contain the COVID-19 or remedy its impact, among others.

The actual and threatened spread of COVID-19 globally could also have a material adverse effect on the regional economies in which we operate, could continue to negatively impact stock markets, including any future trading price of our shares, could adversely impact our ability to raise capital, could cause continued interest rate volatility and movements that could make obtaining financing or renegotiating the terms of our existing financing more challenging or more expensive.

2019

CREDIT FACILITY AMENDMENT

On March 31, 2019, the Company entered into a second amendment to its credit agreement with its Canadian lender. The amendment adjusts certain financial covenants for the remainder of the credit facility term, which matures on November 3, 2020.

On September 30, 2019, the Company entered into a third amendment to its credit agreement with its Canadian lender. The amendment adjusts certain financial covenants for the remainder of the credit facility term. In consideration for the amendment, the Company prepaid $2.0 million against the outstanding balance of the credit facility. There were no penalties associated with this prepayment.

TRULANCE®

On October 10, 2019, Cipher received a Notice of Compliance from Health Canada approving the sale of Trulance. The Company made a $0.8 million milestone payment relating to this regulatory achievement in January 2020.

Significant Partnerships

GALEPHAR

In 2002, the Company entered into a master licensing and clinical supply agreement [the "Galephar Agreement"] with Galephar, Pharmaceutical Research, Inc. ["Galephar"], a Puerto Rico based pharmaceutical research and manufacturing company. Under the Galephar Agreement, the Company acquired the rights to package, test, obtain regulatory approvals and market CIP-FENOFIBRATE, CIP-ISOTRETINOIN and CIP-TRAMADOL ER in various territories. In particular, the Company has the rights to sell, market and distribute, on a perpetual basis, as follows:

- exclusive rights throughout the world for Galephar's capsule formulation of Tramadol;
- exclusive rights in North, South and Central America, the Caribbean and Bermuda for Galephar's capsule formulation of Isotretinoin and non-exclusive rights in certain other countries; and
- exclusive rights in North, South and Central America, the Caribbean and Bermuda for Galephar's capsule formulation of Fenofibrate and non-exclusive rights in certain other countries.

Cipher is obliged to pay Galephar fifty percent [50%] of any (i) distribution fees it receives, (ii) net sales revenue less manufacturing costs and (iii) royalties received, except that prior to issuance of a patent for a product, only 30% of royalties are payable. If Cipher or its affiliates are directly selling to wholesalers, 12% of net sales received by Cipher is payable to Galephar, or 7% prior to issuance of a patent. No payments are required with respect to a sale of a product occurring 20 years after the first sale of the product in the country or, if a patent is obtained, when the patents lapse in that country for the product, whichever is later. Galephar also supplies product to Cipher through commercial supply agreements for each product.

Certain of the Company's marketed products utilize drug delivery technologies licensed from Galephar:

- *Oral Lidose® Technology*. Galephar's oral semi-liquid capsule drug delivery technology is a patent-protected drug delivery system. Active ingredients are incorporated in semi-solid or liquid compositions contained in capsules. This delivery system facilitates low manufacturing costs, while delivering super-bioavailability for relatively water-insoluble compounds. CIP-FENOFIBRATE and CIP-ISOTRETINOIN are based on the Lidose drug delivery system.

- *Oral Controlled-Released Bead Technology*. Galephar's multiple particle-controlled release capsule technology ["MPCRC"], is based on unique extrusion and spheronization methods, and produces beads containing up to 80% active ingredient. Each coated bead is a controlled release system in itself, and the multi-particulate system provides smooth consistent plasma levels

over an extended period of time. The system is virtually pH-independent enabling the product to be taken with or without food. MPCRC enables CIP-TRAMADOL ER.

In 2016, Galephar entered into an agreement with another party [the "Galephar Assignee"] to assign certain rights relating to CIP-ISOTRETINOIN in the U.S. market. The Company consented to this agreement, agreeing to remit revenue on the same terms as the Galephar Agreement from licensing and distribution within the U.S. for CIP-ISOTRETINOIN directly to the Galephar Assignee.

On May 11, 2017, the founder, vice president and a shareholder of Galephar was elected to the Company's board of directors as a non-independent member. As a result, Galephar is considered a related party.

Licensed Products

CIP-ISOTRETINOIN

United States - Absorica®

In 2012, Cipher's U.S. distribution partner Sun Pharmaceutical Industries, Inc. ["Sun"] [previously Ranbaxy Laboratories Inc.] launched CIP-ISOTRETINOIN under the trade name Absorica. According to IQVIA, the U.S. isotretinoin prescription market increased by 10% in the first quarter of 2020 compared to the first quarter of 2019.

Absorica is currently protected by five issued patents which are Orange Book listed and expire in September 2021. Galephar was issued a product patent [Patent Number 7,435,427] from the U.S. Patent and Trademark Office in 2008 with a second patent [Patent Number 8,367,102] issued in 2013. A third patent [Patent Number 8,952,064] was issued in February 2015 and the fourth and fifth patents [Patent Numbers 9,078,925 and 9,089,534, respectively] were issued in July 2015. The five patents are formulation-related patents describing the product ingredients.

In September 2013, Sun received a Paragraph IV Certification Notice from Actavis, notifying Sun that Actavis had filed an Abbreviated New Drug Application (ANDA) seeking to make and market a generic version of Absorica. A Paragraph IV Certification Notice is filed when the sponsor company of the ANDA believes that its generic product is not infringing on a particular patent and/or that such patent is not valid. A patent infringement lawsuit against Actavis was filed by Sun, Cipher and Galephar in October 2013 and, as a result, the ANDA was subject to a 30-month stay of FDA approval, beginning on the date the notification letter was received. In October 2015, the Company, along with Sun and Galephar, entered into a settlement agreement with Actavis that dismissed the patent litigation suit. As part of the settlement agreement, Cipher, Sun and Galephar entered into a non-exclusive license agreement with Actavis that will permit Actavis to commercially launch its generic isotretinoin product.

Under the terms of the agreement with Sun, the Company receives a royalty percentage in the mid-teens on net sales. Cipher's agreement with Sun is for a period of 10 years from the first commercial sale expiring in November 2022 and Sun has the right to extend the term for additional two year periods.

In July 2018, the Company amended its distribution and supply agreement [the "Sun Amendment"] with Sun for Absorica. The Sun Amendment provides Sun with the ability to launch new isotretinoin products prior to the expiration of the agreement in November 2022. The Company will receive a royalty until December 2024 based on U.S. net sales from Sun's isotretinoin product portfolio. In addition, the Absorica New Drug Application ["NDA"] will be returned to the Company on expiry of the agreement in November 2022. On February 3, 2020, Sun launched their new isotretinoin products under the brand name of Absorica LD.

On December 19, 2018, the Company received a Paragraph IV Certification Notice advising Sun, Sun Pharmaceuticals Industries Ltd. and Galephar that Upsher Smith Laboratories, LLC ["Upsher Smith"] has filed an ANDA with the FDA seeking approval to manufacture, use, or sell a generic version of Absorica [10 mg, 20 mg, and 30 mg] prior to the expiration of U.S. Patent Nos. 7,435,427; 8,367,102; 8,952,064; 9,078,925; and 9,089,534. On January 30, 2019, Sun, Cipher and Galephar filed a complaint against Upsher Smith asserting infringement of the five patents. On February 12, 2019, Upsher Smith filed its answer to the complaint. On or around September 16, 2019, Sun, Cipher, and Galephar received a second Paragraph IV Certification Notice from Upsher Smith, related to the 40 mg formulation of Absorica. On November 6, 2019, Sun, Cipher, and Galephar filed an Amended Complaint against Upsher Smith, which Upsher Smith answered on November 19, 2019. On March 9, 2020 an arbitration meeting was held. On April 21, 2020, the Company and Upsher Smith concluded a binding arbitration.

Rest of World

In 2014, the Company entered into a definitive distribution and supply agreement with Ranbaxy Laboratories Ltd. ["Ranbaxy India"], a Sun Pharma Company, under which Cipher granted Ranbaxy India the exclusive right to market, sell and distribute isotretinoin capsules in Brazil. Ranbaxy India plans to promote the product through a brand dermatology division in Brazil. Under the terms of this agreement, Cipher received an upfront payment and may be eligible for pre-commercial milestone payments. Cipher will supply the product and

product manufacturing will be fulfilled by Galephar. Ranbaxy India will be responsible for all regulatory-related activities associated with gaining and maintaining regulatory approval of the product in Brazil. The product is not currently approved in Brazil.

In January 2018, the Company entered into a distribution and supply agreement with Italmex Pharma S.A. ["Italmex"] granting Italmex the exclusive rights to market, sell and distribute isotretinoin products in Mexico. Under the terms of the agreement with Italmex, Cipher is eligible for regulatory and commercial milestone payments. Cipher will supply the product to Italmex, and product manufacturing will be fulfilled by Cipher's partner, Galephar. Italmex will be responsible for all regulatory activities associated with gaining and maintaining regulatory approval of the product in Mexico. The product is not currently approved in Mexico.

In August 2019, Italmex submitted their dossier to Mexican regulatory agency, COFEPRIS, for review. The dossier has been previously reviewed by a third party which could shorten the response time from COFEPRIS. Italmex expects a response from COFEPRIS by the second quarter of 2020. Upon achievement of certain regulatory milestones, payments totalling up to $175,000 are due.

During the quarter, one regulatory milestone was achieved and a payment of $120,000 was received, of which 50% was payable to Galephar.

During the quarter, Cipher entered into an agreement with Galephar to return the distribution rights of Latin America to Galephar in exchange for a 7% royalty on net sales to these regions.

Litigation

From time to time, during the ordinary course of business, the Company may be threatened with, or may be named as, a defendant in various legal proceedings, including lawsuits based upon product liability, wrongful dismissal, personal injury, breach of contract and lost profits or other consequential damage claims. Refer to "Significant Transactions and Developments – 2020 – Trulance Notice of Termination" above.

Selected Financial Information

The interim consolidated statements of income and comprehensive income and interim consolidated statements of cash flows for the previously reported U.S. segment are presented as discontinued operations, separate from the Company's continuing operations which is comprised of the Canadian segment. This MD&A reflects only the results of continuing operations, unless otherwise noted.

The following information has been prepared in accordance with IFRS in U.S. dollars.

(IN MILLIONS OF U.S. DOLLARS EXCEPT FOR PER SHARE AMOUNTS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Net revenue	**4.7**	5.6	**10.6**	10.7
Total operating expenses	**2.1**	3.5	**4.4**	7.1
Total other expenses	**0.2**	0.3	**0.2**	0.5
Income for the period from continuing operations	**0.4**	1.4	**2.9**	2.2
Income for the period from discontinued operations	**—**	—	**0.2**	—
Income from continuing operations per share:				
Basic and diluted income	**0.02**	0.05	**0.11**	0.08
Income from discontinued operations per share:				
Basic and diluted income	**—**	—	**0.01**	—
Total assets	**46.0**	53.0	**46.0**	53.0
Total non-current liabilities	**1.7**	8.5	**1.7**	8.5

The fluctuations in reported results during this period were primarily from the following factors:

- In Q2 2020, licensing revenue decreased by $0.8 million, due to declining Absorica sales,
- In Q2 2020, operating expenses decreased by $1.4 million, due to a reduction in selling, general and administrative costs; and,
- In Q2 2019, the Company incurred restructuring costs of $0.7 million recorded in operating expenses.

Review of Operating Results

REVENUE

(IN THOUSANDS OF U.S. DOLLARS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Licensing revenue	**2,719**	3,526	**6,065**	6,857
Product revenue	**1,989**	2,070	**4,543**	3,882
Net revenue	**4,708**	5,596	**10,608**	10,739

Total net revenue decreased by $0.9 million or 16% to $4.7 million for the three months ended June 30, 2020 compared to $5.6 million for the three months ended June 30, 2019. Total net revenue decreased by $0.1 million or 1.2% to $10.6 million for the six months ended June 30, 2020 compared to $10.7 million for the six months ended June 30, 2019.

Licensing Revenue

Licensing revenue decreased by $0.8 million or 23% to $2.7 million for the three months ended June 30, 2020 compared to $3.5 million for the three months ended June 30, 2019.

Licensing revenue from Absorica in the U.S. was $1.8 million for the three months ended June 30, 2020, a decrease of $1.1 million or 36% compared to $2.9 million for the three months ended June 30, 2019. Absorica's market share for the three months ended June 30, 2020 was approximately 6% compared to approximately 8% for the three months ended June 30, 2019, according to IQVIA. Market share including Sun's Absorica LD was approximately 7%.

Licensing revenue from Lipofen and the authorized generic version of Lipofen remained relatively unchanged at $0.5 million for the three months ended June 30, 2020 and 2019.

Licensing revenue from the extended-release tramadol product (ConZip in the U.S. and Durela in Canada) was $0.3 million for the three months ended June 30, 2020, an increase of $0.2 million compared to revenue of $0.1 million for the three months ended June 30, 2019.

Licensing revenue decreased by $0.8 million or 12% to $6.0 million for the six months ended June 30, 2020 compared to $6.8 million for the six months ended June 30, 2019.

Licensing revenue from Absorica in the U.S. was $4.6 million for the six months ended June 30, 2020, a decrease of $1.1 million or 19% compared to $5.7 million for the six months ended June 30, 2019.

Licensing revenue from Lipofen and the authorized generic version of Lipofen was $1.0 million for the six months ended June 30, 2020, compared to $0.9 million for the six months ended June 30, 2019.

Licensing revenue from the extended-release tramadol product (ConZip in the U.S. and Durela in Canada) was $0.4 million for the six months ended June 30, 2020 compared to $0.3 million for the six months ended June 30,2019.

Included in licensing revenue for the three and six months ended June 30, 2020 is a regulatory milestone payment from Italmex for $0.1 million.

Product Revenue

Product revenue decreased by $0.1 million or 4% to $2.0 million for the three months ended June 30, 2019 compared to $2.1 million for the three months ended June 30, 2019.

Product revenue from Epuris was $1.9 million for the three months ended June 30, 2020, remaining unchanged from $1.9 million for the three months ended June 30, 2019. Product revenue from Epuris is transacted in Canadian dollars, in its native currency Epuris revenue increased by approximately 4% or $0.1 million. According to IQVIA, Epuris had a prescription market share of approximately 41% in Canada for the three months ended June 30, 2020 compared to 38% for the three months ended June 30, 2019.

Product revenue for the remaining brands, Ozanex, Beteflam, Actikerall, Brinavess and Vaniqa was $0.1 million for the three months ended June 30, 2020 compared to $0.2 million for the three months ended June 30, 2019.

Product revenue increased by $0.7 million or 17% to $4.5 million for the six months ended June 30, 2020 compared to $3.9 million for the six months ended June 30, 2019. While the specific reason for the increase is unknown, it is speculated that self isolating from COVID-19 led to stocking the channel to avoid shortages by our wholesalers and pre-filing of prescriptions. Additionally, price increases originally intended to take effect April 1 was delayed to July, resulting in higher volume of sales prior to July so wholesalers can take advantage of lower prices.

Product revenue from Epuris increased to $4.3 million for the six months ended June 30, 2020 compared to $3.5 million for the six months ended June 30, 2019.

Product revenue for the remaining brands, Ozanex, Beteflam, Actikerall, Brinavess and Vaniqa was $0.3 million for the six months ended June 30, 2020 compared to $0.4 million for the six months ended June 30, 2019.

OPERATING EXPENSES

(IN THOUSANDS OF U.S. DOLLARS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Cost of products sold	**722**	718	**1,571**	1,362
Research and development	**13**	21	**37**	76
Selling, general and administrative	**1,317**	2,105	**2,758**	5,048
Restructuring costs	**—**	660	**—**	660
Total operating expenses	**2,052**	3,504	**4,366**	7,146

Total operating expenses decreased by $1.5 million or 41% to $2.1 million for the three months ended June 30, 2020 compared to $3.5 million for the three months ended June 30, 2019. The decrease in operating expenses for the three months ended June 30, 2020 is primarily due to a decrease in selling, general and administrative expenses.

For the six months ended June 30, 2020 total operating expenses decreased by $2.8 million or 39% to $4.4 million compared to $7.1 million for the six months ended June 30, 2019, which includes $0.7 million in restructuring charges.

Cost of Products Sold

Cost of products sold for the three months ended June 30, 2020 was $0.7 million, remaining unchanged from the three months ended June 30, 2019. Gross margin on product sales declined slightly to 64% for the three months ended June 30, 2020 compared to 65% for the three months ended June 30, 2019.

Cost of products sold for the six months ended June 30, 2020 was $1.6 million compared to $1.4 million for the six months ended June 30, 2019. Gross margin on product sales for the six months ended June 30, 2020 and 2019 was 65%.

Research and Development

Research and development (“R&D”) expenses represent the costs directly associated with developing and advancing our pipeline products and the cost of regulatory submissions in Canada.

R&D expense was minimal for the three and six months ended June 30, 2020 and the respective comparative periods.

Selling, General and Administrative

Selling, general and administrative (“SG&A”) expense was $1.3 million for the three months ended June 30, 2020, a decrease of $0.8 million or 37% compared to $2.1 million for the three months ended June 30, 2019. The decrease in SG&A costs was driven by a reduction in costs related to human resources and a reduction in sales and marketing spend.

SG&A expense was $2.8 million for the six months ended June 30, 2020, a decrease of $2.3 million or 45% compared to $5.0 million for the six months ended June 30, 2019. The decrease in SG&A expense for the six months ended. The decrease in SG&A costs was driven by a reduction in the compensation costs, including share-based compensation and reduction in consulting and professional fees.

Also included in SG&A is amortization of intangible assets of $0.2 million for the three months ended June 30, 2020 compared to $0.2 million for the three months ended June 30, 2019. Amortization of intangibles for the six months ended June 30, 2020 was $0.5 million

compared to $0.4 million for the six months ended June 30, 2019. The increase relates to the amortization of Trulance, which commenced in the fourth quarter of 2019.

Restructuring Costs

Restructuring costs were nil for the three and six months ended June 30, 2020 compared to $0.7 million in the respective comparative periods. These include termination benefits, severance costs and related professional fees.

OTHER EXPENSES (INCOME)

(IN THOUSANDS OF U.S. DOLLARS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Interest expense	**90**	266	**214**	541
Change in fair value of derivative financial instrument	**17**	(3)	**15**	(15)
Interest income	**(3)**	(45)	**(31)**	(98)
Foreign exchange loss (gain)	**52**	(37)	**(29)**	89
Total other expenses	**156**	255	**169**	517

Total other expenses for the three months ended June 30, 2020 was $0.2 million compared to $0.3 million for the three months ended June 30, 2019. Total other expenses for the six months ended June 30, 2020 was $0.2 million compared to $0.5 million for the six months ended June 30, 2019.

Interest Expense

Interest expense decreased by $0.2 million or 66% to $0.1 million for the three months ended June 30, 2020 compared to $0.3 million for the three months ended June 30, 2019. The decrease relates to both the declining balance of the credit facility and decrease in interest rates. The interest rate is impacted by LIBOR and the Company's improved debt to adjusted EBITDA ratio. The interest rate applicable to the credit facility in the second quarter of 2020 was 2.63% compared to 5.09% in the second quarter of 2019. Interest expense also includes imputed interest accretion on the credit facility and lease obligation.

Change in Fair Value of Derivative Financial Instrument

The change in the fair value of the derivative financial instrument was negligible for the three and six months ended June 30, 2020 and 2019. The increase in value during the second quarter relates mainly to the increase in the Company's share price.

Interest Income

Interest income for the three and six months ended June 30, 2020, decreased due to lower interest rates on cash held at financial institutions.

Foreign Exchange

The Company experienced de minimus foreign exchanges gains/losses for the three and six months ended June 30, 2020 and 2019. The Company is exposed to currency risk through its net assets, namely its lease obligation and certain recurring transactions denominated in Canadian dollars.

INCOME TAXES

Income tax expense is recognized based on domestic and international statutory income tax rates in the jurisdictions in which the Company operates. These rates are then adjusted to effective tax rates based on management's estimate of the weighted average annual income tax rate expected for the full year in each jurisdiction taking into account taxable income or loss in each jurisdiction and available utilization of deferred tax assets. Deferred tax assets are recognized to the extent that it is probable that the asset can be recovered. The income tax expense for the three months ended June 30, 2020 was $2.1 million compared to $0.5 million for the three months ended June 30, 2019. The income tax expense for the six months ended June 30, 2020 was $3.1 million compared to $0.9 million for the six months ended June 30, 2019.

As at June 30, 2020, the Company has recognized deferred tax assets in the interim consolidated statement of financial position of $0.9 million. The Company believes that it is probable that future taxable income will be available against which tax losses can be utilized.

In the third quarter of 2019, the Company received a Canada Revenue Agency (the "CRA") draft assessment for its 2014 and 2015 tax filing years. The draft assessment purports that the valuation of certain intangibles assets upon migration of the Company to Canada in 2004 are overstated. Consequently, amortization reported for tax purposes in excess of the CRA's valuation was overstated. Based on the CRA's proposed changes to the valuation of the intangible assets, the Company estimated an additional income tax expense including interest of approximately CDN$1.7 million ($1.3 million).

During the quarter, the Company received the final assessment in respect of the 2014 and 2015 CRA audit, which in addition to revaluating the intangible assets at a lower value than reported for tax purposes, disallows certain intangible assets additions in 2015. There is an additional income tax expense, including interest of approximately CDN$2.0 million ($1.4 million) for amortization taken on those intangible assets from 2015 through to Q2 2020.

The Company believes its basis for the valuation is defendable and will file a notice of objection with the CRA.

INCOME AND INCOME PER COMMON SHARE

(IN THOUSANDS OF U.S. DOLLARS, except for share and per share amounts)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Income for the period from continuing operations	**411**	1,359	**2,888**	2,175
Basic and diluted income per share from continuing operations	**0.02**	0.05	**0.11**	0.08
Income (loss) for the period from discontinued operations	**—**	35	**164**	35
Basic and diluted income per share from discontinued operations	**—**	—	**0.01**	—
Income and comprehensive income for the period	**411**	1,394	**3,052**	2,210

Basic income per common share is calculated using the weighted average number of common shares outstanding during the period. Diluted income per common share is calculated taking into account dilutive instruments that are outstanding.

Income from continuing operations per common share on both a basic and diluted basis for the three months ended June 30, 2020 was $0.02 compared to income per common share on both a basic and diluted basis of $0.05 for the three months ended June 30, 2019. Income from continuing operations per common share on both a basic and diluted basis for the six months ended June 30, 2020 was $0.11 compared to income per common share on both a basic and diluted basis of $0.08 for the six months ended June 30, 2019.

The weighted average number of common shares outstanding for the three months ended June 30, 2020 was 27,040,178 (three months ended June 30, 2019 – 26,923,492). The weighted average number of common shares outstanding for the six months ended June 30, 2020 was 27,020,521 (for the six months ended June 30, 2019 – 26,884,457).

The dilutive weighted average number of common shares outstanding for the three months ended June 30, 2020 was 27,364,780 (three months ended June 30, 2019 – 27,115,909). The diluted weighted average number of common shares outstanding for the six months ended June 30, 2020 was 27,198,874 (for the six months ended June 30, 2019 – 27,017,573).

ADJUSTED EBITDA

EBITDA (earnings before interest, taxes, depreciation and amortization) is a non-IFRS financial measure. The term EBITDA does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement IFRS measures by providing a further understanding of operations from management's perspective. The Company defines Adjusted EBITDA as earnings before interest expense, income taxes, depreciation of property and equipment, amortization of intangible assets, loss on debt extinguishment, restructuring costs, non-cash share-based compensation, changes in fair value of derivative financial instruments, impairment of intangible assets and foreign exchange gains and losses from the translation of Canadian cash balances.

The Company considers Adjusted EBITDA as a key metric in assessing business and management performance and considers Adjusted EBITDA to be an important measure of operating performance and cash flow, providing useful information to investors and analysts.

The following is a summary of how EBITDA and Adjusted EBITDA are calculated:

(IN THOUSANDS OF U.S. DOLLARS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	**$**
Income from continuing operations	**411**	1,359	**2,888**	2,175
Add back:				
Depreciation and amortization	**294**	310	**601**	609
Interest expense, net	**87**	221	**183**	443
Income taxes	**2,089**	478	**3,185**	901
EBITDA	**2,881**	2,368	**6,857**	4,128
Change in fair value of derivative financial instrument	**17**	(3)	**15**	(15)
Restructuring costs	**—**	660	**—**	660
Loss (gain) from the translation of Canadian cash balances	**(37)**	(37)	**17**	(63)
Share-based compensation	**45**	37	**89**	69
Adjusted EBITDA	**2,906**	3,025	**6,978**	4,779
Adjusted EBITDA per share – basic	**0.11**	0.11	**0.26**	0.18
Adjusted EBITDA per share – dilutive	**0.11**	0.11	**0.26**	0.18

Adjusted EBITDA for the three months ended June 30, 2020 was $2.9 million, a decrease of $0.1 million or 4% compared to $3.0 million for the three months ended June 30, 2019.

Adjusted EBITDA for the six months ended June 30, 2020 was $7.0 million, an increase of $2.2 million or 46% compared to $4.8 million for the six months ended June 30, 2019.

Liquidity and Capital Resources

(IN THOUSANDS OF U.S. DOLLARS)	**Three months ended June 30, 2020**	Three months ended June 30, 2019	**Six months ended June 30, 2020**	Six months ended June 30, 2019
	$	$	**$**	$
Cash provided by operating activities	**1,924**	3,360	**7,313**	4,917
Cash used in investing activities	**—**	(111)	**(750)**	(1,288)
Cash used in financing activities	**(2,113)**	(1,905)	**(4,204)**	(4,155)
Cash used in discontinued operations	**—**	(56)	**—**	(645)
Net change in cash	**(189)**	1,288	**2,359**	(1,171)
Impact of foreign exchange on cash	**37**	37	**(17)**	63
Cash, beginning of period	**8,840**	7,924	**6,346**	10,357
Cash, end of period	**8,688**	9,249	**8,688**	9,249

Cash

As at June 30, 2020, the Company had cash of $8.7 million compared to $6.3 million as at December 31, 2019.

Operating Activities

Cash provided by operating activities was $1.9 million for the three months ended June 30, 2020 compared to $3.4 million for the three months ended June 30, 2019. Cash provided by operating activities, excluding working capital was $0.6 million for the three months ended June 30, 2020 compared to $2.3 million for the three months ended June 30, 2019. Working capital changes reflects a recovery

of $2.5 million during the three months ended June 30, 2020 compared to a recovery of $1.0 million in working capital in the comparative period.

For the six months ended June 30, 2020, cash provided by operating activities was $7.3 million compared to $4.9 million for the six months ended June 30, 2019. Cash provided by operating activities, excluding working capital was $3.7 million for the three months ended June 30, 2020 compared to $4.0 million for the three months ended June 30, 2019. The increase in cash reflects a recovery of $3.6 million of working capital compared to a recovery of $0.9 million in working capital in the comparative prior period.

Working capital changes are largely attributable to the payments received from our licensing partners during the quarter, which is based on licensing revenue earned in the previous quarter. Royalties earned are paid by our partners on a quarterly basis, subsequent to each quarter end.

Investing Activities

Cash used in investing activities was nil and $0.8 million for the three and six months ended June 30, 2020, respectively, compared to $0.1 million and $1.3 million for the three and six months ended June 30, 2019, respectively.

Cash used in investing activities for the six months ended June 30, 2020 is the payment of a regulatory milestone achieved in respect of Trulance. Cash used in investing activities for the six months ended June 30, 2019 primarily relates to the purchase of property and equipment and a regulatory milestone payment in respect of Eskata, product rights acquired from Aclaris.

Financing Activities

Cash used in financing activities was $2.1 million for the three months ended June 30, 2020 compared to cash used in financing activities of $1.9 million for the three months ended June 30, 2019. The comparative period includes a recovery of the lease obligation for leasehold improvements, offset with a $2.0 million principle payment against the credit facility.

For the six months ended June 30, 2020 and 2019, cash used in financing activities was $4.2 million. The six months ended June 30, 2019 includes a recovery of the lease obligation for leasehold improvements offset by higher interest payments.

Future cash requirements will depend on a number of factors, including investments in product launches, expenditures on R&D for product candidates, costs associated with maintaining regulatory approvals, the timing of payments received or made under licensing or other collaborative agreements, the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims and other intellectual property rights, defending against patent infringement claims, the acquisition of licenses for new products or technologies, the status of competitive products and the success of the Company in developing and maintaining markets for its products.

Financial Instruments

As at June 30, 2020, the Company’s financial instruments consisted of cash, accounts receivable, accounts payable and accrued liabilities, the credit facility and a derivative financial instrument. The derivative financial instrument is measured at fair value with any changes recognized through the interim consolidated statements of income (loss) and comprehensive income (loss) and is classified as Level 2 (as defined under IFRS). Cash, accounts receivable, accounts payable and accrued liabilities are measured at amortized cost and their fair values approximate carrying values.

The credit facility is also measured at amortized cost. As at June 30, 2020, the fair value of the credit facility is approximately $3.7 million. The fair value is based on cash flows discounted using a rate based on the borrowing rate.

The Company's financial instruments are exposed to certain financial risks, including credit risk, liquidity risk, currency risk, interest rate risk and capital management risk.

Risk Management

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: credit risk, liquidity risk, currency risk, interest rate risk and capital management risk. The Company's overall risk management program and business practices seek to minimize any potential adverse effects on the Company's financial performance.

Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. Financial instruments that potentially expose the Company to significant concentration of credit risk consist of cash and accounts receivable. The Company's investment policies are designed to mitigate the possibility of a deterioration of principal and enhance the Company's ability to meet its liquidity needs and provide reasonable returns within those parameters. Cash is on deposit

with Canadian chartered banks. Management monitors the collectability of accounts receivable and estimates an allowance for doubtful accounts.

The Company has concentration risk, as approximately 80% of total sales came from three customers and 77% of total accounts receivable is due from two customers.

Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulties in meeting its financial liability obligations as they become due. The Company has a planning and budgeting process in place to help determine the funds required to support the Company's normal operating requirements on an ongoing basis.

The Company has financed its cash requirements primarily through operations and its credit facility. The Company controls liquidity risk through management of working capital, cash flows and the availability and sourcing of financing.

The Company has financial covenants in its credit facility that are based on predefined trailing adjusted earnings before interest, taxes, depreciation and amortization ["EBITDA"] formula. The Company's adjusted EBITDA is sensitive to significant fluctuations based on revenue from its licensing business. A significant decline in licensing revenue could impact the Company's ability to repay the remaining balance of its credit facility or other financial obligations as they become due.

The Company anticipates that its current cash, together with the cash flow that is generated from operations will be sufficient to execute its current business plan for 2020 and meet its debt obligations.

Currency Risk

The Company is exposed to currency risk related to the fluctuation of foreign exchange rates. The Company is exposed to currency risk through its net assets and certain recurring transactions that are denominated in Canadian dollars.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The credit facility bears interest that is pegged to LIBOR and as such is subject to interest rate cash flow risk resulting from market fluctuations in interest rates.

Capital Management Risk

The Company's managed capital is comprised of cash, the credit facility and shareholders' equity. The Company's objective when managing its capital structure is to safeguard its ability to continue as a going concern in order to provide returns for shareholders, finance strategic growth plans and satisfies financial obligations as they become due. In order to maintain or adjust the capital structure, the Company may issue new common shares from time to time. The Company relies on cash on hand, cash flows from operations and debt financing to finance growth initiatives.

Outstanding Share Data

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares, issuable in series. As at June 30, 2020, the Company had 27,046,396 common shares issued and outstanding compared to 26,933,744 as at June 30, 2019. No preference shares were issued and outstanding as at June 30, 2020.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Risk Factors

Reference is made to the description of risk factors with respect to the Company and its business in the Company's most recently filed Annual Information Form filed on SEDAR at www.sedar.com and to related information in other filings with Canadian securities regulatory authorities.

Disclosure Controls and Procedures

There have been no changes in the Company's internal control over financial reporting during the most recent interim period ended June 30, 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

As of the end of the period covered by this MD&A and the accompanying condensed interim consolidated financial statements, the Company's management evaluated the design of its disclosure controls and procedures and internal controls over financial reporting. Based on that evaluation, the Company's Chief Executive Officer and Interim Chief Financial Officer have concluded that the Company's disclosure controls and procedures and internal controls over financial reporting have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of condensed interim consolidated financial statements for external purposes in accordance with IFRS as at June 30, 2020.

Selected Quarterly Information

(IN MILLIONS OF U.S. DOLLARS EXCEPT FOR PER SHARE AMOUNTS)	**June 30, 2020**	Mar 31, 2020
	$	$
Net revenue	**4.7**	5.9
Income and comprehensive income for the period	**0.4**	2.5
Basic income per Common Share	**0.02**	0.09
Diluted income per Common Share	**0.02**	0.09

(IN MILLIONS OF U.S. DOLLARS EXCEPT FOR PER SHARE AMOUNTS)	Dec 31, 2019	Sept 30, 2019	June 30, 2019	Mar 31, 2019
	$	$	$	$
Net revenue	5.9	5.8	5.6	5.1
Income (loss) and comprehensive income (loss) for the period	2.6	(2.1)	1.4	0.8
Basic income (loss) per Common Share	0.10	(0.08)	0.05	0.03
Diluted income (loss) per Common Share	0.10	(0.08)	0.05	0.03

(IN MILLIONS OF U.S. DOLLARS EXCEPT FOR PER SHARE AMOUNTS)	Dec 31, 2018	Sept 30, 2018	June 30, 2018	Mar 31, 2018
	$	$	$	$
Net revenue	6.4	4.8	7.0	4.6
Income (loss) and comprehensive income (loss) for the period	(0.6)	0.7	2.1	(1.0)
Basic income (loss) per Common Share	(0.02)	0.03	0.07	(0.04)
Diluted income (loss) per Common Share	(0.02)	0.03	0.07	(0.04)

Cipher Pharmaceuticals Inc.

Interim condensed consolidated financial statements
Unaudited

For the three and six months ended
June 30, 2020

Cipher Pharmaceuticals Inc.

NOTICE TO READER

The interim condensed consolidated financial statements for the three and six months ended June 30, 2020 have not been reviewed by the auditors of the Company.

Cipher Pharmaceuticals Inc.

Interim consolidated statements of financial position

[in thousands of United States dollars – unaudited]

As at

	June 30, 2020	December 31, 2019
	$	$
Assets		
Current assets		
Cash	**8,688**	6,346
Accounts receivable	**7,211**	8,878
Inventory	**1,053**	1,043
Prepaid expenses and other assets	**471**	963
Total current assets	**17,423**	17,230
Property and equipment, net	**2,035**	2,198
Intangible assets, net	**9,913**	10,378
Goodwill	**15,706**	15,706
Deferred tax assets	**936**	943
Total assets	**46,013**	46,455
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities *[notes 10 & 12]*	**9,157**	8,594
Contract liability *[note 12]*	**223**	274
Current portion of lease obligation *[note 10]*	**121**	127
Credit facility *[note 3]*	**3,656**	7,620
Total current liabilities	**13,157**	16,615
Derivative financial instrument *[note 3]*	**23**	8
Lease obligation *[note 10]*	**1,662**	1,821
Total liabilities	**14,842**	18,444
Commitments and contingencies *[note 10]*		
Shareholders' equity		
Share capital *[note 4]*	**18,738**	18,677
Contributed surplus	**5,028**	4,981
Accumulated other comprehensive loss	**(9,514)**	(9,514)
Retained earnings	**16,919**	13,867
Total shareholders' equity	**31,171**	28,011
Total liabilities and shareholders' equity	**46,013**	46,455

See accompanying notes

Cipher Pharmaceuticals Inc.

Interim consolidated statements of income and comprehensive income

[in thousands of United States dollars – unaudited]

	Three months ended June 30		Six months ended June 30	
	2020	**2019**	**2020**	**2019**
	$	$	$	$
Revenue				
Licensing revenue *[note 5]*	**2,719**	3,526	**6,065**	6,857
Product revenue	**1,989**	2,070	**4,543**	3,882
Net revenue	**4,708**	5,596	**10,608**	10,739
Operating expenses				
Cost of products sold	**722**	718	**1,571**	1,362
Research and development	**13**	21	**37**	76
Selling, general and administrative *[notes 6 & 7]*	**1,317**	2,105	**2,758**	5,048
Restructuring costs	**—**	660	**—**	660
Total operating expenses	**2,052**	3,504	**4,366**	7,146
Other expenses (income)				
Interest expense *[note 3]*	**90**	266	**214**	541
Change in fair value of derivative financial instrument	**17**	(3)	**15**	(15)
Interest income	**(3)**	(45)	**(31)**	(98)
Foreign exchange loss (gain)	**52**	37	**(29)**	89
Total other expenses	**156**	255	**169**	517
Income before income taxes from continuing operations	**2,500**	1,837	**6,073**	3,076
Current income tax expense *[note 9]*	**2,413**	152	**3,178**	302
Deferred income tax expense (recovery) *[note 9]*	**(324)**	326	**7**	599
Total income tax expense	**2,089**	478	**3,185**	901
Income and comprehensive income from continuing operations	**411**	1,359	**2,888**	2,175
Income and comprehensive Income from discontinued operations *[note 12]*	**—**	35	**164**	35
Net income and comprehensive income for the period	**411**	1,394	**3,052**	2,210
Net income from continuing operations per common share *[note 8]*				
Basic	**0.02**	0.05	**0.11**	0.08
Diluted	**0.02**	0.05	**0.11**	0.08
Net income from discontinued operations per common share *[note 8]*				
Basic	**—**	0.00	**0.01**	0.00
Diluted	**—**	0.00	**0.01**	0.00

See accompanying notes

Cipher Pharmaceuticals Inc.

Interim consolidated statements of changes in shareholders' equity

[in thousands of United States dollars – unaudited]

For the six months ended June 30

	Share capital		Contributed surplus	Other comprehensive loss	Retained earnings	Total shareholders' equity
	[000s]	$	$	$	$	$
Balance, January 1, 2019	26,821	18,324	5,324	(9,514)	10,625	24,759
Net income for the period	—	—	—	—	2,210	2,210
Shares issued under the share purchase plan *[note 4]*	48	57	—	—	—	57
Shares issued under the Restricted Share Unit plan	65	208	(208)	—	—	—
Share-based compensation expense *[note 4]*	—	—	61	—	—	61
Balance, June 30, 2019	26,934	18,589	5,177	(9,514)	12,835	27,087
Balance, January 1, 2020	**26,991**	**18,677**	**4,981**	**(9,514)**	**13,867**	**28,011**
Net income for the period	**—**	**—**	**—**	**—**	**3,052**	**3,052**
Shares issued under the share purchase plan *[note 4]*	**33**	**23**	**—**	**—**	**—**	**23**
Shares issued under the Restricted Share Unit plan	**22**	**38**	**(38)**	**—**	**—**	**—**
Share-based compensation expense *[note 4]*	**—**	**—**	**85**	**—**	**—**	**85**
Balance, June 30, 2020	**27,046**	**18,738**	**5,028**	**(9,514)**	**16,919**	**31,171**

See accompanying notes

Cipher Pharmaceuticals Inc.

Interim consolidated statements of cash flows

[in thousands of United States dollars – unaudited]

For the six months ended June 30

	2020	2019
	$	$
Operating activities		
Net income for the period from continuing operations	**2,888**	2,175
Add (deduct) items not affecting cash:		
Depreciation of property and equipment	**136**	185
Amortization of intangible assets	**465**	424
Share-based compensation	**89**	69
Foreign exchange loss (gain) on cash and lease obligation	**(75)**	16
Change in fair value of derivative financial instrument	**15**	(15)
Interest on credit facility and lease obligation	**214**	541
Deferred income taxes	**7**	599
Changes in working capital balances related to operating operations:		
Accounts receivable	**1,667**	2,638
Inventory	**(10)**	160
Prepaid expenses and other assets	**311**	408
Accounts payable and accrued liabilities	**1,493**	(2,330)
Contract liability	**113**	47
Cash provided by operating activities	**7,313**	4,917
Investing activities		
Purchase of property and equipment	**—**	(796)
Gain on disposal of property and equipment	**—**	23
Acquisition of intangible assets	**(750)**	(515)
Cash used in investing activities	**(750)**	(1,288)
Financing activities		
Interest payments	**(101)**	(473)
Principal repayments	**(4,000)**	(4,000)
Payment (recovery) of lease obligation	**(123)**	269
Proceeds from shares issued under the share purchase plan	**20**	49
Cash used in financing activities	**(4,204)**	(4,155)
Cash used in discontinued operations	**—**	(645)
Net increase (decrease) in cash during the period	**2,359**	(1,171)
Impact of foreign exchange loss (gain) on cash	**(17)**	63
Cash, beginning of period	**6,346**	10,357
Cash, end of period	**8,688**	9,249

See accompanying notes

Cipher Pharmaceuticals Inc.

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

1. Nature of operations

Cipher Pharmaceuticals Inc. ["Cipher"] and its subsidiaries [together the "Company"] is a specialty pharmaceutical company with a diversified portfolio of commercial and early to late stage products. The Company acquires products that fulfil unmet medical needs, manages the required clinical development and regulatory approval process, and markets those products either directly in Canada and the United States ["U.S."] or indirectly through partners in the U.S., Canada and Latin America. The Company is building its business through product licensing and acquisitions. Cipher was incorporated under the *Business Corporations Act* of Ontario on January 9, 2004 and is located at 209 Oak Park Blvd., Suite 501, Oakville, Ontario.

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard ["IAS"] 34, *Interim Financial Reporting*. The disclosures contained in these interim condensed consolidated financial statements do not include all of the requirements of International Financial Reporting Standards ["IFRS"] as issued by the International Accounting Standards Board for annual financial statements. The interim condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2019, which have been prepared in accordance with IFRS, and are available on SEDAR at www.sedar.com. The interim condensed consolidated financial statements are based on accounting policies as described in the 2019 annual consolidated financial statements.

The interim condensed consolidated financial statements include the accounts of the Company and its wholly owned legal subsidiaries: Cipher US Holdings Inc., Cipher US Holdco LLC and Cipher Pharmaceuticals US LLC. On February 1, 2020, Cardiome Pharma Corp ["Cardiome"] was amalgamated with Cipher. All significant inter-company balances and transactions have been eliminated upon consolidation.

The Board of Directors approved these interim condensed consolidated financial statements on August 12, 2020.

The Company is closely monitoring the developments of the Coronavirus-19 ["COVID-19"] situation. It is too soon to assess the impacts of the current outbreak on the Company, given the many unknowns related to COVID-19. The global response to the COVID-19 outbreak has resulted in, among other things, border closures, severe travel restrictions and extreme fluctuations in financial and commodity markets. Additional measures may be implemented by one or more governments in jurisdictions where the Company operates. Labour shortages due to illness, Company or government imposed isolation programs, or restrictions on the movement of personnel or possible supply chain disruptions could result in a reduction or cessation of all or a portion of the Company's operations. The extent to which COVID-19 and any other pandemic or public health crisis impacts the Company's business, affairs, operations, financial condition, liquidity, availability of credit and results of operations will depend on future developments that are highly uncertain and cannot be predicted with any meaningful precision, including new information which may emerge concerning the severity of COVID-19 and the actions required to contain the COVID-19 or remedy its impact, among others.

The actual and threatened spread of COVID-19 globally could also have a material adverse effect on the regional economies in which we operate, could continue to negatively impact stock markets, including any future trading price of our shares, could adversely impact our ability to raise capital, could cause continued interest rate volatility and movements that could make obtaining financing or renegotiating the terms of our existing financing more challenging or more expensive.

Any of these developments, and others, could have a material adverse effect on our business and results of operations. In addition, because of the severity and global nature of the COVID-19 pandemic, it is reasonably possible that the estimates in the financial statements will change in the near term and the effect of the change will

be material. Potential impacts may include, but are not limited to, impairment of long-lived assets and a change in the estimated credit loss on accounts receivable.

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 judgment 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.

As at June 30, 2020, the Company's financial instruments consisted of cash, accounts receivable, accounts payable and accrued liabilities, the credit facility and a derivative financial instrument. The derivative financial instrument is measured at fair value with any changes recognized through the interim consolidated statements of income and comprehensive income and is classified as Level 2 [as defined under IFRS]. Cash, accounts receivable, accounts payable and accrued liabilities are measured at amortized cost and their fair values approximate carrying values.

The credit facility is measured at amortized cost. As at June 30, 2020, the fair value of the credit facility is approximately $3,656. The fair value is based on cash flows discounted using a rate based on the borrowing rate.

3. Credit facility

In November 2017, the Company entered into a credit agreement with a Canadian lender to extinguish its existing senior secured notes and replace with a credit facility. In connection with the credit agreement, the Company used proceeds of $20,000 to fully extinguish the remaining balance of the senior secured notes. The credit facility has a three-year term, carrying an interest rate of LIBOR plus an applicable margin ranging from 1.5% - 2.5% based on the total debt to EBITDA ratio, as defined in the credit agreement. Principal and interest payments are payable quarterly in arrears. The credit facility also carries an accordion feature that allows for an additional $10,000 of capacity, subject to customary terms and conditions. The Company is subject to certain financial and non-financial covenants. The credit facility is secured by the assets of the Company. The interest rate applicable in the second quarter was approximately 2.63%.

In May 2018, concurrent with the acquisition of Cardiome, the Company drew $5,000 from its existing credit facility. Net of transaction costs of $108, the amount recorded to the interim consolidated statement of financial position was $4,892. As a result, the scheduled quarterly payments increased from $1,666 to $2,000. There was no corresponding change in the interest rate terms or term of the credit facility. Subsequent to the drawdown, the accordion was reset to $10,000.

[in thousands of United States dollars, except per share amounts – unaudited]

The following is the continuity of the credit facility from January 1, 2020 to June 30, 2020:

	$
Balance, January 1, 2020	**7,620**
Accrued interest expense	63
Interest paid	(48)
Imputed interest accretion	21
Repayment	(2,000)
Balance, March 31, 2020	**5,656**
Accrued interest expense	38
Interest paid	(53)
Imputed interest accretion	15
Repayment	(2,000)
Balance, June 30, 2020	**3,656**

Derivative financial instrument

In April 2015, the Company issued 600,000 common share purchase warrants to the lender of the senior secured notes with an option for a cashless exercise in which the settlement price caused the conversion ratio to be variable. Accordingly, the warrants are classified as a financial liability. Gains and losses on re-measurement are presented separately in the interim consolidated statements of income and comprehensive income. The exercise price of the warrants is $9.22 [equal to the five-day volume-weighted average price on the Toronto Stock Exchange prior to closing, converted to U.S. dollars] and expire seven years from the date of issuance. A pricing model with observable market-based inputs was used to estimate the fair value of the warrants issued. The estimated fair value of the warrants as at June 30, 2020, March 31, 2020 and December 31, 2019 were $23, $6, and $8, respectively.

The variables used to compute the fair value as at June 30, 2020, March 31, 2020 and December 31, 2019 are as follows:

	June 30, 2020	**March 31, 2020**	**December 31, 2019**
Share price	**$0.88**	$0.49	$1.15
Expected life	**1.8 years**	2.0 years	2.3 years
Volatility	**93.8%**	90.4%	61.8%

4. Share capital

Authorized share capital

Authorized share capital consists of an unlimited number of preference shares, issuable in series, and an unlimited number of voting common shares, with no par value.

The Company has three share-based compensation plans: The Stock Option Plan [“SOP”], the Employee and Director Share Purchase Plan [“ESPP”] and the Restricted Share Units and Performance Share Units. Full descriptions of the three share-based compensation plans are included in note 14 “Share Capital” to the Company’s annual consolidated financial statements for the year ended December 31, 2019.

Share purchase plan

The Company's ESPP allows employees and directors to share in the growth of the Company through share ownership. Through the ESPP, employees and directors may contribute amounts to purchase shares of the Company at a 15% discount from the prevailing trading price. Plan members must hold their shares for a period of at least six months before they can be sold. During the three months ended June 30, 2020, 15,979 shares were issued under the ESPP at weighted average trading price of CDN$0.99 [three months ended June 30, 2019 – 21,960]. Included in share-based compensation expense is $2 [three months ended June 30, 2019 – $3], which reflects the discount on the shares issued during the period.

During the six months ended June 30, 2020, 33,007 shares were issued under the ESPP at weighted average trading price of CDN$0.96 [six months ended June 30, 2019 – 47,824]. Included in share-based compensation expense is $4 [six months ended June 30, 2019 – $9], which is the discount on the shares issued during the period.

Stock option plan

The following is a summary of the changes in the stock options outstanding from January 1, 2020 to June 30, 2020:

	Number of options [000s]	**Weighted average exercise price** [CDN$]
Balance, January 1, 2020	618	3.70
Granted during the period	223	0.73
Forfeited/expired during the period	(214)	4.05
Balance, June 30, 2020	**627**	**2.53**

As at June 30, 2020, 236,681 options were fully vested and exercisable [June 30, 2019 – 342,129].

During the quarter, the Company granted 222,840 stock options under the SOP. The options vest over a four-year period from the grant date, at a rate of 25% per year and expire seven years from the day of grant. The expected volatility is based on the Company's historical volatility over a comparable period based on expected life. There is no expected dividend. The exercise price and Black Scholes assumptions are as follows:

Grant date	**Number granted**	**Exercise price** [CDN$]	**Black Scholes value** [CDN$]	**Risk-free interest rate**	**Expected life**	**Expected volatility**
April 8, 2020	205,340	0.72	0.41	0.75%	4.9 years	69.3%
May 7, 2020	17,500	0.90	0.42	0.75%	4.9 years	69.9%

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

The following information relates to stock options that were outstanding as at June 30, 2020:

Range of exercise prices [CDN$]	Number of options [000s]	Weighted average remaining contractual life [years]	Weighted average exercise price [CDN$]
0.72 – 1.48	372	6.26	1.45
2.88 – 5.39	196	4.56	4.33
6.17 – 13.88	59	5.76	7.15
	627	5.68	3.90

The Company's SOP provides that an option holder may elect to receive a number of shares equivalent to the growth value of vested options, which is the difference between the market price and the exercise price of the options. During the three months ended June 30, 2020, no stock options were exercised [three months ended June 30, 2019 – nil]. The total stock option expense for the three months ended June 30, 2020 is $20 [three months ended June 30, 2019 – $16].

During the six months ended June 30, 2020, no stock options were exercised [six months ended June 30, 2019 – nil]. The total stock option expense for the six months ended June 30, 2020 is $50 [six months ended June 30, 2019 – $7].

Restricted Share Unit ["RSU"] and Performance Share Unit ["PSU"] Plan

On May 13, 2015, the Company adopted an RSU and PSU Plan. RSUs and PSUs are notional share units exchangeable for common shares of the Company. RSUs are granted to all employees and directors of the Company and PSUs are granted to certain executives. RSUs granted to employees vest annually over three or four years and RSUs granted to directors' vest over a one-year period. There are no PSUs outstanding as at June 30, 2020.

A summary of the RSUs granted and outstanding as at June 30, 2020 is as follows:

	RSUs number of units [000s]
Balance, January 1, 2020	**65**
Granted during the period	294
Vested during the period	(22)
Forfeited/cancelled during the period	(13)
Balance, June 30, 2020	**324**

The total expense for RSUs for the three months ended June 30, 2020 is $23 [three months ended June 30, 2019 – $18]. The total expense for the six months ended June 30, 2020 is $35 [six months ended June 30, 2019 – $53].

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

5. Revenue

The Company earns licensing revenue from both royalties and product sales to its partners, the breakdown is as follows:

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
	$	$	$	$
Licensing revenue				
Royalty revenue	**2,225**	2,817	**5,056**	5,832
Licensing product sales	**434**	709	**949**	1,025
Milestone revenue	**60**	—	**60**	—
	2,719	3,526	**6,065**	6,857

6. Expenses by nature

The interim consolidated statements of income and comprehensive income include the following expenses by nature:

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
	$	$	$	$
Employee salaries and benefits				
Salaries, bonuses and benefits	**209**	856	**489**	2,316
Share-based compensation	**45**	37	**89**	69
Termination benefits	—	630	—	630
	254	1,523	**578**	3,015

For the three and six months ended June 30, 2020 and June 30, 2019, all employee salaries and benefits are recorded in selling, general and administrative expenses. Termination benefits are recorded in restructuring costs.

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

7. Compensation of key management

Key management includes directors and executives of the Company. The compensation paid or payable to key management for services is shown below:

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
	$	$	$	$
Salaries, bonuses and benefits	**139**	283	**272**	589
Share-based compensation	**34**	58	**61**	32
Directors fees	**51**	68	**104**	129
Termination benefits	—	110	—	110
	224	519	**437**	860

The interim Chief Executive Officer of the Company did not receive compensation in that capacity, however directors' fees were paid. In 2020, there are two personnel considered as key management compared to five personnel in 2019.

8. Income per common share

Income per common share is calculated using the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the three months ended June 30, 2020 was 27,040,178 [three months ended June 30, 2019 – 26,923,492]. The weighted average number of shares outstanding for the six months ended June 30, 2019 was 27,020,521 [for the six months ended June 30, 2019 – 26,884,457].

Diluted income per common share is calculated using the weighted average number of common shares outstanding taking into consideration the weighted average impact of dilutive securities. The dilutive weighted average for the three months ended June 30, 2020 was 27,364,780 [three months ended June 30, 2019 – 27,155,909]. The diluted weighted average number of shares outstanding for the six months ended June 30, 2020 was 27,198,874 [for the six months ended June 30, 2019 – 27,017,573].

9. Income tax expense

In the third quarter of 2019, the Company received a Canada Revenue Agency [the "CRA"] draft assessment for its 2014 and 2015 tax filing years. The draft assessment purports that the valuation of certain intangibles assets upon migration of the Company to Canada in 2004 are overstated. Consequently, amortization reported for tax purposes in excess of the CRA's valuation was overstated. Based on the CRA's proposed changes to the valuation of the intangible assets, the Company estimated an additional income tax expense including interest of approximately CDN$1,690 [$1,275]. of which CDN$808 [$610] is recorded to accounts payable and accrued liabilities and CDN$882 [$665] is recorded to the deferred tax asset on the interim consolidated statements of financial position.

During the quarter, the Company received the final assessment in respect of the 2014 and 2015 CRA audit, which in addition to revaluating the intangible assets at a lower value than reported for tax purposes, also disallows certain intangible assets additions in 2015. There is an additional income tax expense, including interest of approximately CDN$1,903 [$1,362] recorded as a current income tax expense on the interim consolidated statements of income and comprehensive income for amortization recognized on those intangible assets from

2015 through to Q2 of 2020, as well as the remaining unamortized tax balance. Of this amount, CDN$2,014 [$1,461] is recorded in accounts payable and accrued liabilities and CDN$111 [$99] is recorded as a recovery of the deferred tax asset on the interim consolidated statements of financial position.

The Company believes its basis for the valuation is supportable and will file a notice of objection with the CRA.

10. Commitments and contingencies

In the normal course of business, the Company may be the subject of litigation or other potential 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 litigation.

Lease obligation

The Company has an office lease for its corporate operations head office. The term of the lease is 10 years and three months and commenced on January 1, 2019. The undiscounted commitment for the remaining lease term as at June 30, 2020 is approximately CDN$3,493.

Licensing agreements with Galephar

In 2002, the Company entered into a Master Licensing and Clinical Supply Agreement [the “Agreement”] with Galephar, a Puerto Rico based pharmaceutical research and manufacturing company. Under the Agreement, the Company acquired the rights to package, test, obtain regulatory approvals and market CIP-FENOFIBRATE, CIP-ISOTRETINOIN and CIP-TRAMADOL ER [the “CIP Products”] in various countries. In accordance with the Agreement, the Company retains 50% of all revenue from licensing and distribution arrangements entered into with respect to the CIP Products, with the other 50% due to Galephar. Galephar retains the right to manufacture and supply the CIP Products. With respect to licensing and distribution arrangements, the Company manages the product supply arrangements with their respective marketing partners and Galephar; product is shipped directly from Galephar to the respective marketing partners. Where the Company has opted to market and sell the CIP Product directly, the Company purchases the finished goods from Galephar directly.

With respect to CIP-ISOTRETINOIN, the Company has entered into licensing and distribution arrangements for the U.S., Mexico and Brazil, while opting to market and sell the product directly in Canada. The Company also has in place, various licensing and distribution arrangements with respect to CIP-FENOFIBRATE in the U.S. and CIP-TRAMADOL ER in Canada, the U.S. and Latin America.

During the three and six months ended June 30, 2020, the Company paid Galephar $957 [three months ended June 30, 2019 – $754] and $1,370 [six months ended June 30, 2019 – $1,452], respectively. As at June 30, 2020, the amount in accounts payable and accrued liabilities owed to Galephar were $2,133 [December 31, 2019 – $1,997]. Amounts payable to Galephar are remitted quarterly, after the Company collects from its licensing partners. Accordingly, the Company’s accounts receivable has a corresponding balance representing amounts owed by its licensing partners.

11. Segmented information

The Company operations are categorized into one reportable segment, being specialty pharmaceuticals.

The Company generated approximately 42% of its net revenue within Canada, with the remainder attributable to the U.S. There are no significant assets located outside of Canada.

Notes to interim condensed consolidated financial statements

[in thousands of United States dollars, except per share amounts – unaudited]

12. Discontinued operations

In May 2017, the Company entered into an Asset Purchase Agreement and completed the sale of substantially all of the assets comprising the U.S. segment.

As at June 30, 2020, the liabilities retained by the Company are $56 [December 31, 2019 – $237] recorded in accounts payable and accrued liabilities and nil [December 31, 2019 – $164] recorded in contract liability. During the six months ending June 30, 2020, there was a reduction in the contract liability of $164 due to fewer product returns than what was provided for and the expiration of the returns window related to those products.